

By Robert J. Prah, CPCU

# EQUIPMENT BREAKDOWN COVERAGE

*A growing need — even for small businesses*

In the not too distant past, boiler and machinery insurance was viewed by many as a rather obscure specialty line that was too complex, and too remote, to be of interest to mainstream insurance practitioners. “If a business doesn’t have a boiler on the premises, it doesn’t have a boiler and machinery exposure,” is a misconception that to some extent still lingers today in insurance circles.

Boiler and machinery insurance is not confined merely to covering boiler explosions. On the contrary, the insurance responds to “accidents” such as breakdown of mechanical, electrical, and production equipment as well as steam boiler explosions. The term “object” (or “covered equipment” in the AAIS form), as defined in boiler and machinery insurance, encompasses much more than simply steam boiler equipment. In actual practice, the term “boiler and machinery” has evolved to “equipment breakdown.”

The electrical exposure, in particular, has grown dramatically in recent years as business firms have become more automated and integrated through electronic networks. Even small firms have become dependent on computer networks and other forms of electronic equipment for inventory management or to store customer account and product information, and they also rely on scanners, fax machines, card readers, and the like. This equipment is exposed to power surges, short circuits, and to general electrical disruption that can cause extensive losses. Typical BOP insureds often face this exposure just as do larger business concerns.

It is important to emphasize, too, that standard commercial property and most multi-peril or package policies contain exclusions for electrical disturbance, mechanical breakdown, and explosion of steam boilers and piping.

## AAIS BOP endorsement

AAIS has developed an endorsement option that enables insurers to add equipment breakdown coverage to an AAIS Businessowners (BOP) policy. The coverage, developed in conjunction with the Hartford Steam Boiler Inspection & Insurance Company, is equivalent to that which is provided by a stand-alone equipment breakdown or boiler and machinery policy.

The equipment breakdown endorsement includes its own rating procedure. The development of loss costs was



based on information from Hartford Steam Boiler’s extensive database. With a separate rating procedure, an equipment breakdown reinsurer such as Hartford Steam Boiler can assume the premium and exposure for equipment breakdown, while the commercial property insurer retains the premium and exposure for other perils. Also, because the coverage is written as an endorsement, in a loss situation the insured usually can deal only with one insurer in a seamless process. Claim disputes between the insurer and reinsurer can be eliminated because all claims can be paid (with the reinsurer’s agreement) by the BOP insurer, which can work out any equipment breakdown aspect of the claim with the reinsurer.

In addition to the equipment breakdown endorsement, AAIS has developed two additional property endorsements as options with the BOP policy. One covers direct physical loss to property caused by the interruption of a utility

located off premises, and the other adds time element coverage for utility interruption.

## Equipment breakdown endorsement — BP 0650

This endorsement adds equipment breakdown coverage to the businessowners policy, providing coverage that is otherwise excluded in standard BOP forms. Coverage is provided for an accident to covered equipment subject to the terms of the endorsement. “Accident” and “covered equipment” are defined in the endorsement.

For a building owner, coverage is provided for direct physical damage caused by or resulting from an accident to covered equipment, unless an exclusion applies. Note that the covered peril here, or that which triggers coverage, is an “accident,” as defined.

When the BOP policy covers a tenant, coverage is provided for business personal property and for any non-owned building equipment for which the insured is responsible under the lease.

Equipment breakdown coverage is subject to a separate deductible, which must be shown on the front of the endorsement.

*Accident* means direct physical loss and includes such situations as mechanical breakdown, rupturing or bursting of moving parts of machinery, electrical arcing, steam boiler explosion, or loss to hot water boilers or heaters caused by a condition within such equipment. Note that the term “accident” is broad in scope, including not only steam boiler explosion but also mechanical breakdown and electrical damage to covered equipment.

*Covered equipment* refers to property covered under Coverage A and Coverage B of the underlying BOP policy that is built to operate under vacuum or pressure or is used for the generation, transmission, or utilization of energy.

Examples of covered equipment are air conditioning and heating equipment, electrical equipment, and telephone systems, as well as business equipment such as computers, scanners, copiers, printing equipment, and security systems.

Computer hardware and software are not covered unless used to control or operate other covered equipment. However, separate coverage applies to computer equipment under an *additional coverages* provision.

Additional coverages are also included for loss caused by an “accident” to covered property containing CFC refrigerants, and for expediting expenses, pollution-related expenses, and spoilage.

## Extension of Coverage C (loss of income)

The endorsement contains two extensions of coverage relating to loss of income. They are *loss of income* and *service interruption*.

*Loss of income* coverage extends Coverage C in the underlying policy to provide coverage during the restoration period when the insured’s normal business activities are interrupted because of an accident (mechanical breakdown, electrical damage, steam boiler explosion, etc.) to covered equipment. The loss of income coverage is activated by an accident as defined in the endorsement.

*Service interruption* coverage extends Coverage C to pay for the insured’s loss of earnings and necessary extra expense incurred when an accident involves damage to property or equipment operating under vacuum or pressure or used to generate or transmit energy that is *owned by a utility or a landlord*. (Emphasis added.)

Unlike the first extension, with service interruption coverage, the property damaged is not owned by the insured but by a utility that provides the insured with electrical power, communications, or a related utility service.

When Coverage C in the underlying BOP policy is written with a limit, these extensions are subject to that limit; that is, the extensions do *not* increase the limit.

Coverage responds to risks of direct physical loss caused by or resulting from an accident to covered equipment, unless the loss is limited or caused by a peril that is excluded.

## Conditions

Two additional conditions apply. The first, *jurisdictional inspections*, indicates that if any covered equipment requires inspection to comply with state or municipal boiler and pressure vessel regulations, the insurer (or reinsurer) will make the inspection on the insured’s behalf. This is a valuable feature of equipment breakdown coverage, as the inspection service is sometimes viewed as being as important as the insurance itself.

The second condition, *suspension*, allows the insurer to suspend coverage

immediately if it determines that any covered equipment is in an unsafe condition. This provision gives the insured an incentive to maintain his/her equipment in a safe working condition.

## Conclusion

Boiler and machinery insurance or, more aptly stated, *equipment breakdown insurance* is not just for large business firms. In this age of technology, even small businesses face an exposure to equipment breakdown and interruption of business that can prove costly in the absence of appropriate insurance protection. That insurance protection is now conveniently available as an option to the AAIS BOP policy.

For more information about AAIS insurance programs, contact Robert Schnoll, AAIS marketing manager, at (800) 564-AAIS (2247), extension 222; fax: (630) 681-8356, or e-mail address: BobS@aaionline.com. ■

## The author

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