

# Downstream Property Damage Insurance: How Effective is Your Machinery Breakdown Coverage?

This article considers a clause which, in the absence of standard market terminology, can lead to uncertainty and a lack of clarity as to the width of coverage available.



## Introduction

The Property Damage sections of Oil & Gas Package Policies often provide a Machinery Breakdown extension in respect of Downstream risks. However, the coverage provided by such Machinery Breakdown extensions can lack clarity.

This article reviews some of the key issues policyholders may wish to consider in order to ensure that effective coverage is in place.

The aforementioned Property Damage sections ordinarily afford coverage on an "All Risks" basis with certain standard exclusions applying. In order to ensure that the "All Risks" cover includes physical damage

to insured property arising from a latent defect, the policy wording should expressly provide such latent defect cover. However, the coverage provided will ordinarily expressly exclude the cost of repairing or replacing the part which contains the latent defect, even though such a part may have sustained physical damage i.e. the standard cover relates to consequent damage to surrounding sound insured property caused by the latently defective subject-matter.

It is important to note that a latent defect will be brought about by a specific cause such as a fault in design, materials or workmanship.

Accordingly, an exclusion relating to the repair and replacement of latently defective parts has the potential to be wide ranging and of itself can give rise to the need for specific extensions such as a Machinery Breakdown clause. Furthermore, certain wordings may specifically exclude physical damage to plant and machinery caused by its own mechanical breakdown and the like.

## Machinery Breakdown & Accidental Damage

It will be appreciated, as outlined in the *Introduction*, that the standard policy exclusion in respect of damage sustained by latently defective parts could be potentially wide ranging. Accordingly, an extension of coverage in respect of Machinery Breakdown could still leave a considerable gap in cover between the policy definition of "Machinery Breakdown" and damage sustained by a wide range of other insured property containing latent defects.

Subject always to individual policy definitions, commercial Non-Marine underwriting markets can make a distinction between normal Property policy coverage and Accidental Damage coverage. Unlike normal Property coverage, Accidental Damage cover does not have to be triggered by an external event.

Certain Accidental Damage definitions may still require the coverage extension to be triggered by a "*breakdown*", albeit without the reference to "*machinery*". The specific policy definition of "*breakdown*" thus being central to the extent of the coverage available.

However, an appropriately worded extension clause could encompass physical damage sustained by all latently defective subject-matter insured i.e. beyond the potentially restrictive breakdown of machinery terminology.

## Excepted Perils

Underwriters may seek to impose the exclusions of faulty design, faulty materials and faulty workmanship on the policy extension. However, it is important to recognise that coverage for such perils will be central to the effectiveness of any policy extension, whether that extension be for machinery breakdown or the more all encompassing full latent defect exposure.

If underwriters insist on the restrictive exclusions applying to the policy extension it should be noted that the onus rests on insurers to prove that the faulty design, faulty workmanship or faulty materials caused the loss. It is not the Insured's responsibility to prove that the excepted perils did not cause the loss.

Accordingly, in the event that machinery and the like sustains significant damage, it may prove difficult for underwriters to demonstrate that an excepted peril caused the loss.

## Electrical System Failures

Electrical system failures can be a significant source of risk. For example, microprocessors and circuitry that control such devices can be susceptible to electrical injury.

The risk factor increases when microprocessors are embedded in machinery and equipment.

When considering Machinery Breakdown extensions and the like, it is important to recognise that the standard policy wording may already contain a restriction in relation to physical damage caused by electrical injury.

Accordingly, it may be necessary to ensure that the terminology of the policy extension expressly includes physical damage arising from electrical defect.

## Duration of Coverage

In view of the nature of the property to which a Machinery Breakdown extension applies, it is important to ensure that coverage remains in force for the duration of all activities to which the subject-matter could be exposed.

For example, would the policy terminology benefit from an express reference to coverage remaining in force during normal operation and whilst at rest and whilst the property is being dismantled for the purpose of cleaning, inspection and overhauling or removal to another working position, including during the course of such operations and any subsequent re-erection?

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### **Business Interruption**

Many policyholders' insurance programmes will include Business Interruption coverage. Therefore, a lack of clarity regarding the extent and application of any Machinery Breakdown coverage will adversely impact the ability to trigger such Business Interruption cover.

In particular, such difficulties in triggering Business Interruption coverage may arise in the event of damage being sustained by a specialist piece of equipment, the replacement property being a long lead item resulting in prolonged downtime.

### **Further Details**

In addition to advising and representing policyholders in respect of complex and distressed claims, Trident is also available to pressure test existing policy wordings in order to establish if they are fit for purpose in the event of a loss.

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