

RISK ALERT

NEWSLETTER FROM INDIA'S LEADING INSURANCE BROKING HOUSE, **bharat RE** 



From the Editor's Desk

The Motor Insurance business especially the new vehicles market is predominantly influenced by the automobile dealers.

This area has, by and large been unregulated over the years. With a view to have a regulatory oversight on the activities, the Regulator has brought in guidelines to monitor the insurance business of the Dealers. The Dealers will be recognized as Motor Insurance service providers and will have to abide by the regulations pertaining to eligibility criteria, training and examination, code of conduct, reporting requirements, penalties etc..

The distribution fee has been capped to a maximum of 22.50% for two wheelers and 19.50% for other than two wheelers, which is a huge reduction from the kind of remuneration that the Dealers are used to.

Again, we will have to wait and see the effect of these regulations, as the market pressures will work against the regulations. In any case, a period of uncertainty!!

The General Insurance Council (GIC) has issued a public notice seeking feedback on proposed changes in the policy wordings for two common commercial insurance policies - the Standard Fire and Special Perils and the Machinery Breakdown policies, with the intention to remove ambiguities in the policy wordings and reduce litigations.

The GIC in its public notice mentions that the changes have been prepared in

discussion with insurance experts from its member insurance companies. Almost all areas where courts have been giving a positive interpretation in favor of the insured have been modified, to make the wordings more insurer friendly.

In our opinion, modifying time tested wordings will create more issues than solving them.

The intermediary industry should be pushing for freeing up policy wordings, as only then, customization and innovation in addressing the insurance needs of the commercial enterprises will be possible. This is essential to shift the focus from the current malice of competition based only on price, which is a no-win situation for both the insurer and the insured, where the insurance companies are struggling to sustain on unrealistic premium rates and the commercial enterprises are pushed to the wall in order to get even a fraction of their genuine claims settled.

This year's March renewal season has seen price war at its worst and consequently the pressures on a fair and reasonable claims settlement is certain to go from bad to worse!

 **Vijay T**

AICWA, ACS, BL, AIII
CEO & Executive Director

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On Outsourcing

“The knowledge needed for any activity has become highly specialized. It is therefore increasingly expensive, and also increasingly difficult, to maintain enough critical mass for every major task within an enterprise. And because knowledge rapidly deteriorates unless it is used constantly, maintaining within an organization an activity that is used only intermittently guarantees incompetence.”

- Peter Drucker

What Peter Drucker Means...

The requirement for “Outsourcing” cannot be more critical than in the insurance and risk management areas. Enterprise Risk Management (ERM) has moved way beyond insurance expertise alone, and today requires skills from other domains - both technical and commercial. It is impossible for an enterprise to have in-house expertise for ERM, and more importantly, keep it updated and useful, especially when the usage can only be in the event of an infrequent major claim.




In The News

Accidents ...defective insurances...guaranteed to take your enterprise to insolvency!!



Two major insurance companies (one public sector undertaking and the other a private sector) may take a combined hit of Rs 300 crores from the fire that gutted a manufacturing unit, one of the biggest sweets and snacks makers in the country.

The fire, which had raged for 15 hours had taken more than 100 fire tenders and more than 200 firefighters to douse, destroyed a new manufacturing unit with modern machines.

“The claim has come due to fire in one of the units which had modern equipment and were manufacturing chips and other snacks,” said the Insurance Company.



The Economic Times

A major fire broke out at a factory engaged in manufacturing of disposable hygiene products and soon engulfed its entire premises. Several fire tenders (around 35) were called in to control the uncontrollable blaze, which ravaged for close to 3 days.

The fire originated in the godown and the workers in the shift raised the alarm and evacuated the building. The fire blazed on and spread to the remaining sections of the plant and engulfed the entire building through the humidification ducts and pneumatic pipes and spread over the entire plant area.



The fire spread rapidly due to the presence of huge quantity of raw materials and finished goods, involving combustible materials and could not be brought under control immediately, and the entire factory was extensively gutted.

The precise cause of above incident is yet to be ascertained. However the probable cause of fire was stated to be electrical short circuiting and estimated losses upwards of Rs.700 crores.



The Internet



Bharat RE view

The objective of insuring the assets of any commercial enterprise ideally should be with an expectation that in the event of an accident threatening the survival of the enterprise, the insurance compensation is received in a timely and reasonable manner.

Regrettably, the intense competition to write business at any cost and the focus of commercial enterprise owners or their finance team on pricing has made the claims process difficult and complicated, as the premiums no longer justify the insurance companies looking at claims settlement the way it should be!!



Simple On PaperComplex In Practice

A fire in a bulk drug manufacturing company resulted in substantial damage to building and plant and machinery and the factory remained closed for a period of 5 months.

The claim was in excess of Rs.30 crores. Even when the Surveyor recommended for an on-account payment, the insurance company paid the on-account only after 3 months of the Surveyor's recommendation and even then, reduced it by 20%.

The Surveyor, after a few months, assessed the entire loss partly on re-instatement basis and partly on market value basis, which was accepted by the claimant and the Surveyor submitted the report to the insurer.

The insurance company while settling the claim, arbitrarily reduced the amount of settlement by more than Rs.2.50 crores.

The insured had made a representation to the Surveyor for settlement of the claim on market value basis for assets not replaced which were damaged in the fire accident and for the assets which were replaced on replacement cost and was accepted by the Surveyor.

Though the insurance company had not raised any objection to the survey report, they brought in a new plea of improvements in technology/increased efficiency and

capacity and concluded that reinstatement of some of the damaged property was not carried out primarily because the reinstated property was technologically adequate or better in terms of efficiency and / or capacity to take care of the total efficiency claimed to have been lost. So the portion not reinstated was taken out of the claim settlement.

The insured contented that the destroyed block was not reinstated as it was located in-between 3 blocks and it was practically not possible to operate excavators, earth movers etc., for checking foundations in a narrow space as there was a risk of the surrounding two blocks getting damaged.

Also, the reconstruction of the blocks would involve substantial additional expenditure as equipments, machines, cables and pipe lines would have to be removed for reconstruction and reinstalled, which would increase the restoration cost substantially, and a conscious decision was taken to keep the space of the damaged block idle.


For the damaged equipment, new equipment was procured and installed in another block and claimed on reinstatement value basis and the remaining damaged equipment, which could not be procured were claimed under the market value basis.

The matter was taken up to arbitration and the three arbitrators, who were all retired high court judges, gave the arbitration award in favour of the insured, citing the following:

- * There is no dispute that the fire policy issued discloses, that in addition to the standard indemnity provision, it also contains a special provision regarding the reinstatement value.
 - * The conditions of the policy clearly contemplated that if the reinstatement was not completed within the required time, the insured will be eligible for market value settlement.
 - * Further, in the preamble of the policy, it is contemplated that an option to reinstate or replace the property or any part thereof, is available.
 - * The Surveyor had submitted his final report assessing the loss, keeping in view all the terms and conditions of the policy taken by the insured, both on reinstatement and market value basis. This report and evaluation of loss was not disputed by the insured and the insurer. Consequently, it was deemed that the report was accepted without any demur.
 - * The reason given by the insurer regarding the reinstated property being adequate in terms of the overall efficiency and capacity of the plant is only a ruse and baseless in order to deny the legitimate loss incurred by the claimant and is an afterthought by the insurer. This conclusion by the insurer has no basis in the final survey report. In fact, the recommendation made by the insurer's local branch office to their head office was for the full and final settlement of the claim.
 - * The failure to indemnify assets admittedly destroyed by fire goes against the contract of indemnity.
 - * The reinstatement is only an option given to the insured and when reinstatement is not possible, the contract reverts to the default status as an indemnity contract. Secondly, the clause itself provides for part reinstatement. Thirdly, this clause covers only the assets that were replaced.
- The assets which were left out for consideration from the reinstatement principle cannot be assumed as settled. Such an omission is arbitrary and unilateral, hence invalid.

 **Vinod Reddy**
Director

One of the pioneers in the corporate insurance consultancy domain with specialization in Bulk Drugs and Pharmaceutical insurances.

 **Venugopal Rao**
General Manager

More than 30 years' experience in handling insurances of Bulk Drugs and Pharmaceutical companies.

Bharat RE view

Reading between the lines has become a way of life in the general insurance industry, especially pertaining to commercial insurances.

Bharat RE's team at Hyderabad was instrumental in taking this claim to arbitration and ensuring that the client was compensated adequately as per the terms and conditions of the policy.

Bharat RE's unique strength is the unparalleled expertise of our team of professionals in handling complex claims and representing it on behalf of the insureds. This extends to in depth knowledge and skill in legal remedies, including arbitration, which has become inevitable in the current insurance environment.

Risk Management

Risks in Security Offerings

The process of raising capital through an Initial Public Offering (IPO), or a secondary listing, brings in potential litigation threats to a company's risk landscape. Securities legislation imposes wide-ranging liability for any misrepresentation and misleading statements made in an offering prospectus or at a listing road show or other communications like press statements, public interviews etc.

Liability extends not only to the company, but also beyond the limits of the company to encompass directors and officers, both past and present and current shareholders, all of whom may be targeted for litigation by investors or regulators.



Public Offering of Securities Insurance (POSI) protects against this exposure, by providing coverage in the event of litigation arising from the capital raising process. Coverage is provided to the company, its directors and officers, the controlling shareholder and any shareholders selling shares in the offering.

This includes damages awarded in civil courts and in administrative or regulatory proceedings, and the potentially substantial defense costs incurred in criminal, administrative or regulatory charges or investigations.

Bharat RE view

It is our belief that business organisations, irrespective of the sector or domain in which they operate, should look at new and innovative covers more proactively, as majority of commercial enterprises continue to rely only on the traditional insurance covers.

Risks are ever changing, and unless the enterprise keeps evolving to look at changing risk perceptions and new coverages, they risk exposure to financial crisis or bankruptcy.

Risk Exposures - Mergers & Acquisitions

Warranties and Indemnities Insurance (W&I) is the generic name for insurance which provides cover for losses arising from a breach of warranty, or in certain cases, under an indemnity in the context of investment in a corporate entity. Cover is bought either by the buyer or the seller of the company and sometimes by both individually to cover their respective interest.



W&I Insurance aims to offer as close as possible "back-to-back" cover with the warranty conditions in the Share Purchase Agreement as well as liability under any indemnity for claims arising out of matters which have not been fairly disclosed or known to the insured, for example regulatory, environmental, tax related issues etc..

There are other general covers for representations and warranties which generally provide covers for unknown liabilities in a transaction and help parties manage the risks in a transaction in a better fashion.

This policy is usually covered by expert underwriters and terms are offered from reinsurance hubs like Lloyds, Singapore etc. and fronted by insurers in various insurance markets.



T. L. Arunachalam

B.A. B.L. AIII

Director - Emerging Risks Practice
Having international exposure with specialization in Liability insurances including Cyber & Commercial Crime risks.


Case Study

Neither Here nor There...

A roller flour mill was hit by a cyclone. Two days later, a mob of more than a thousand people forcibly entered the flour mill after assaulting the company staff, broke down the shutters of the godown and looted the stocks.

The incident was reported to the police and an FIR was filed. The claim was also reported to the insurance company who in turn appointed a surveyor. The surveyor assessed the loss and after extensive discussions, visits to the factories and perusal of records recommended settlement.

The mill owner had taken both fire and burglary policies. To his surprise, the insurance company repudiated the claim under both policies. The insurance company ingeniously contended that following the cyclone, there was a disruption of normal activity and the law enforcing authorities were taken unawares and were not able to maintain law and order. Taking advantage of this situation, a large number of people looted the mill godown.

Though the fire policy covers the risk of flood, cyclone and storm, the insurance company cited the exclusion in the fire policy which excludes burglary during or after the operation of an insured peril, which in this case, was the cyclone.

The fire policy also covers the risk of riot, strike or malicious damage, for which the insurance company argued that there was no intention of the looters to riot, strike or create malicious damage.

Having repudiated the claim under the fire policy, the insurance company then proceeded to quote the exclusion under the burglary policy and refused the claim under that policy also.

The insurance company argued that the theft / looting had arisen out of or related to a cyclone situation and is excluded as per the policy exclusion.

Obviously, the insured took the issue to court, and the judgement given was in favour of the insured.....

- ✳ While the court maybe inclined to agree with the insured's counsel that the present loss may not be covered under the Fire policy, they were unable to agree with the argument that the loss is not covered by the Burglary policy.
- ✳ The operative clause of the Burglary policy provides for loss, destruction or damage by theft, following upon an actual forcible and violent entry into the premises by the person or persons committing such theft.
- ✳ In the present case, there is little room for doubt that a large body of people forcibly and violently, after assaulting the factory staff, entered the premises and removed the stocks physically, which is clearly covered under the operative clause of the Burglary policy.
- ✳ Relying on the exclusion under the Burglary policy, that the loss or damage is associated with any of the natural calamities mentioned therein, is completely misplaced. In the present case, there were two separate episodes with the storm occurring on a particular day and the looting almost two days later. Not even remotely it can be said that these two instances were the outcome or relatable to the natural calamity. What has

been issued is a Burglary policy and the purpose of the exclusion is to exclude loss by a natural phenomenon, and if the insured wants coverage for such natural perils, then separate policy needs to be obtained.

- ✳ In order to come within the purview of the terms of the Burglary policy, certain man made ingredients like forcible / violent entry, theft etc..are required to be fulfilled. It is not the exclusion that comes first. It is the inclusive provision of the policy which comes first.
- ✳ In order to fall within the purview of the policy, the insured has to prove and satisfy that theft took place following an actual and forcible entry into the premises, which stands proven in this case. Thus in our view, a wholly wrong meaning is being given to this clause without appreciating the spirit of the Burglary policy, with the sole objective of ousting the claim of the insured.
- ✳ The Surveyor's report had not been found to suit the insurer's line of thinking because of which aspersions had been cast upon the Surveyors, who, as per experience in this court, are credited to be one of the leading surveyors for all insurance companies.
- ✳ The grounds of repudiation relied upon by the insurer are misplaced!!
The court directed the insurer to pay to the insured the amount of the loss as assessed by the Surveyor along with interest.



Bharat RE view

A legal remedy is unlikely to benefit a business venture in India, considering the years of litigation before a judgement can be obtained. This is especially true in the insurance industry, as insurers have the financial strength and the desire to keep the legal battle going for decades across various stages of litigation.

Companies need to ensure that their insurance program is as comprehensive as possible and choose the right partners and also pay the right price, if they expect an insurance policy to come to their rescue in the event of a major accident.

Claims Analysis

Big Bang Kiln.....

There was a major explosion in an insulator factory in a kiln. The kiln is meant for heat treatment to raw structures of insulators. The heat treatment is given by raising the temperature of the kiln to around 1700 - 1800°C. This temperature is attained by firing the kiln with the help of a number of burners which are fired with industrial gas, which is supplied and controlled through solenoid valves.

On the day of the incident, there was a power failure in the plant, and in approximately two minutes, the power was restored. When the power was restored, the operator had started, in sequence, the burners inside the kiln. When the burner in the rear side of the kiln was given ignition command, a big bang was heard and the rear side refractory of the kiln collapsed.

When the claim was made on the insurer, and the Surveyor appointed, he came to the conclusion that the explosion, though a covered risk under the policy, will not be admissible when read in context with the terms and conditions of the policy!!

Even though the policy does not define explosion, the Surveyor contended that the policy provides for an explosion coverage only when the pressure of any vessel increases beyond the sustainable limits, and results in explosion. Likewise, the policy according to him, covers implosion, when the external pressure in a closed vessel increases more than the internal pressure, resulting in implosion. These two types of explosions are covered under the Fire policy as per the Surveyor.



Since the kiln is not an airtight vessel and has no internal pressure, no explosion had taken place. The blast of unburnt gas in the form of a cloud which had remained at the rear side of the kiln had caused the damage and according to him, was not an explosion under the policy. The subsequent damages to the kiln refractory had occurred due to shock waves which might have been created due to gas cloud burst, which does not come under the policy coverage.

The client appointed a chartered engineer to understand the root cause of the failure and the expert gave his opinion that, after the resumption of electrical power, the operator tried to flare the third burner but ignition failed. At the same time, the plunger of the solenoid valve malfunctioned because of which the flow of fuel gas was not stopped. Further, repeated efforts to fire the burner by the operator caused accumulation of fuel gas mixture near the tip of the burner, causing an instant fire and then an explosion took place.

Since the Surveyor's opinion was that the accident was not covered under the policy, great efforts were made to convince the insurance company to relook at the accident and finally, they agreed to review.

Issues raised and explained were:

- ✳ *The Surveyor noticed, from the data logs, that continuous air supply was present during the duration of the power failure, and wanted clarity if this was achieved through any battery operated fans. Similarly, gas supply also seemed to have continued during the power failure when the system had an auto trip mechanism.*

The client clarified that all fans and gas strains automatically switch off when there is a power failure. The data log was an error of instruments when they suddenly reached a stop condition.

- ✳ ***The standard operating process provides for full closing of fuel gas exhaust dampers when there is a power failure. Was there any procedure for manual scavenging or removal of trapped air?***

There is no procedure for scavenging or removal of trapped air in the kiln as there is a risk of sparking which could lead to an explosion in the presence of hot air and gas mixture.

- ✳ ***The video clipping did not show any evidence of flame and there is a possibility that the sudden outburst or explosion which was visible could be a blow out of air only.***

The video clearly showed the presence of smoke at the stack area. Even though the flame was not visible in the video clipping, there should have been a fire inside to cause the smoke, which was not seen as the kiln is an opaque body.

- ✳ ***Also, the sudden flaring up of the accumulated fuel increased the pressure inside the kiln, which ultimately led to the explosion. Videos of the kiln showed a sudden burning of gas and it was also noted that at that instant, the furnace pressure was 4-6 times more than the normal. In the case of fuel explosion, the pressure should have been much higher.***

The instruments available for measurements have only a limited range. Hence the increase in pressure will not be observed on the logs of the instruments. But the sequence of events clearly show that the pressure must have increased substantially due to sparking that led to explosion within the furnace.

- ✳ ***The burner is also provided with control mechanisms for detecting a pilot flame before a full open valve command is given. If the pilot flame was not established, full opening of the fuel valve will not occur and hence accumulation of gas situation may not arise.***

Even though there is a control mechanism for the burner, wherein if the burner is not ignited within a stipulated time, full opening of the fuel valve will not happen. However, in the present instance, since the

operator had tried repeatedly to get the burner to ignite, there has been a gas accumulation in the kiln.



Minesh Patel

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General Manager - Technical

Specialization in customizing insurances for Chemical and Engineering industries.



Bharat RE view

The fire policy may look simple to read, but the interpretations of simple looking wordings could leave you baffled!!

The ingenious interpretation of the policy wordings has been increasing in direct proportion to the reduction in the premium rates over the years and it has now reached alarming proportions, leaving the uninitiated business organizations grappling with invisible exclusions and conditions in the policy and a sustained struggle to get a fair claim, little realizing that they will ultimately have to compromise on their rightful compensation.