



# CAMBRIDGE

## PROPERTY & CASUALTY

### SPECIAL REPORT

## I DON'T NEED EQUIPMENT BREAKDOWN COVERAGE BECAUSE I DON'T HAVE A STEAM BOILER

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Many business owners believe that they do not need so called “boiler and machinery” or equipment breakdown coverage for a variety of reasons including:

- They do not have a steam boiler
- They have a property insurance policy that protects their business for machinery breakdown
- They would not suffer loss of income if they had a breakdown in equipment
- They have a maintenance contract for the upkeep of equipment
- They do not own the building and their landlord is responsible for maintaining the building equipment
- Their equipment is new and is covered under the manufacturer’s warranty

The purpose of this Special Report is to dispel certain myths about “boiler and machinery” coverage, which is insurance designed to cover mechanical breakdown of equipment including air conditioning systems, heating systems, electrical systems, telephone systems or other communication systems and production machinery. It also covers steam boiler explosion and electrical arcing within electrical panels or systems.

### **The Standard Property Insurance Policy Contains Three Critical Exclusions**

Almost all property insurance policies exclude claims arising out of:

- *Steam Boiler Explosion* - both damage to the steam boiler and damage to the building are excluded.
- *Mechanical Breakdown of Machinery & Equipment* - damage to transformers, presses, heating and cooling equipment, motors, ovens, scanners, computers, refrigeration equipment, telephone

equipment, fiber optic cables, pressure systems arising out of a sudden breakdown is not covered.

- Electrical Arcing - damage to electrical panel buss duct or wiring from arcing or power surges is excluded.

These exclusions can be and should be bought back by way of an endorsement to that policy or by way of a separate comprehensive machinery policy (sometimes referred to as a “boiler & machinery policy”).

In addition, this coverage will protect you for loss of business income and extra expenses arising out of these events.

### **Examples of Claims**

1. A cold storage facility housed some expensive live plants. A broken ammonia line in the cold storage facility resulted in a failure in the cooling system and damage to the plants.
2. A rat found its way into a cabinet that housed a phone system in a hotel. The rat did damage to the system and the hotel lost 200 phone lines. The paid loss was \$42,000.
3. An off-premises utility transformer exploded, causing an electrical surge that damaged an expensive electrical panel.
4. A printing press was damaged when a bearing malfunctioned, causing the press to seize up. As a result, the press could not be used and the printing company lost thousands of dollars in revenues.
5. A furnace suffered a sudden and accidental breakdown that caused a retail store to close down for two days, resulting in lost sales.
6. A landlord requested that a tenant have an air conditioning system compressor burnout repaired based on the requirements in the lease that the tenant maintain such equipment.
7. A steam boiler exploded, causing damage to the building and to the boiler itself.
8. A medical radiology center had an electrical loss that resulted in \$180,000 of business interruption costs.
9. A maintenance worker accidentally spilled coffee into an electrical server that controlled a production press.

### **If You Are a Tenant You Still Need Mechanical Breakdown Coverage**

You do not have to own a building to face an equipment breakdown risk. If you are a tenant you still have equipment such as phone systems, fax machines, computers, air conditioners and electrical

systems. These types of systems also fail from time-to-time and even a modest loss can be painful to a business.

Your lease agreement may also make you responsible for maintaining equipment that services your premises. If this is the case, you would otherwise have to pay out-of-pocket for loss associated with a breakdown of such equipment. The breakdown of a larger air conditioning compressor can be costly. Even if your lease does not make you responsible for such maintenance, you still rely on equipment to service your premises. In the event of a breakdown in the electrical, heating or cooling system in your building, the interruption of services could seriously impact you.

### **Mechanical Breakdown Coverage Is Not Just for Steam Boilers**

Many business owners believe that they do not need mechanical breakdown coverage because they do not use steam boilers in their business. However, such policies cover "objects" that are not limited to boilers and instead include other equipment, machinery and apparatuses.

Property insurance policies typically exclude coverage for equipment accident from the unique causes of equipment failure such as short circuits, centrifugal force or mechanical breakdown. Moreover, many property insurance policies exclude electrical arcing or electrical injury.

Often times the type of policy used to address the exposure of mechanical breakdown is referred to as "boiler and machinery" coverage. Such policies cover two things: First, they cover the costs of repair associated with covered accidents. Second, they cover loss of income or extra expense associated with such an accident.

### **“Why Do I Need This Coverage When I Am Covered by a Warranty or Service Contract?”**

A warranty or service contract may cover some repairs but will probably exclude sudden and accidental breakdown or acts of God such as lightning damage or external power surges. It will also not cover operator error or related business interruption or consequential spoilage or damage to other property.

### **Key Considerations in Purchasing Mechanical Breakdown Coverage**

Policies vary in the insurance industry. Careful attention should be paid to the policy language. The following are some considerations to take into account in purchasing this coverage:

1. **Comprehensive form.** This form covers a broad range of equipment which the policy often defines as an "object." Some insurers offer policies that do not define "object," however, which is preferred.
2. **Production equipment.** Production equipment such as presses which are used in the manufacturing or assembly process can be excluded or included from coverage. Breakdown of large pieces of production machinery, such as presses, can result in large repair costs and should always be covered.

3. **Loss control services.** You should understand and take advantage of the loss control services offered by your boiler and machinery insurance company. Such services are often free of charge and can include boiler inspection and loss control recommendations.
4. **Limit of insurance.** Boiler and machinery policies are typically written with a limit of insurance for the equipment breakdown and for property damage. Such values should be written at 100% of the replacement cost of the items.
5. **Business interruption and extra expense limit.** The limit of insurance for business income and extra expense should be sufficient to cover you during the repair or replacement period plus an additional period to allow you to recover your business and pay for all continuing expenses. Some policies are written on an "actual loss sustained" basis for any losses incurred while the equipment is being repaired or replaced up to 12 consecutive months. The problem with this, however, is that some forms may limit coverage to pay for your ordinary payroll to 60 days. A related issue is whether coverage can be afforded after repairs are completed for business that was lost during the repair period. Your equipment may be up and running in 90 days; however, you may have lost customers during this period. Many forms do not cover the period after repairs or replacement is completed.
6. **Spoilage.** Businesses that have considerable food or beverages that are damaged in the event of a malfunction in coolers, etc. should be certain that there are sufficient limits for spoilage coverage and that spoilage coverage is provided.
7. **Combined business income and extra expense form.** Most policies of this type cover loss of income associated with a covered event. However, you should be certain that extra expense coverage form is also included so that the costs over and above your ordinary expenses are covered. This would include expenses to expedite repairs.
8. **Computer equipment.** It is usually preferred to have computer hardware, software and media coverage written as part of a specialized computer "electronic data processing" (EDP) policy that is typically endorsed on the package insurance policy for the business. While some boiler and machinery policies include coverage for computer breakdown, it is generally preferred to have a separate policy to cover such items. The reason for this is that many boiler and machinery policies limit coverage to loss of electronic data due to a covered equipment breakdown which may or may not include computer systems.