Supporting paper to go with **Chartered Insurance Institute CPD video: Business Interruption Insurance Explained** presented by Damian Glynn BA(Hons) FCA FCILA FUEDI ELAE FIFAA, head of financial risks, Vericlaim.

Watch video here:
http://www.editor.cii.co.uk/knowledge/claims/articles/business-interruption-insurance-explained/44697

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CONCLUSIONS

1. **Maximum Indemnity Period –** 12 months is rarely long enough (See Café de Lecq v Rossborough, Jersey 2012)

2. **Gross Profit –** Uninsure as little as possible**.**

3. **Declaration Linked policies are preferable,** but significant under declarations may give grounds for voidance, subject to the Insurance Act).

4. **Eurokey recycling v Giles 2014 –** policyholders are responsible for getting the sums insured right, but brokers are responsible for explaining the rules within which sums insured are set.

5. **2012 CILA/CII report: Business Interruption Policy Wordings – challenges highlighted by claims experience**

THE COVER – RECAP: OPERATIVE CLAUSE

Policy Wording

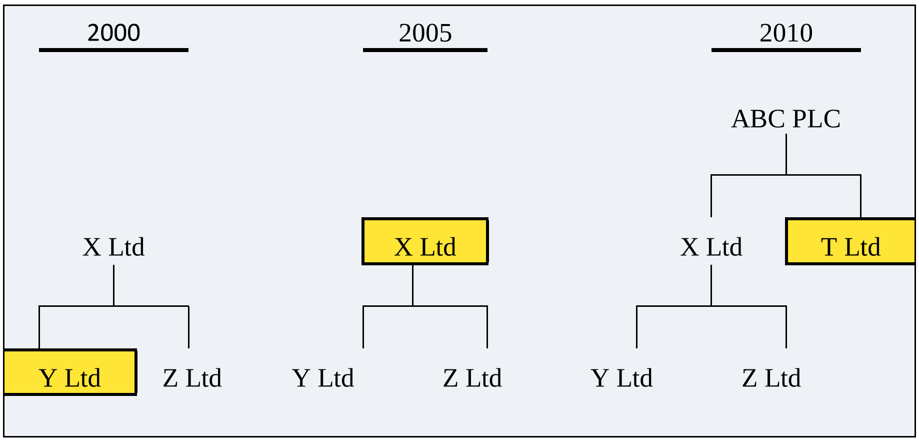
"The Insurer agrees (subject to the terms, definitions, exclusion, and conditions of this policy) that if after payment of the first premium any building or other property used by the ***Insured*** *at the* ***Premises*** *for the purpose of the* ***Business*** *be accidentally lost, destroyed or damaged during the period of insurance … and in consequence the business carried on by the Insured at the Premises be interrupted or interfered with then the Insurer will pay … provided that :*

1) *At the time of the happening of the loss, destruction or damage there shall be in force an insurance covering the interest of the insured in the property at the Premises against such loss, destruction or damage and that i) payment should have been made or liability admitted therefore ii) ["losses" below the excess will not debar a claim].*

2) *[Concerns sums insured]"*

1. Who is the Insured?

- Corporate Groups – example policy set up in the name of X Ltd and/or subsidiary companies in 2005. Main trading Business boxed and highlighted in yellow below. ABC PLC is a dormant holding company incorporated for tax reasons.



  - Shadow Directors (Companies Acts)
  - A director is defined by an individual's role rather than job title
  - A shadow director is defined as a person who advises the directors how to act (other than an external professional providing advice)

- Insurable interest and Insuring as agent
- Limited Companies and sole traders/partnerships
- Related party transactions: when is the Insured not the Insured

2. What are the Premises?

- Policy Definition – (Assuming Premises has a large 'P')'*Premises listed in the schedule'*; qv the buildings definition in the Property/Buildings section of the policy

- Are the Premises the building or the whole site?

    - Surveyors would look to the definition in the lease, which would generally include associated land – i.e. Premises is not just the building
    - Dictionary definition: Building and the grounds/Land and the buildings on it/a piece of real estate

- Compliance with warranties e.g. waste removal from the Premises weekly/daily

- Is the business generated at the Premises or not? Are the Insured likely to be able to comply with the Material Damage Proviso?

- Geographic restrictions on the scope of Premises

- Concessions within supermarkets/department stores, fitness clubs in hotels, retail units in shopping centres, any business operating as an ancillary to another:

- Consider multi-tenanted Premises

> A business occupied premises in London. A series of power failures occurred, following a fire at the terminal end to the multi tenanted building. Different power feeds serviced the common areas and tenants units. Some of the failures affected the whole building, some only the common areas. Each tenant had a discreet service point at which power entered their unit.

3. What is the business being conducted?

- New/marginal income sources e.g. Rental income streams
- Totally new basis of trading

An insured business reconditioned sewing machines. An acquaintance of one of the Directors invited the Insured to assist in an international arms deal. The acquaintance would be able to arrange delivery of the weaponry to a foreign government, and would also secretly be able to establish the lowest tender quote from other potential bidders just before the bid deadline. The Insured simply had to front a bid, inserting a winning bid into a prepared document on the morning of the deadline. Over the previous night, there was a break-in and the computer with the tender on it was stolen (there was no backup). A claim for £850,000 was submitted.

THE COVER – RECAP: LOSSES AND DAMAGE

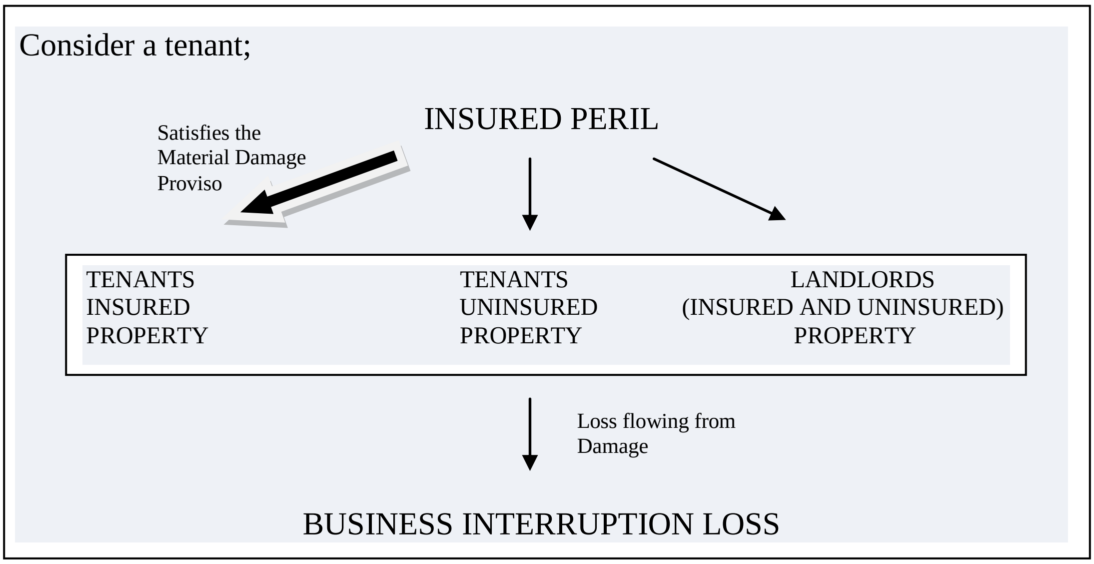
1. Coverage and the Material Damage Proviso

- BI losses flowing from fire, flood, theft etc are generally uninsurable.

- BI losses flowing from **Damage** caused by a peril are generally insurable.

- The Proviso is not qualified- 1p of damage will satisfy it as much as £1,000,000.

- Once the Material Damage Proviso is satisfied, the Operative Clause will respond to BI losses flowing from any of the damage, not just the Damage that satisfied the Proviso.



- **Glengate - KG Properties Ltd v Norwich Union Fire Insurance Society Ltd and Others (1995)**

  - Alleged failure to satisfy the material damage proviso
  - Insurable interest: narrow and wider interests

- **Coromin -v- Axa Re & 9 ors 30.11.07**

  - Assets don’t need to exist at the time of the incident for lost profit that they would have generated to be claimed

THE COVER – RECAP : LOSSES AND DAMAGE

2. Damage - Definitions

- Policy Definition – ‘loss or damage’
- CILA/IIL BI Wordings report – ‘Damage’ at the Premises, ‘damage’ re extensions (should policies clarify that damage in the vicinity must be of a nature that would be covered as ‘Damage’ at the premises?)
- Dictionary Definition – ‘injury or harm impairing the function or condition of a person or thing’
- Operative clause – ‘solely caused by’/’directly or indirectly caused by’ etc
- Market practice – flooding 2007, Bangkok demonstrations
- Temporary Impairment of use (eg frozen water mains)

3. Damage – concurrent causes

- Insured and Uninsured/Insured and Excluded

  - Miss Jay Jay (1987) – If insured and uninsured damage causes loss con-currently and the impact of each can't be separated, Insurers pay all (eg competitor gossip after a fire)

  - Wayne PumpTank (1974) – As above, but with concurrent Insured and excluded causes, Insurers pay nothing

  - Tektrol v Hanover Ltd – energy saving devices for industrial motors; source code affected by random virus and also a burglary. Malicious persons (virus) exclusion as well as Insured theft so Insurers didn't pay

  - Notifiable Disease within 25 miles (SARS) in the context of ongoing footfall reduction in rural areas anyway; also Mad Cow Disease

> The Insured are a restaurant operating as tenants form a Victorian building. The building collapses, damaging the contents therein. There is a collapse exclusion on both the landlord's and the tenant's policy. The landlord's Insurer turns the building claim down. To what extent is the tenant's BI claim payable?

- Damage: which is the dominant cause?

  - Leyland v NU (1918); Boat was torpedoed on the way to Le Havre, couldn't stay in the harbour, went back out to sea and sank after bad weather. Held – War Perils were the dominant cause (not necessarily the first, last or dominant causes)

  - Gray v Barr (1971); Theft from a building was suffered after it suffered bomb damage; held – not the same cause, two incidents. Lord Denning – use common sense.

4. The Loss must flow from the Damage

- Gunsmiths – gun explodes injuring hand of employee (chauffer charges etc) – loss flows from injury not damage to Insured property

- HSE – exacerbation of loss; no break in proximate cause; at what point does extended exacerbation not flow from Damage

- Consider the following:

2 sandwich shops are located near a city centre suffering bomb damage. One sustains a small crack in the bottom corner of its front window, the other suffers no direct damage. Both suffer significant Gross Profit losses.

A boatyard on the Thames stores customer's boats on dry dock (ie on columns of bricks in the yard) over the winter period. Turnover is achieved primarily through decommissioning and re-servicing customer's boats at the end/start of the boating season. There is also a chandlery shop which sells fixtures to customers. Vandals set fire to the boats and destroy almost all of them. Fortunately, the chandlery shop itself is undamaged. Is the resulting BI loss covered?

A large accountancy practice suffers a power spike that blew all of the fuses, by passed the UPS, and causes several hours downtime. Lost chargeable time is submitted at over £100,000. In the absence of any utility extension, should the BI cover respond?

6. Wide Area Damage

- 2007 and 2009 flooding in UK – wide area flooding produced extended periods of loss and occasions of windfall profit

- Damage at the Premises, and damage in the vicinity (and beyond) simultaneously, arising out of the same event

- 2010: Orient Express Hotels v Generali: 23 storey Windsor Court Hotel in the CBD, physically damaged by hurricanes Katrina and Rita in August/September 2005, re-opening on 1 November 2005

- Simultaneously, widespread flooding in the city – mandatory evacuation 28 August, curfew imposed 27 August to the end of September. New Orleans was 'closed'.

- Core cover addresses BI loss flowing from Damage at the Premises, not loss flowing from damage not at the Premises (subject to the extensions). Insurers noted that hotel would not have had any customers even if undamaged (other circumstances clause applied)

- Tribunal supported this position: tribunal finding challenged under Arbitration Act 1996.

- OEH arguments:

  - Assumption of a peril affecting the wider area but stopping at an invisible wall around the Premises is artificial;

  - Insurers argument reduced their exposure as a consequence of the scale of damage increasing;

  - General principle of Concurrent causes was being ignored;

- RCJ: tribunal decision upheld

  - Other circumstances clause is concerned with Damage, not the causes of damage (therefore the fact that the same flood caused Damage at the Premises and damage in the vicinity is irrelevant)

  - Court correctly applied the policy wording, but outcome satisfies nobody

- Consider Wide Area non damage (Bologna earthquake 2012)

THE COVER - NOT ALL CONSEQUENCES ARE COVERED

1. **Customer Penalties (driven by historic contract)**

2. **Wasted Costs**

    - pre incident advertising / promotional commitments
    - normal purchase commitments post incident

> After a large fire, a significant customer appeared to be willing to continue to use the insured business. The latter bought shrink wrap rolls quarterly in advance, and made a purchase post fire in the normal way. Very soon after, the customer withdrew its business and a substantial quantity of unusable shrink wrap remained.

3. **Under Insurance**

    - Material Damage under-insurance may or may not affect the BI claim

4. **Landlord's Intransigence**

> The Insured ran a small care home from a tenanted terraced property. Water damage in the dining room was discovered. The Insured moved the residents into other accommodation, incurring significant ongoing losses. The landlord advised the Insured that the Damage was irreparable. The Insured notified their Insurer after several months. The Damage was eventually repaired over a three month period.

- Disinclination to rebuild/repair

5. Post Loss Risk Improvements

- Insurer driven

Following a major fire, Insurers required extensive sprinkler systems to be installed, including fitting within the stock racking systems. To maintain water pressure, a water tower was required adjacent to the building. Issues arising: Delay, producing increased BI losses, as a result of additional design and commissioning time, planning requirements, and the need to prepare external areas (in the case in hand, the building did not occupy all of the demised Premises); Also, cash flow difficulties – the sprinkler system, water tower, and all ancillary and consequential costs were not losses arising from Damage.

- Insured driven

The Insured were a printing and design company and suffered a series of break-ins. After the most recent incident they decided to relocate the and identified a first floor unit in an old warehouse. When a large printing machine was delivered, it would not fit in the lift or around the stairs. It had to be craned in through a window. The local authority's permission to close the road to achieve this was required. The death of a council officer resulted in delay. The pre-incident facilities were eventually available in-house again after 14 months, when the need for outsourcing (and increased costs) ended.

- Externally driven

- Local authorities, particular planners – there are likely to be further issues for planners to consider in the future, including green issues relating to power generation amongst other things. (Most local Authority Clauses relate to re-instating damaged property in a form meeting current standards rather than a requirement to install entirely new things).

- Customers/suppliers - Dominant customers will be in a position to require change regardless of legal enforceability (the position of temporary premises occupied to mitigate BI loss to be differentiated from permanent re-instatement)

- Others, e.g. neighbours – encroachment/re-zoning.

6. Gossip / Blemishing

- Concurrent causes of loss (insured/uninsured and insured/excluded)

> A furniture retailer was located next door to a car showroom. The car dealer suffered a fire which caused smoke damage to the external wall of the furniture retailer. No smoke entered the Premises. Local radio reported that the furniture shop had suffered extensive damage. Business was significantly depressed over the next quarter.

7. Wages

- Normal Wage costs (including normal levels of overtime) would have been payable but for an incident and are still payable. There is neither an increased cost or a cost reduction arising. Normal wage costs are included in any claim for loss of gross profit, which includes labour, all other overheads and net profit.

8. Management Time/Head Office Overheads

- Is it an additional cost (Polikoff v North British and Mercantile)?
- Third Party cases
- CILA guidance note on Management Time

MAXIMUM INDEMNITY PERIOD (MIP)

1. Definition

- The *actual* indemnity period :

"The period beginning with the occurrence of the Damage and ending not later than the Maximum Indemnity Period thereafter during which the results of the Business shall be affected in consequence of the Damage."

- The *Maximum* indemnity period is a backstop; 12 months is generally going to be too short.

2. Commencement of the Maximum Indemnity Period

- Begins with the occurrence of the Damage
- Commercial subsidence cases present particular difficulty

> A retailer occupied a unit as a tenant. The front section of the property they occupied had started to move with some ingress of water (cracks were filled with silicone sealant to mitigate this). Repairs could not be undertaken without a long period of monitoring. They had to move out after a year so that repairs could be undertaken.

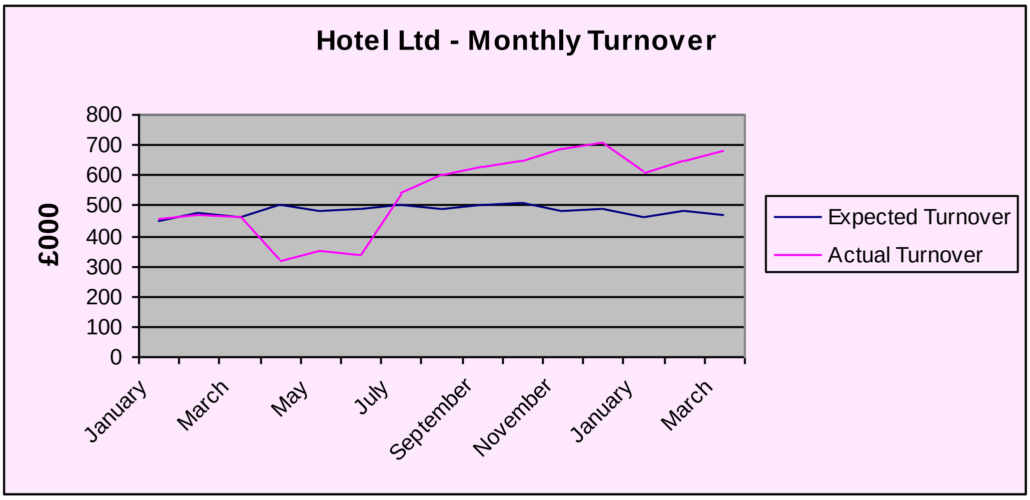
- The occurrence of damage is when the cracking is first noted (qv the application of excesses).

- Coromin v AXA Re – In that case the Maximum Indemnity period commenced at either the date or damage or interference with the business.

3. Period during which results are affected

- Turnover can be affected by being higher or lower than otherwise expected. The benefit of higher than expected turnover accrues to Insurers

- Hostels re-opening as hotels/Refurbished chip shops/Shopping tourists after high profile incidents.



- A fire occurs at the end of March Y1
- Depressed trading until repairs complete at the end of June
- 12 Month Maximum Indemnity Period, ends March Y2

- Additional Uninsured Investment

A Business has a 24 month MIP. Repairs are completed after 11 months. Insurers pay £1m for the insured damage. The Insured invest a further £1m of their own money to improve the facility. Turnover in year two is double that which it would have been but for the fire. How should the upturn be treated, and how long is the Indemnity period?

6. The 2 phases to the BI loss: Reinstatement and Recovery

- There is a disproportionate relationship between the two

Reinstatement period	Further recovery
1 day	4 days
1 week	60 days
1 month	180 days
6 months	730 days

7. Reducing the reinstatement period is key

- Losses driven by an inability on the part of the business to produce
- Losses driven by a disinclination on the part of the customer to buy
- Can the business incur ICW to mitigate the loss?

MIP - STAFF

1. Competence of the Management Team

2. Outsourcing

- Production – printing, dyeing, metal treatments
- Administration – HR, Invoice factoring

3. Key Personnel

- High technology/specialist businesses

> A pharmaceuticals business had a fire. The steps to be taken to rebuild were identified. Sub committees were established to liaise with customers, licensing authorities, source replacement plant etc. Technical issues were key to each of these sub committees. The Technical Director could only be in one place at a time.

4. Staff Profile

- Will the staff work overtime – students, part time carers

MIP - PRODUCTION/OPERATIONS

1. Non physical limitations

- noise abatement orders (preventing work after 7pm in the evening, for example
- relations with neighbours
- planning restrictions

2. Plant and machinery

- lead times to replace
- ease of machine removal/access

> Following flooding to a foundry, the impact absorption pit below a hammer filled with water. The hammer needed to be lifted to allow cross-piled oak beams to be removed from the pit, and for the water to be extracted. To remove the hammer, a section of the factory roof had to be removed to allow it to be craned out. This process took so long that the customers went elsewhere. The Insured business became insolvent after the expiry of the Maximum Indemnity Period.

- production layout
    - minimum footprint
    - proximity of lines to each other
    - inter-dependency of production lines
- specialist foundations / services (including drainage)
- Material Damage insurance on an indemnity basis

3. Special/Demonstration Assets

4. Is turnover generated at the Premises?

- ice cream vans/consultants/electricians/ tradesmen
- impact / consequence of Damage at the Premises

5. Importance of the Premises?

- role of advertising
- Do customers visit site or not?
- Importance of ambience (e.g. car dealerships)

MIP - THE BUILDINGS

- Physical fabric

  - asbestos
  - sprinklers
  - non standard construction
  - obsolete / non-modern
  - construction methods

- Listed status

  - heritage bodies
  - restricted repair options
  - unknown historical features
  - post-repair loss of uniqueness/ambience

- Tenancy

  - lack of control over building repairs
  - presumption of landlord co-operation
  - impact of landlords' under-insurance
  - pre-incident relationship with landlord : wanted?
  - pre-incident protocol re smaller repairs.

MIP - THE SITE

1. Available space on site

- Is there spare room on site or will post loss relocation be essential?

> Following a fire at a furniture manufacturer, temporary units were installed at the side of the car park in which many different types of foam were stored. The damaged part of the building was boarded up and customers were aware of no ongoing disruption.

> A private school consisted of a range of buildings on a rural site. The main building and boy's dormitory were destroyed by fire. Temporary dormitory, kitchen, library, and other units were required. Temporary paths between these units were necessary. Street lighting along the paths was installed, with security patrols being arranged. The parents considered the experience to be character building for their children and Revenue was maintained.

> A commodity trader suffered ongoing power problems over a three day period. Fortunately, as part of its disaster planning, and given the critical need for a constant power supply, there was a pre-arranged deal with a generator supplier to have a power generator on site within an hour of the agreement being invoked. The generator supplied was 4m*1.5m*1.5m and was placed in the only two car parking spaces enjoyed by the building. These were rented by another tenant.

2. Having to move is a bad thing

- If the business can remain on site, the customers will perceive the incident to be a less serious matter and a reduction in customer confidence is less likely.

MIP - THE VICINITY

1. **Change in use of the area**

    - Executive Housing built around an abattoir site
    - Edge of town retail/car dealership developments around heavy industrial sites

2. **Intended change in use of the area**

    - Re-zoning by planners

3. **Changes in status of the area**

    - Review of areas liable to flooding
    - Designation as an area of archaeological interest

4. **Local waterways**

    - Potential access issues to the site
    - Utility exposures

5. **Local employment pool**

6. **Location of the business**

    - if relocation post fire becomes necessary, will options be restricted? For retailers, for example, must they be on a major arterial route or on a retail park?

> A fire occurred at a gentleman's club. Relocation was considered pending repairs to mitigate the loss but it was concluded that the time period involved in enticing the members to a temporary venue and the cost thereof would not be an economic exercise.

MIP - THE SUPPLY CHAIN

1. Partial losses

- 90% of losses represent a diminution in efficiency rather than total destruction

2. Customer spread

- If there is a dominant customer, there is an increased risk of large turnover loss (compared to a large number of small accounts) – a business might require an extended period of insurance support whilst a replacement account was secured.

3. Customer Penalties

- Contractual Penalties
- Non contractual penalties
- Consequences of non payment

4. Being a Dominant Customer for a supplier

> A large company suffered a fire. It was the dominant customer for a subcontract manufacturer, X ltd. That manufacturer received no orders from the company subsequent to the fire. X ltd advised that, without financial support (banks/loans were exhausted as a source of finance), it would not exist when the fire damage was re-instated. The company would not be able to manufacture product without the (unique) supplies from X ltd. Should the company finance X ltd? Is that covered under the policy?

- Consider advising clients to ensure that suppliers have customer extensions on their BI policies.

5. Other supply chain issues

- Geographic spread
- Fellow suppliers of customers, or customers of suppliers
- Lead times in sourcing product

DEFINITION OF GROSS PROFIT

1. **Statutory Accounts**

    - Companies Acts 1985 onwards
    - No rigid definition of gross profit
    - Companies House – filing and time limits
    - Purpose of Statutory Accounts

2. **Accounting Standards –** no definition of gross profit

3. **'The' Accounts**

	2009	2008
	£ 000	£ 000
Turnover	23,982	20,461
Cost of Sales	(11,124)	(9,623)
Gross Profit	12,858	10,838
Administrative Expenses	7,864	6,257
Distribution Costs	1,578	1,461
Interest	283	341
Net Profit before tax	3,133	2,779

4. Detailed Profit and Loss Account

- Trading account/detailed trading account

- Tax Computations
- Not part of the Statutory Accounts
- Not used to manage the business: this is a retrospective annual document

	£ 000	£ 000
Turnover		23,982
Opening Stock	1,839	
Purchases	6,743	
Wages	2,479	
Power	2,227	
Closing Stock	(2,164)	
Cost of Sales		(11,124)
Gross Profit		12,858

- Gross Profit (assuming a standard policy definition):

	£ 000	£ 000
Turnover		23,982
Opening Stock	1,839	
Purchases	6,743	
Closing Stock	(2,164)	
		(6,418)
		17,564

4. Policy Wording

"Gross Profit : The amount by which :

i) the sum of the amount of the Turnover and the amounts of the closing stock and work in progress shall exceed
ii) the sum of the amount of the opening stock and work in progress and the amount of the Uninsured Working Expenses."

	£ 000	£ 000
Turnover	23,982	
Closing Stock	2,164	
		26,146
Purchases	6,743	
Opening Stock	1,839	
		8,582
Gross Profit		17,564

5. Uninsuring Costs Generally

- **Intention**: identify costs that will reduce in line with any reduction in turnover
- **Mechanics**: deduct the identified costs from turnover, which will reduce the percentage recovery on any turnover loss
- **Outcome:** if the costs which are presumed to decrease in line with turnover do so, the policy will cover the remaining cost base and profit.
- **THE PROBLEM**: Getting the guess wrong.
- **90%** of losses are partial losses
    - pre-conceived scenarios and unforeseen incidents
    - departmental variations
- **Categories of cost**
    - Variable costs
    - Fixed costs
    - Purchases
- **Terminology** – what is fixed and what is variable?

- Over the course of 0.01 seconds, everything is fixed
- Over the course of 1000 years, everything is variable
- Many costs are partially variable
- Direct and indirect costs

7. Variable Costs

- Beware the partial loss

- Carriage costs

A business despatched pieces of equipment, 20 to a lorry, using external hauliers. Carriage was uninsured, the finance director surmising that if equipment was not being manufactured, haulage would stop. Following a partial loss, customers wanted product as soon as it was available. Equipment was sent out in vans in batches of 5 items and the carriage cost increased.

- Power/wages/other operational costs

A retailer concluded that almost all operational costs would cease if any particular shop burnt down. Staff wages, lighting, heating etc were all consequently uninsured. Following water ingress at the rear of a shop, it opened for business as usual. Customers opened the front door but didn't enter because of the smell. Costs continued but turnover declined.

8. Fixed Costs

- It is rarely appropriate for fixed costs to be uninsured

  - Rent /rates are generally fixed
  - Wages / labour costs are largely fixed (in the UK)

- Impact is not only to reduce the ROGP, also affects the recoverability of ICW

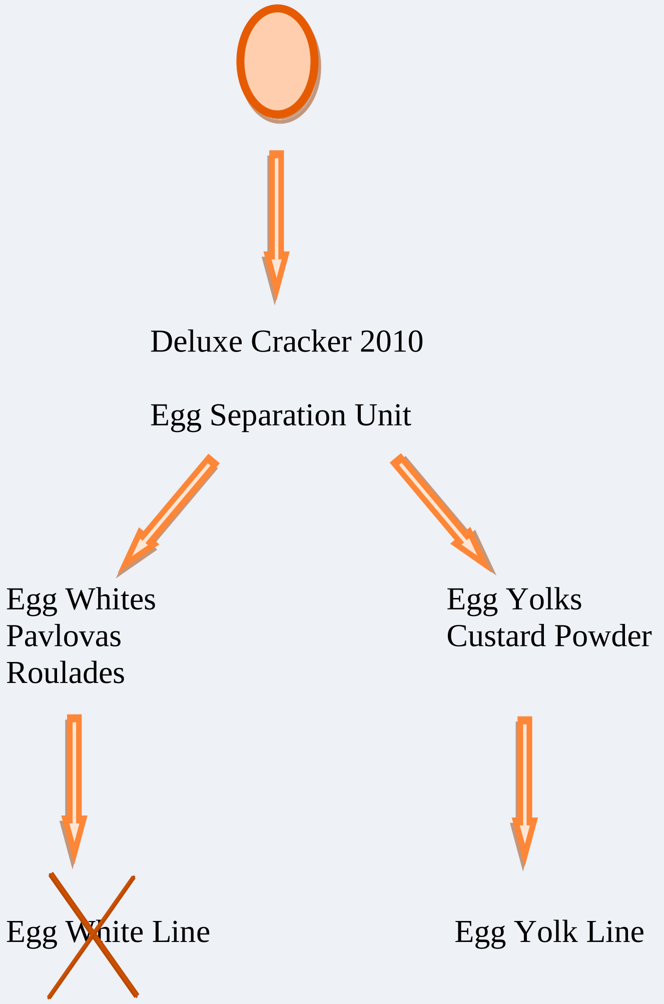
- Uninsured Standing Charges clause :

"If any standing charges [fixed costs] of the Business be not insured by this policy (having been deducted in arriving at the Gross Profit as defined herein) then in computing the amount recoverable hereunder as Increase in Cost of Working, that proportion only of any additional expenditure shall be brought into account which the Gross Profit bears to the sum of the Gross Profit and the uninsured standing charges".

9. Uninsuring Purchases

- What are Purchases?
  - Policy wordings
  - BI texts: Riley/Hickmott
  - Purchases in business usage eg VAT returns
- Accounts Designation Clause – which set of accounts?
- CILA/IIL BI Wording report
- Contractual commitments

A company purchased eggs which were separated into yolks and whites on a separating machine. The two raw materials then passed down separate production lines. Purchases were uninsured. A fire occurred on the egg white line.



A company committed to take a farmer's crop even before he had planted it. A fire occurred at the company's factory. A standard Gross Profit Policy was in place, and Purchases had been uninsured. The crop still had to be paid for even though it could not be processed.

- Fashion industry : boutiques ordering six months in advance.
- Long lead time raw materials

- Commercial commitments

A scrap metal yard suffered Damage to its fragmentiser. Scrap was collected from customers (who continued to produce it and required it to be removed) as usual whilst repairs were ongoing but the yard eventually became full. The Insured had to collect scrap and take it to landfill until repairs were complete.

- scarce raw materials / maintenance of relationship with supplier
- need to support the supply chain

- Other commercial issues (including stepped discounts)

(MANUFACTURED) STOCK

1. The Business Interruption / Material Damage Overlap:

	£000	£000		
Turnover		100,397	}	This part of the profit and loss account is insured as Material Damage (Stock) (or is assumed to cease)
Opening stock	4,299			
Purchases	52,499			
Closing Stock	(5,317)			
Cost of Sales		(51,481)		
Gross Profit		48,916		
Administrative Expenses		33,772	}	This part of the Profit and Loss Account is insured as Business Interruption
Distribution Costs		8,643		
Interest Payable		1,232		
Profit before Tax		5,269		

- The Business Interruption claim and the stock claim together can never add to more than the selling price.

- If overheads are included in a stock valuation, then there will be double counting if the same overheads are also be insured under the business interruption cover.

Consider : a Widget manufacturer values his stock as follows:

	£
Raw materials	50
Wages	10
Power	5
General overheads	15
Total cost of Stock	80

Widgets are sold at a 50% mark-up for £120.
A fire occurs, destroying the widgets and there is a loss of turnover. The stock claim is resolved at £80 per widget. A business interruption claim is then submitted at £70 per widget (selling price £120 less raw material purchases of £50). The claims total £150 – normal selling price is only £120. How should this be dealt with?

2. Policy Wording;

- basis of stock settlement in the policy :

"the Insurer will pay to the Insured the value of the property at the time of its loss or destruction or the amount of the damage or at the Insurers' option reinstate or replace such property or any part of it". (The BI section of the policy uses the normal accountancy methods of the Insured to value stock when calculating gross profit).

3. Component parts of a stock valuation

- Raw materials/Variable overheads/Fixed overheads
- Direct / indirect overheads
- Standard costings

Production of a deluxe cardigan in the "Manor Born" design

Standard spec	*Std Weight*	*Waste Factors*	*Costing Weight*	*Material Cost*	*Cost £/sqm*
Yarn	1.306	0.05	1.371	4.87	6.68
Polyprop	1.000	0.10	1.100	0.22	0.24
Lochweave	1.000	0.10	1.100	0.25	0.28
Latex	1.205	0.00	1.205	0.21	0.25
					7.45
Overheads	*Direct*	*Indirect*			
Labour	0.285	N/A			
Variable	0.069	N/A			
Fixed	0.174	0.506			1.03
	Direct	*Indirect*			
Sales & Admin	0.05	1.57			
Distribution	0.47	0.08			2.17
					10.65

A bad thing happens destroying 100 units. The claim is submitted at £1,065

What is the appropriate claims settlement?

Fixed costs are not payable (normally) by Insurers

NB: The premium has been paid for the last 15 years on the basis of the Accounts valuation

DECLARATION LINKED POLICIES

Key Features :

- 62.5% of policies are written on a Declaration Linked basis
- No provision for proportionate reduction
- Claim limit of 133.33% of Estimated Gross Profit. (133.33% is not relevant to the amount of the Declaration

Under Declarations

- CILA Surveys:

Event	In what proportion of policies is the Declaration too low?	If a Declaration is too low, how severe is the shortfall?
2008	37%	50%
2009	52%	63%
2012	40%	45%

Policy Implications:

- No under insurance sanction, but Significant under-declaration may constitute a breach of Utmost Good Faith/constitute non-disclosure

- Policy may be voidable - could affect material damage as well as business interruption

- Does the under-declaration have to be deliberate?

- Beware indemnity periods longer than 12 months when establishing the Gross Profit likely to accrue over the Maximum Indemnity Period (cf MIP's shorter than 12 months)

- Declarations may be made for premium adjustment purposes for non-declaration linked policies: Just because a declaration is made, that does not necessarily mean that the policy is Declaration Linked.

Impact of the Insurance Act 2015

INSURANCE ACT 2015

- Duty of Fair Presentation – What is that?

- Breach of the Duty of Fair Presentation

Breach of the duty of fair presentation: deliberate or reckless? No	Yes	**Policy voidable, Insurers keep premium**
Would Insurers have still taken the risk with the adverse feature but at a different premium? Yes	No	**Policy voidable, Insurers return the premium**
Apply proportionate reduction in ratio that the premium that would have been charges compares to that actually charged		**(In other words average based on premium shortfall not asset values)**

- Question: does a significant under valuation of any policy caption of itself constitute a breach of the duty of fair presentation?

- If so, likely introduction of proportionate reduction

- Where are the silos?

- Compare current position:

	Current position	**Position under the Act**
Basis of Reduction	Asset values	Premium paid/payable
Party calculating the Amount	Loss Adjusters	Insurers
Scope	Average caption based	Premium across the policy
Reason for shortfall	Irrelevant	Is it deliberate or reckless?

THE FANCY THINGS: Increased Costs Of Working

1. Definition

"… the additional expenditure (subject to the provisions of the Uninsured Standing Charges Clause) necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in Turnover which but for that expenditure would have taken place during the Indemnity Period in consequence of the incident, but not exceeding the sum produced by applying the Rate of Gross Profit to the amount of the reduction thereby avoided".

2. Key Features

- What has to be within the MIP is the reduction in turnover avoided, not the timing of the increased costs incurred (Synergy Healthcare 2010)
- Economic Limit – consider with reference to the Maximum Indemnity Period.
- Incurred to avoid a future turnover loss: excludes (for example) contractual penalties paid re a historic contract and not solely to avoid a future reduction in turnover.
- Practicality of applying the economic test – is the retrospective review still reasonable (CILA/IIL wording report)
- Blundell Spence –does it still apply?
- Policy doesn't require advance clearance by Insurers/adjusters (but expect strict economic limit application if kept secret)

On one occasion a car dealer held a final settlement meeting with loss adjusters and agreed the loss of gross profit and increased costs. As the adjusters were packing to leave he asked how his loss of margin would be dealt with. He had never previously advised that he had reduced selling prices to improve the footfall – there was a loss of gross profit on the reduction in turnover but also a loss of gross profit on the turnover achieved. Is this an increased cost? Is it reasonably and economically incurred?

- Does the policy imply that an increased cost has to be consciously incurred to fall within the scope of the cover?

> A company suffered a fire and worked overtime to avoid Gross Profit losses. It was agreed in advance with loss adjusters that overtime costs would be dealt with. It later transpired that there were maximum levels of gas available under a supply contract, which were exceeded as a result of the extended working. The supply company cancelled the contract and issued a new one involving higher unit prices throughout and beyond the maximum indemnity period. Was the increased cost covered?

- Group costs together to justify the business decision and then deal with them all consistently.

- Increased Costs can be claimed in respect of captions that have been uninsured:

> To mitigate loss after a fire, a company traded from temporary premises. These were smaller than those damaged and raw materials could not be bought in bulk (lack of storage space). Purchase discounts were reduced – a loss of gross profit.

- the policy will only pay for the additional element of cost :residual values in assets (and leases) will still need to be addressed.

THE FANCY THINGS: Additional Increase in Cost of Working

- **Standard Definition**

  "the additional expenditure necessarily and reasonably incurred by the insured as a consequence of the incident in order to prevent or minimise the interruption of or interference of the business during the Indemnity Period".

    - no economic limit, but must be reasonable and necessary
    - separate limit of indemnity, not subject to under-insurance (item 2 on a policy wording); How much cover is appropriate?
    - need to show benefit within the Indemnity Period
    - consider advertising costs incurred near the end of the Maximum Indemnity Period
    - residual values / benefit still needs to be taken in to account

THE FANCY THINGS: Denial of Access

1. **Definition**

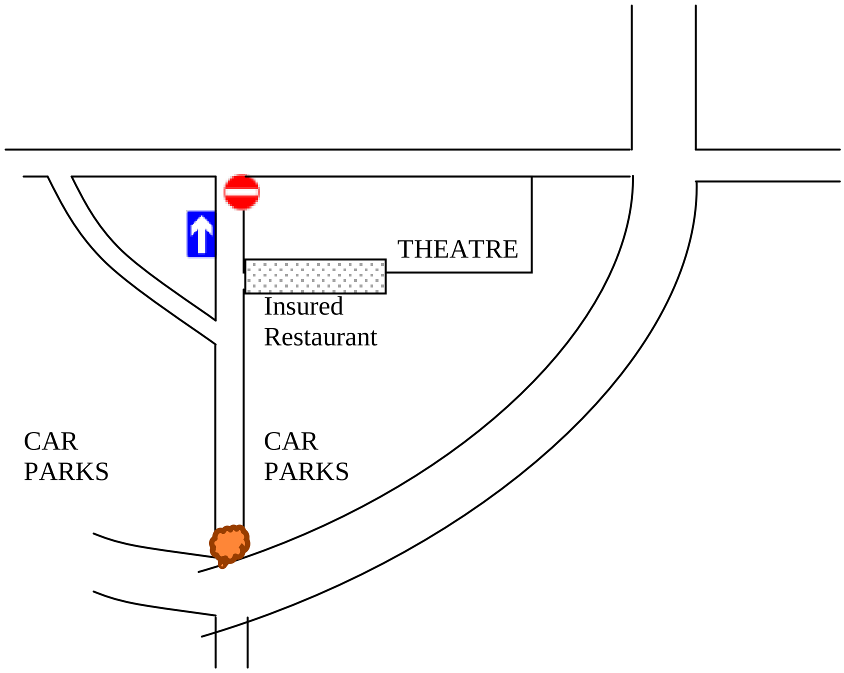
- concerns "property in the vicinity of the premises, loss or destruction of or damage to which shall prevent or hinder the use of the Premises or access thereto, whether the Premises or property of the Insured therein shall be damaged or not [excluding damage to power/utility services]".

- Prevention or **hindrance** of access to or use of the premises

- Some policies require the property which is damaged in the vicinity to be Insured

- Some policies specify a distance from the point of damage: in some cases it may be self defining

- When does an event stop hindering access?



Damage ( ) occurs at the access end of a one way street. Footfall past an Insured restaurant to a theatre is abruptly halted. After 12 hours scaffolding is erected allowing pedestrian access. After 14 days the 'no entry' sign at the other end of the street is covered by the council with a black bin liner to allow some vehicle access. Temporary signs are provided to redirect traffic but are stolen/re-sited by youths. After 1 month normal access resumes.

- cover relates to access to the Premises, not within it, or exit from it

- Non damage denial of access extension to include prevention/hindrance due to the instruction/intervention of a public authority (Act of the competent authority)

THE FANCY THINGS: Loss of Attraction

- Definition: “Property in the vicinity of the Premises, destruction of or damage to which shall cause loss of custom to the Insured directly due to loss of amenities in the immediate vicinity of the Premises, whether the Premises or property of the Insured therein shall be damaged or not”.

- Specify the attraction for the avoidance of doubt.

- The loss must flow from the damage – consider London 2007, Paris 2015, Brussels 2016

THE FANCY THINGS: Utilities

2 types of extension are available

1. **Incident at the generating Site - ** Cessation of supply due to an insured event at the generating site

    - requires physical damage
    - definition of Premises
    - Restricted perils (generally not available as all risks)
    - Exclusions; notably the deliberate act of the supply authority

2. **Failure at the Terminal Ends** (☺) Accidental failure at the (Insured's) terminal ends

    - wider range of circumstances
    - includes cabling/pipework

Key Features:

- This is a BI extension. Material Damage, such as spoilage of stock, is not hereby insured.
- Utility extensions to an engineering policy will probably include a franchise period.
- Beware sub-stations on site beyond the terminal ends : have these been picked up as part of the insurance programme?

THE FANCY THINGS: Suppliers / Customers

1. Definition

Loss *"resulting from interruption of or interference with the Business in consequence of loss, destruction or damage at the under noted situations or to properties undernoted shall be deemed to be an incident (as if the damage occurred at the Premises)"*

- Specified customers / suppliers
  - maximum limits (finite or percentage of sum insured)
  - territorial restriction (GB/N Ireland)
  - must be an actual customer/supplier at the time of the incident (not a prospect)
  - restricted perils (not all risks)/restricted supplies (utilities excluded)
- Unspecified customers / suppliers
  - more restricted monetary limits
  - often rolled into package commercial policies

2. Key Issues

What is a customer / supplier : *"suppliers, manufacturers or processors of components, goods or materials"*.

- suppliers of services (eg Internet Service Providers)
- requirement for customer/ supplier to have insurance / satisfy the material damage proviso
- customers of suppliers, suppliers of suppliers etc

THE FANCY THINGS: Advanced Profits

1. **Definition -** defers commencement of the MIP (normally the date of the damage) to *"the period beginning with the date upon which, but for the Damage, Turnover would have commenced to be earned and ending not later than the Maximum Indemnity Period thereafter during which the results of the business shall be affected in consequence of the Damage".*

2. **Purpose** protects income streams where the assets that generate them do not yet exist; a standard BI cover may not help : the material damage proviso may not be satisfied.

3. **Key Features -** ability to show commencement date of the income but for damage

Incident at	Standard Cover	Advanced Profits
Existing Site	Gross Profit from Existing Plant	Gross Profit from planned plant within Maximum Indemnity Period
Greenfield Site	Material Damage Proviso will not be satisfied	Gross Profit from planned Plant, deferment of Maximum Indemnity Period