

LBIA guide to business interruption insurance and claims

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Preface

This guide has been sponsored by the London Business Interruption Association to build on the work produced by the industry's experts, Messrs Hickmott and Riley in their well-known textbooks on the subject. There is a need to continually update reference books such as this and our intention is that the Association will be the lifetime editorial resource to make sure it is regularly reviewed and updated to take account of market changes and innovations.

We intend this guide to be a good ready reference for underwriters, brokers and loss adjusters, and their respective clients, giving a general overview of the current covers available and their practical application. The work is, of necessity, general in nature which holds some attendant dangers in that most business interruption risks are, by definition, unique to the insured and more importantly, the conditions prevailing following an insured incident are ultimately variable. It follows that there can be no single definitive answer to any particular business interruption problem but there are some good, practical, accepted principles, which can be brought to bear to resolve most of the issues arising, given a sufficient degree of lateral thinking to ensure the particular circumstances of the risk are fully taken into account.

We have deliberately avoided too much reference to historical bases of cover, unless they have a bearing on the rating or construction of modern covers. In the UK we are fortunate that the rest of the world has happily followed in our footsteps so most of what we take to be accepted custom and practice in business interruption risk assessment, underwriting and loss settlement in the UK is generally followed around the world, with some notable differences in covers issued on USA forms.

Some recent publications provide some detailed commentary on insured cause of loss and claims. Property damage coverage and exclusions are fully explored in "All Risks Property Insurance" by John Hanson and Christopher Henley. Damian Glynn from Cunningham Lindsey has just published a book entitled "BI Cover Issues" which explores some of the difficulties encountered with current wordings in real claims scenarios.

As ever, there will be differing views on individual risks and circumstances and indeed, this is what makes the subject interesting. We welcome comments on interesting deviations on cover or claims from our readers, which hopefully we can take into account in subsequent revisions.

UK Practice

Chapter 1 Intent of cover



Purpose

The devastation to property following a major incident, as with Buncefield in 2005 captioned above, is bound to be a serious setback for any major concern. However, the loss of property is often nothing compared to the loss of income that ensues as a consequence. Business interruption (BI) insurance has developed to help the Insured regain their predicted pre-loss trading position.

The intention of a BI policy is to maintain the turnover of the business during the indemnity period following an insured incident so that it can resume trading at its anticipated pre loss trading level. (The italicised terms are subject to definition, as described later in this chapter) It follows that if there is no business to maintain (i.e. the insured ceases to trade or goes into liquidation) the BI policy is unable to respond.

In the UK pure manufacturing has fallen below 15% of GDP and many “manufacturers” are actually only assemblers or distributors of product made elsewhere in the world. Their true BI exposure lies not in the UK but in their overseas supply chain.

Our service industry is growing by leaps and bounds, but again is often dependent on capacity from “off shore” call centres or data processing facilities. Business is changing rapidly and so must the risk exposure modelling and cover offerings to keep pace with, or preferably ahead of, the needs of the customer.

We will look at programme design a little later in this guide, but suffice it to say the “off the shelf” policy rarely works for BI. There is usually something unique about an insured’s business that requires specific coverage.

Indemnity:

A business interruption cover is a contract of indemnity – in property insurance the Insured should be put in the same position after the insured incident as he was in immediately before it. In business interruption the principle gets extended as we have seen above to attempt to put the insured in the same trading position after the interruption, as he would have been had the loss not occurred, not just back where he started. The phrase “not a penny more, not a penny less” often comes to mind as the spirit of indemnity when dealing with BI losses. In practical terms, this is not an easy task, as we will see in some of the claims examples later but one of the key features of a traditional BI cover is the “trends” or special circumstances” clause which allows the adjuster to take account of the, upward or downward, trends of the business (and possibly the business of the insured’s peer grouping) when arriving at

a settlement. So, if an insured were in a rapidly expanding business with a clearly demonstrable growth potential, and assuming the limits had been correctly arranged, they could expect a settlement based upon a figure far higher than their current turnover. On the other hand, a declining trade, perhaps UK mass-market car manufacturing, could expect a settlement based upon a reduced turnover from that currently being earned.

A different approach to pure indemnity often has to be taken with businesses that have wildly fluctuating profits and losses. For example, a loss in a dealing room is notoriously difficult to adjust due to the natural rise and fall in both market and margin obtainable from day to day. It makes sense therefore to come to some prior loss agreement as to what should be paid, perhaps a daily rate based on average “net” profit. It has to be acknowledged that both the insured and the insurer are at risk from this solution but it does bring some certainty to the contract and avoids what otherwise might have to be a massive forensic accounting operation and court case to determine an “indemnity.”

Output policies are available for machinery breakdown losses whereby there is an agreed daily rate payable in the event of an insured interruption.

In both cases, insurers would need to limit their liability to a prolonged, and therefore potentially unquantifiable or unsustainable, interruption by imposing a relatively short indemnity period, probably no more than three months.

(See page 10 for a fuller explanation of the “trends” clause)

Cover trigger

The trigger for a BI loss is found in the preamble to the BI policy (see appendix 1) – traditionally along the following lines:

“The Insurers will pay the amount of the Consequential Loss resulting from interruption of or interference with the Business carried on by the Insured at the Premises consequent upon DAMAGE to Property used by the Insured at the Premises in accordance with the undernoted definitions.”

The key point to note here is the phrase “consequent upon” which drives the loss settlement. In essence, as long as there is insured damage (DAMAGE) to property at the premises then all subsequent consequential loss is picked up, assuming there is no active, intervening cause, or that the subsequent loss is not too remote to be considered consequent, as per the standard doctrine of proximate cause.

A useful rule of thumb is the phrase “but for.” But for the damage, what would have happened to the Business? Consider a firework manufacturer, occupying large premises with two identical production lines. An insured incident occurs (an explosion) which brings about an external investigation by the regulatory authorities. The authorities shut down the premises and will not allow it to re-open until remedial suppression work has been carried out on both lines. The factory was shut down for longer than anticipated due to the time taken to fully comply with the regulations on both the damaged line and the undamaged second line.

But for the explosion, the insured would not have had to carry out the remedial work on either line and would not have incurred the extra loss (of time.) As long as there was no intervening cause (perhaps the authorities had already told them they had to do the work but it had not been undertaken by the time of the loss) and the subsequent loss was not too remote (in this case the line was in the same premises

and was for an identical product, so this could hardly be argued) then the full loss is payable, subject to the policy limits, terms and conditions.

In modern day business it is something of a moot point as to whether anything other than a minor interruption would destroy a "just in time" business, such as a laundry or newspaper publisher. Active competition is often more than willing to fill any gaps left leaving little or no opportunity to regain lost custom. The loss occurring in these circumstances of enforced closure would need special treatment by the adjusters. As long as the client can demonstrate that the business would have been viable *but for* the loss there needs to be a response by the policy as long as all the other conditions of the policy have been satisfied. The likely settlement would involve assessing the savings made and would be likely to stop at the point when the business would have been capable of reinstatement.

Chapter 2 Definitions

A BI policy operates by definition, all of which need care in their construction to ensure the policy can fully respond to an insured interruption:

Consequential loss

The standard definition of Consequential Loss is as follows:

The words Consequential Loss shall mean loss resulting from interruption of or interference with the Business carried on by the Insured at the Premises in consequence of DAMAGE to property used by the Insured at the Premises for the purposes of the Business.

The key features that need further definition are:

The Business

It is vital to nominate all the constituent parts of an insured's business that might be affected by an interruption. If the particular activity is not identified within the definition then the policy cannot respond to the losses incurred by that part of the business. Consider an office block owned and partially occupied by the Insured for their business, with a portion sublet to a third party tenant. In the event of an interruption, unless "property owning" has been defined as part of the business description, the policy would be unable to respond to any loss of rent receivable from the tenant on the operation of a rent cessor clause in the lease.

Many larger or global policies are drafted to give an all-encompassing definition of the business, along the lines of:

All past, present and future activities undertaken or to be undertaken by the Insured.

Clearly the insured owes a duty to the underwriters to keep them fully informed of any unusual or hazardous activities although the majority of the insured's activities are usually a matter of public knowledge freely available from published reports and accounts and articles on their website.

The Insured

The BI policy will define the Insured and it will be important to fully identify all the entities that could be affected by an interruption to the business. Often policies are arranged on a "group" basis as a loss at one subsidiary could well have a knock on effect to the profits of another. Having said that, any identified Insured must have more than just a financial interest in the business continuing. A bank, for example, has an insurable interest in property the subject of a loan or mortgage, and is frequently noted in a property damage policy as a joint insured. However, a bank cannot be a joint insured on a BI policy because its own business (banking) will be the one that suffers, and this will not be the defined *Business* of the Insured, so the policy cannot respond.

The Premises

it is equally important to identify all the Premises that might be affected by an interruption. Under the chapter on extensions, we will see that the definition can be expanded to include other premises not in the Insured's occupation or control, but the initial list needs to include all those that they do occupy.

As with the definition of Business, larger clients are usually given an all- embracing definition (subject to separate detailed disclosure) along the lines of:

Any premises owned occupied or utilised by the Insured within the Territorial Limits, which has been declared to and accepted by the Insurers.

(Insured) DAMAGE to property being used

There has to be insured damage to property being used by the *Insured* at the *Premises* in the course of the *Business* to trigger a BI claim – otherwise claims could be brought for all sorts of unforeseen circumstances that could affect the Business, (compulsory purchase orders for example), without any prior insured damage.

The damage has to be insured (although not necessarily by the insured – for example they may occupy leased premises which would be insured by the landlord, but the lack of which would certainly affect their business if they were damaged.) For a BI policy to operate, the material damage policy has to respond unless it is prevented from doing so because the loss is below an excess or deductible amount. The BI policy usually includes a material damage proviso to make this point clear. The main purpose of the clause is to mitigate the policy's potential BI claim payment in that the business will be far quicker to recover if the damaged property is reinstated promptly and this is more likely to happen if the damage is insured rather than having to be funded by the Insured.

Other items that may be used could be computers or steam boilers and other vessels. These are traditionally insured under specialist engineering policies but could create a serious interruption. Whilst most BI policies will not cover the breakdown element offered by computer policies, they would respond to an insured peril loss of the equipment and/or data. Steam boiler explosion is *included* in the definition of explosion in a BI policy, although normally specifically excluded from the MD policy due to the need to carry out statutory inspections to ensure their integrity and the degree of specialist knowledge required to underwrite the exposure. One major issue will be the extent of surrounding property damage provided by the engineering policy, as this will usually be a key component of any subsequent BI claim. As we now know, if the material damage exposure is not insured, the BI policy cannot respond.

From the foregoing it will be clear that it is important to avoid creating a BI policy or section that only responds to damage to property covered by the Insured's main property damage policy or section.

Indemnity Period

A BI policy is unique in that the liability is limited by time, referred to as the Indemnity Period, as well as by a monetary amount (sum insured or loss limit.)

The policy defines an Indemnity Period as:

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

This is reasonably self-explanatory, although for the sake of good order there are two further definitions that need mentioning:

Incident means:

Loss or destruction or damage to property used by the Insured at the Premises for the purpose of the Business.

This saves repeating the phrase every time it needs mentioning in the definitions exclusions and conditions. Also, it is better than using the word "DAMAGE" as this would only relate to perils affecting property insured in the main property damage section and not necessarily to property insured by other policies or markets.

Maximum Indemnity Period means:

The period beginning at the commencement of the Incident and ending no later than the number of months shown in the Schedule during which the Insured's Business shall suffer Consequential Loss.

Turnover

Turnover is traditionally defined as:

The money paid or payable to (or earned) by the Insured for goods sold and delivered or services rendered in the course of the Business at the Premises.

Sometimes it may be necessary to insert the words "or earned" in the definition. It is entirely possible that with longer-term contracts there may not be any moneys paid or payable during the Indemnity Period, as payments are made in stages outside the Indemnity Period length. The policy therefore is unable to respond even though money has certainly been *earned* for future stage payments. However, with the insertion of these words, the policy can now pay to keep the Business going during the Indemnity Period and hopefully until the deferred stage payment is received.

Chapter 3 How the BI Policy Works

As we have learned, a BI policy works by definition. Just to remind ourselves, initially there has to be an Insured Incident (i.e. not excluded by the property damage policy or section) that causes interruption to or interference with the Business during the Indemnity Period. We have already explored the definition of all these terms but whilst this explains the theory this doesn't tell us *what exactly* will be paid.

Have a look at the Specification to the UK "all risks" form shown in Appendix 1. The wording starts to tell us how a claim can be paid by referring to the heads of cover:

1. **Gross Profit Basis**

Item 1 Gross Profit

The insurance under Item 1 is limited to loss of Gross Profit due to

(a) Reduction in Turnover and

(b) Increase in Cost of Working

This tells us that the sum insured or limit on Gross Profit can be paid for both actual reduction in turnover *and* increased costs (ICOW) to minimise or prevent such reduction. Of course, the policy cannot pay more than the total limit so in effect ICOW is limited to 100% of the sum insured or policy limit on Gross Profit.

The policy then goes on to tell us exactly how the loss on either item is going to be calculated:

and the amount payable as indemnity hereunder shall be :-

1(a) In respect of reduction in turnover the sum produced by applying the Rate of Gross Profit to the amount by which the Turnover during the Indemnity Period shall fall short of the Standard Turnover

For reduction in turnover we compare the normal or "standard" turnover that should have been achieved with that actually achieved at the end of the Indemnity Period and make allowance for *uninsured variable costs* (q.v.) by applying the Rate of Gross Profit to it, which in effect is the percentage of turnover left after the deductions.

1(b) In respect of Increase in Cost of Working the Additional Expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of Gross Profit 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 reduction thereby avoided.

The ICOW must be necessary and reasonable, in other words agreed by adjusters but importantly needs to be "economic" in that it cannot exceed the "amount of reduction thereby avoided." We discuss this point in some detail in Chapter 8.

You will note that the ICOW payment is limited by the rate of Gross Profit too, so the more uninsured variable costs that are deducted, the less Gross Profit and ICOW limit is available.

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Profit as may cease or be reduced in consequence of the Incident.

The policy is one of indemnity; therefore it would be inappropriate for the insured to save money by perhaps not using power or heat and attempt to claim it as a cost to the business. Clearly if the cost has not been incurred it cannot be claimed.

The formulas have introduced some new items such as Indemnity Period, Standard Turnover, Rate of Gross Profit and so on all of which are defined later on in the wording as follows:

Indemnity Period

The period beginning with the occurrence of the Incident and ending not later than the Maximum Indemnity Period (stated in the schedule) thereafter during which the results of the Business shall be affected in consequence thereof

Standard Turnover

The turnover during that period in the twelve months immediately before the date of the occurrence of the Incident which corresponds with the Maximum Indemnity Period

Rate of Gross Profit

The Rate of Gross Profit earned on the Turnover during the financial year immediately before the date of the occurrence of the Incident

We have also seen that, in the interests of providing an indemnity, the policy will include a **trends or other circumstances clause** to allow the adjuster to consider upturns or downswings in the business. This is applied to both the last two new definitions and normally goes along the following lines:

*to which such adjustments shall be made as may be necessary to provide for the trend of the Business either before or after the Incident or which would have affected the Business had the Incident not occurred so that the figures thus adjusted shall represent as nearly as may be practicable the results which **but for** the Incident would have been obtained during the relative period after the Incident.*

In summary, the claim is compiled by comparing the actual turnover earned during the interruption with that of the preceding calendar period. Any loss arising is then adjusted for any trends and reduced for any savings made because the business was not fully operating. In Gross Profit losses, any loss established is further adjusted for the Rate of Gross Profit, (essentially the percentage of turnover remaining following deletion of the defined uninsured variable costs, - see *the next chapter*) for *both* Gross Profit and ICOW losses. Of course all the above assumes a 12-month period of indemnity so losses for longer periods have to be adjusted accordingly.

As you can see, our old friend, the phrase “but for” appears in writing here. This means the adjusters have to carefully consider *all* the effects of the incident – sometimes it is easy to reach confusion over the difference between **perils** causing the Incident and the effects of the incident itself. Consider the case of a fire damage loss where it is agreed to do the repairs in a scheduled manner, to allow important parts of the business to continue to run. As part of the schedule some of the roof of the property has to be removed to make good damage caused by the fire. A storm occurs and floods the electrics, causing further delay. Is that delay a new event, or to be treated as part of the original damage? We believe the correct answer is that it is part of the agreed, original damage and needs to be settled under that head, and not attract a further deductible because a new peril has occurred.

The policy does not normally pay for any time/costs expended in actually compiling the claim, so this needs to be made clear to the insured.

2. Gross Revenue basis

The normal policy wording reads as follows:

Item 2 Gross Revenue

The insurance under Item no 2 is limited to (a) Loss of Gross Revenue and (b) Increase in Cost of Working and the amount payable as indemnity thereunder shall be

*2(a) In respect of Loss of Gross Revenue the amount by which the Gross Revenue shall fall short of the **Standard Gross Revenue** in consequence of the Incident.*

Again the operative clause introduces a new term, Standard Gross Revenue that needs definition:

2(b) In respect of Increase in Cost of Working the Additional Expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of Gross Revenue which but for that expenditure would have taken place during the Indemnity Period in consequence of the Incident, but not exceeding the amount of reduction thereby avoided.

Note here that as we are insuring the full Revenue without deduction there is no need to reduce the amount of ICOW, as in the Gross Profit Basis, but the ICOW still has to be economic.

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Revenue as may cease or be reduced in consequence of the Incident.

The policy then goes on to define Standard Gross Revenue as follows:

Standard Gross Revenue

The Gross Revenue during that period in the twelve months immediately before the date of the occurrence of the Incident which corresponds with the Maximum Indemnity Period.

As with standard turnover, a **trends** clause is applied to attempt to achieve an indemnity:

to which such adjustments shall be made as may be necessary to provide for the trend of the Business either before or after the Incident or which would have affected the Business had the Incident not occurred so that the figures thus adjusted shall represent as nearly as may be)practicable the results which but for the Incident would have been obtained during the relative period after the Incident.

In summary, as with Gross Profit, the Gross Revenue earned during the interruption is compared with Gross Revenue earned in the previous calendar period, adjusted for the trends in the Business, any savings made and for any differential in Indemnity Period. As there are no variable costs these are not mentioned.

One important point to note is that any ICOW payments will be met in full on a Revenue basis and not limited by the Rate of Gross Profit, as would be the case on a Gross Profit basis.

To some extent we have taken the definitions and operative clauses out of context to assist with your understanding. It may now be helpful to review the wordings in full in the model wordings shown in Appendix No 1.

Chapter 4 Gross Profit

Why insure on a Gross profit basis?

The Gross Profit basis of cover is best used for manufacturing risks where a high element of the turnover comprises expenses that vary in direct proportion to it. An example is “purchases”, which are already insured under the property policy or section as raw stock and could represent as much as 35% of the turnover. If the Insured ceases to manufacture, or has to reduce the output, the amount of purchases he will use will vary in direct proportion.

By selecting items from the balance sheet that will *not* be insured (uninsured variable costs or specified working expenses) we can design the cover to reflect the Insured’s likely BI exposure. Effectively we reduce the sum insured upon which the policy rate is based so that the Insured does not incur premium on items that he will not claim for under the BI policy.

What is Gross Profit?

Accountants Definition:

Net Profit + Fixed Costs = Gross Profit

Policy Definition

Turnover plus closing stock and work in progress

Less

Variable costs plus opening stock and work in progress

To arrive at their Gross Profit figure, accountants traditionally take the net profit of the Business and add back in the fixed costs, or standing charges. Two points arise from this:

1. Accountants regard “factory wages” as a variable cost so will not include them in their standing charges.
2. It is possible to forget (or be unaware of) all the insured’s standing charges.

In the first point we have a miss match in terminology, as we need to *include* factory wages in the cover. Whilst in a prolonged interruption people are likely to be laid off, no one can be certain what proportion, or even type of worker will be affected. It will depend on the timing, scale and precise circumstances. Additionally, it is impossible to know precisely the insured’s liability for redundancy payments to such workforce. It is therefore custom and practice in business interruption insurance to include wages in full, on the understanding that the rate charged has already been modified to reflect the reduced exposure.

As far as the second point is concerned, we work “top down” and deduct uninsured variable costs from turnover to arrive at the Gross Profit figure required for the policy, so we can be sure all fixed costs are included unless specified.

Clearly it would have been more helpful if we had invented another term to reflect the differences in approach between accountants and ourselves, but, so far, no one has been brave enough to suggest an alternative! Be that as it may, it is most important

that for the avoidance of any doubt, the insured is given a formula to enable his accountants to arrive at the insurance figure we require rather than the lesser one shown as Gross Profit on the balance sheet.

Establishing the variable costs

Have a look at the attached (abbreviated) budgeted Profit and Loss account for Go Faster Bicycles, a small manufacturing company operating from a single site in Nottingham. See if you can identify the costs that might vary in direct proportion to turnover, assuming a total loss at the factory.

GO-FASTER BICYCLES - BUDGET

TRADING ACCOUNT		
	£'000's	£'000's
TURNOVER		10,075
RENTAL INCOME		305
CLOSING STOCK (including Work in Progress.)		583
OPENING STOCK (including Work in Progress)	478	
PURCHASES	3,425	
FACTORY WAGES	1,210	
OUTWORKERS	75	
SUBCONTRACTORS	475	
PACKING	500	
FREIGHT	150	
GROSS PROFIT	4,650	
	10,963	10,963
PROFIT AND LOSS ACCOUNT		
GROSS PROFIT		4,650
DISCOUNTS ON PURCHASES		171
SALARIES	627	
SALESMEN'S COMMISSIONS	255	
POWER	108	
ADVERTISING	110	
POSTAGE AND TELEPHONE	52	
RENT & RATES	156	
MAINTENANCE	27	
STATIONERY	42	
LIGHT & HEAT	54	
INSURANCE	135	
BANK CHARGES	31	
DEPRECIATION	26	
SUNDRIES	19	
BAD DEBTS	25	
NET PROFIT	3,154	
	4,821	4,821

Some Answers

Lets work through each in turn, and see if we have come to similar conclusions.

Rental income

This is a bit of a “red herring” that will need further discussion. Where does this income come from? Is it from letting premises on the same site or elsewhere? If it's on the same site then it needs to be included in the exposed turnover (i.e. not excluded) as the Insured will lose income from it if the factory burns down.

Opening stock and work in progress

This is the valuation of the residual stock and work in progress at the factory at the beginning of the financial year. It forms part of the formula for defining the policy Gross Profit. The item does not need mentioning in your list

Closing stock and work in progress

This is the (estimated) valuation of what will be left unused or unsold in the factory at the close of the financial year. Again it forms part of the formula and will, when the figures are validated, give us a differential between what the factory started and finished the year with. The item does not need mentioning in your list

Purchases

As discussed at the beginning of this chapter, purchases often form a major part of a manufacturing company's turnover and will usually vary in direct proportion to turnover earned. This item should be on your list of uninsured variable costs.

Factory wages

These will, of course vary, but not necessarily in direct proportion. There are too many unknown quantities to be prescriptive. During a long interruption most shop floor staff will be laid off and only taken back on again when the factory is ready to resume production. On the other hand, during a short interruption, it may be prudent to spend more money than usual on wages as overtime payments to maintain production. It follows that there is no solution that fits all circumstances and so it is normal to include them in full but to expect the rate to be discounted to reflect any anticipated reduced exposure, so equity is achieved. The item should *not* be on your list, but does appear on the accountant's list of deductions in arriving at Gross Profit, so beware!

Outworkers

Manufacturers, particularly small ones like this, often use outworkers to do jobs that are either specialised or difficult to do in a factory environment. In this case, lets assume they are assembling bicycle pumps from bought in components. If the factory burns down, they will still be carrying on their job, unless their stocks are held totally at the factory. The components could in any event be supplied direct and they would then build up a stockpile for future use when the factory gets back in operation. On the face of it would seem sensible *not* to exclude them from the turnover, particularly as the amount is hardly going to make much difference to the premium.

Subcontractors

Subcontractors frequently figure in the manufacturing chain. In this case, let's assume they provide a paint shop and transfer application facility for finished bicycle frames. Assuming a total loss at the factory, there would be no frames made so unless there were a stock of them held off site, it would appear that payments to these subcontractors are likely to cease, so they should appear on your list.

Packing and freight

Both these items are to do with outwards goods, so if nothing is being made they will cease, assuming there is no agreement with the carrier to the contrary. With this caveat in mind, they should appear on your list.

Discounts on purchases

Discounts will vary in direct proportion to the level of purchases so need to be on the list, but in a negative sense. They need to be deducted from the purchases figure, as they will reduce as the purchases fall.

Salaries

In much the same way as we do not exclude wages, we also do not exclude salaries. Generally most salaried staff are kept on following a loss and will be needed to actively plan and implement the recovery.

Salesman's commissions

This is an interesting one to debate. Certainly if there is nothing to sell then there can be no commission – however, if the insured want to retain high performing sales staff they are unlikely to do so on basic salary terms, or minimum commissions may be included in the salesman's contract. For a total loss situation it would be safer to leave the figure, or at least a proportion of it, in the Gross Profit calculation so that the business can really get back on its feet quickly by using good quality salesmen to sell goods prior to re-opening for later delivery.

Power, light and heat

Again, we would need to ask some questions. What do the insured mean by "power?" Is it high amperage electrical supply, perhaps for arc welding or is it gas for running a steam boiler – or both?

Once that is established we also need to know if they have any unbreakable agreements with the supply authorities. Whatever the answers may be, we need to be careful not to stifle the recovery of the business by cutting off its power, light and heat! We could perhaps consider excluding a percentage of the cost in the event of a total loss.

Advertising

This is another debateable item. On the face of it, all advertising will cease once there is nothing to sell. However, the Insured may well wish to spend more than the allotted budget advertising a return to business so it would be sensible to either keep the item in, or only exclude a portion of it.

Postage/telephone/stationery/sundries

These office related expenses are likely to continue, albeit the staff may be in a portacabin! They should not be on your list.

Rent and rates/insurance/bank charges

Rent may fall depending on what the rent cessor clause says, but rates will continue, as will insurance and bank charges. Indeed, one could expect the insurance bill to go up to enable the insurer to recoup some of the loss.

Maintenance

This will vary, although not necessarily in direct proportion. It should be on your list, at least for further discussion.

Depreciation

Again, this will vary and should be on your list for further discussion. Some brokers feel this should be deleted altogether as it is largely a “fictitious” accounting device to write off assets and can be challenged as a saving by adjusters. However, if we do that there will be nothing in the pot for a partial loss or off site loss when on site assets may still depreciate, and maybe faster than before if any undamaged ones are made to work harder.

Bad debts

These are often taken as a fixed proportion of turnover, so should be on your list.

Your answers

How did you do? As you will begin to realise with BI there are rarely any absolutely right answers, it rather depends on your point of view. What is clear is that no one can formulate a Gross Profit formula straight from a balance sheet without having the management accounts available to work from and asking a few pertinent questions when there is any doubt. Certainly we must never fall into the trap of just asking for a “Gross Profit” figure without defining what we mean, as the answer will invariably not be what we require.

The reality

When suggesting possible variable costs one fundamental point has to be borne in mind – most losses are partial, not total. So, what would happen in a partial loss situation needs far greater consideration. In most instances, rather than reducing the costs, the Insured may need to spend more to keep the business going.

One of the most likely sources of damage for Go Faster Bicycles would be a fire in a welding bay. Let’s assume Go Faster have properly protected welding bays, with segmented fireproof partitions. The most likely event under these circumstances would be a small, contained fire in one bay – probably causing total damage to the bay and its contents, with some smoke and peripheral damage to the other bays and contents.

Under these circumstances the insured will want to institute overtime working as soon as possible in the unaffected bays to cope with the lack of production from the affected one. This means spending more money on wages, heat, and light than normal, and probably with no reduction, or even an increase in power costs.

They will immediately undertake additional advertising; to tell the world that whilst they have had a small “local difficulty” everything has been done to ensure delivery commitments will be made. They may even want to increase salesmen’s incentivisation at this time to back up the recovery. Packing, carriage and freight costs will continue as usual, as will the cost of outworkers and subcontractors. Had all those items been listed as variable costs, the adjuster would be unable to make payment for them under the policy, including any associated Increase Cost of Working expense, as they were excluded costs from the Gross Profit calculation.

The lesson to learn from this is that when setting uninsured variable costs always consider what would happen following a partial, rather than a total loss, to avoid the embarrassment of not having sufficient cover under the policy to meet all the expenses of the interruption.

Now, in this ultra cautious mode, very little other than purchases and bad debts will usually vary in direct proportion to any loss of turnover. This mood of caution really only reflects the stance we have already taken with wages. If premium is a key consideration for the insured (and it usually is!) then he needs to ensure he can supply quality underwriting information, including business interruption reviews and BCP plans, to justify this is as a better than average risk. In this way an underwriter might be persuaded to agree a substantial rate reduction to reduce the premium, rather than relying upon an erroneously designed, reduced sum insured to do that, at the risk of reduced cover in a partial loss situation.

Looking back at the balance sheet on page 13, this is a possible interpretation of the Estimated Gross Profit:

Estimated Gross Profit for Go Faster Bicycles – Based on a 24 month Indemnity Period

Turnover (net) *	£ 10,380,000	
Closing Stock	£ 583,000	
		<u>£10,963,000</u>
less		
Opening Stock	£ 478,000	
Purchases (net)	£ 3,254,000	
Packing (?)	£ 500,000	
Freight (?)	£ 150,000	
Bad Debts	£ 25,000	
		<u>£ 4,357,000</u>
Gross Profit		<u>£ 6,556,000</u>
Indemnity Period:		24 months
Sum Insured:		£13,112,000
X 133.3% (Declaration Linked)		£17,482,622

**The rental income could be for premises part of the factory, so it must be treated as part of turnover unless you know otherwise.*

Chapter 5 Gross Revenue

Arriving at the sum insured for Gross Revenue is much simpler than for Gross Profit. The Gross Revenue form insures the total turnover of the Business, without any deductions, for the length of the Maximum Indemnity Period. All we need to know is the annual turnover of the Business, which is something any Insured will know, and multiply it by the proportion which 12 months bears to the Maximum Indemnity Period.

Traditionally most members of the service industry have been insured on a Revenue basis because the majority of their costs are staff and IT related, so there is little to specify by way of variable costs. As we have already learned, we make no deduction for potential staff lay offs and there would be few other major items of variable standing charges.

Office risks such as solicitors, accountants, insurance companies and so on would be prime candidates for a Revenue form. What might need some further thought would be the likely Indemnity Periods required, as some businesses may recover quicker than others.

In the St Mary Axe bombing in 1992 the Commercial Union (now part of Aviva), occupied most floors of the central office block at St Helens, Undershaft, right next door to the explosion. As the explosion happened at night, on a Friday, there was fortunately no harm done to personnel but the building was badly damaged (all the glass in the windows was lost) and unusable. Fortunately CU practiced what they preached, and their BCP swung into action with dramatic effect such that they were up and running and accepting business from new offices in Cutlers Buildings on Monday morning.

An insurance company requires experienced staff, offices to operate from and good communications. All three were pretty well instantly available, and whilst BI losses are rarely, if ever, publicised, it is unlikely that more than Additional Costs were involved, and then probably for a fairly limited period whilst the glass was reinstated and other repairs made. However, consider what might have been the result if the building were demolished, rather than merely damaged. Long term temporary accommodation is not so easy to find, so not only would the additional costs be higher, the indemnity period would need to be in the order of 24 to 36 months or longer to allow them to return to their prime site, needed to facilitate easy access by brokers who generated most of their income.

On the other hand, a solicitor's office, damaged in the same explosion, was successfully permanently moved to another, and actually, cheaper, location south of the river. Clearly their maximum indemnity period could have been set far lower than that of the CU, had the potential loss scenarios been fully explored in a thorough BI review.

Chapter 6 Setting the length of the Indemnity Period

Best advice

The length of the Indemnity Period is important from two perspectives. All cover ceases on the expiry of the Indemnity Period so if it is set too short and does not allow for a full recovery of the Business then the Insured may not receive an adequate indemnity.

Secondly, premium is based upon the related multiple of the annual Gross Profit or Gross Revenue, so the longer the Indemnity Period the more premium (albeit not strictly pro rata as we shall see when we consider rating) will be required.

This inevitably produces something of a dilemma for anyone advising an insured. If the insured is given a technically incorrect (too short) Indemnity Period, then he may sue his adviser when a policy fails to provide a proper indemnity. If the premium is made artificially high, by setting a strictly technically correct, but perhaps realistically overly long Indemnity Period, then the business may be lost to a competitor on price if the competition take a more robust view of the potential recovery of the business.

It is generally preferable to provide a variety of options for any insured to consider, which then puts the onus back on the buyer to properly consider their risk and their likely recovery potential.

We noted previously that some “just in time” businesses may be fatally vulnerable to anything other than very short interruptions, and it is clear that these may need special treatment in setting Indemnity Period lengths. It is frequently the case that the FD of the business concerned will say “If we are not back in business in x months, then there will be no business, so why should I pay for more than that?” Indeed, why should he, although as we will consider in the chapter on programme design, we may well advise that this type of Insured requires a different form of cover altogether to fulfil their needs.

Criteria to consider when setting an Indemnity Period

It is usually the case that a manufacturing industry is likely to require a longer Indemnity Period to regain their anticipated prior loss trading level than a service industry. However, whether the cover is Gross Profit or Gross Revenue, similar criteria apply. For larger concerns it would be normal to consider each site as a separate risk and evaluate the individual exposure, and then to consider mitigating factors such as (genuine) spare capacity in other parts of the group that could assist reduce that exposure.

When thinking about Indemnity Period length, we need to consider the worst case scenario and work back from that – no one knows these days what might be the effect of a terrorist attack, pre-planned arson or aircraft disaster. Certainly an underwriter cannot consider a BI exposure of less than 100% for each site/zone unless there is credible evidence to support a reduction.

Most of the following considerations will build-up time blocks that can be factored into a bar chart. Some of the activities will be contiguous, but many require completion of the previous action, but once we know what they are it will be possible to build up a reasonably accurate picture of the likely worst-case interruption potential.

a) Thinking/decision time

The (unforeseen) incident has occurred and decisions have to be made. There may well be an excellent tried and tested business continuity plan (BCP) in place, which swings into action to achieve the immediate necessities of maintaining the business – communications, public relations, human resources and the legal department can all to some extent do their bit to maintain “business as usual” – certainly in the event of a smallish loss.

However, a major loss brings with it opportunities. Maybe its time to dust off those plans to move manufacturing to China – or set up the off-shore call centre that has been languishing on the “to do” pile for some time. Perhaps merger plans can be brought forward – there are endless possibilities rather than just reinstate and carry on as before, which most practitioners have previously modelled their thinking upon. The high level management thinking and planning will all take time, often many, many months to resolve and all the while the clock is ticking.

b) Planning consents and enquiries

Probably at the same time as all the thinking is going on, other issues will raise their heads that will eat up time. Local Authorities can take a very long time coming to a decision on planning consents – indeed they may even refuse permission to reinstate as their overall planning has changed the use of the area from commercial to housing. A factory that has grown up in the centre of town, originally surrounded by worker’s accommodation, is particularly vulnerable to a refusal to re licence, and this in turn will bring about fresh planning needs to move elsewhere.

A chemical explosion or serious fire often attracts the attention of the HSE with the attendant delays of enquiries before any necessary licensing can be considered. Again it may not be possible to reinstate on the same site, but this will not be known until the enquiry is completed.

c) Re-building/building time

Interestingly, this portion of exposure is probably the easiest to determine and can often be much shorter than imagined for new build. If the Insured has a clear hand, reinstating on a new site with modern materials is often a very quick option indeed. There is now a multiplicity of project managers specifically in business to drive downtime out of projects, and they can achieve impressive results. Reinstatement on site however, can be fraught with difficulties, ranging from lengthy debris removal / pollution clean up time to sourcing correct materials for listed building reinstatement.

d) Lead time for replacement machinery/plant

In manufacturing entities many machines are bespoke and can take anything up to a year to replace. Clearly this would not be the case in most service industries where the majority of equipment is available off the shelf within days or weeks. However, switching stations and hubs for telecoms companies, for example, would take much longer to replace so it is vital to understand the make up of the business and where the bottlenecks are, along with any mitigating factors such as spare capacity/redundancy elsewhere.

e) Re-training staff

It is inevitable that in a long interruption staff will have been laid off so it is important to build in time to train new staff and to re-train existing staff in any new processes introduced in reinstating the business.

f) Re-commissioning plant/systems

We need to consider both partial loss situations as well as total replacement. It is often the case that trying to integrate new replacement kit with pre-existing undamaged items often causes more trouble than starting up a whole new plant or system. We will need to get the plant engineers or IT specialists to scratch their heads to come up with suggested time bands for this recovery work.

g) Regaining anticipated pre loss trading level

“Extra” time to regain market position is a key component of the UK BI form, as long as the Indemnity Period is set long enough. There are some caveats to consider here:

Loss of market

Pure “loss of market” is not covered. Following the Manchester bomb incident in 1996 another shopping centre was set up in Old Trafford and many customers moved there for good, rather than coming into the centre of Manchester to shop. As it happens, the damaged area has been redesigned more as an entertainment and leisure centre than for shopping, so it is unlikely that much true loss of market occurred, although sole traders must have been affected.

Property owners

Depending on the wording of the leases, if the previous tenants do not re-occupy there could be some considerable delay, and hence real financial loss, in re-letting the premises following hand-over. A BI policy will pay loss of rent receivable up until the time the property is re-occupied, so a more lengthy indemnity period would be sensible for property owners, or the portion of an Insured’s business relating to property owning.

Seasonality

Many businesses are dependent on trade from a particular “season” – whether it is Easter eggs, toys at Christmas or the skiing industry. If the loss occurs just at the wrong time (i.e. immediately prior to the season concerned) it has to be anticipated that they could miss not just one, but possibly two, seasons, so the Indemnity Period needs to be 12 months longer than normal.

Just in time

As previously discussed, these businesses are vulnerable to an interruption of almost any length over say three months when they will lose market, which is not a coverable item on a BI policy. They probably need a different form of cover based on a loss limit rather than length of Indemnity Period to ensure as much money as possible is thrown at the problem in the short term to ensure recovery. (See Flexible Limit of Loss on page 27)

Chapter 7 Dealing with Inflation

Projecting the sum insured

When considering an adequate sum insured or policy limit to counter inflation we need to take into account the anticipated turnover for the policy period, and project it forward to be adequate for an Incident occurring on the last day of the policy and also sufficient to cover inflation up to the expiry of the Maximum Indemnity Period. If the amount so declared is inadequate average will apply to the loss.

Declaration linked basis.

A method has evolved which generally deals with this problem called "Declaration Linked." The insured declares the estimated Gross Profit or Revenue for the Indemnity Period at inception or renewal – Insurers allow a maximum of 33.3% uplift in the estimated sum insured and waive the application of average.

However, this may not be so generous as it appears, as built into the wording is an adjustment feature whereby the Insured has to declare the actual Gross Profit or Gross Revenue earned at the end of each policy period and the premium is adjusted either upwards or downwards accordingly. Downwards adjustments are capped at 50% of the deposit premium charged, whereas upwards adjustments are unlimited, irrespective of the 33.3% cap placed on the uplift.

Nevertheless, this system has stood the test of time and is generally recognised as being beneficial to most middle market Insureds.

Potential difficulties

There are three main difficulties encountered with this concept:

1. .Rapidly growing businesses:

New (start up) businesses often expand at a far greater rate than the 33.3% factor allowed. It is difficult to achieve an equitable rate for higher rates of inflation, so it is often necessary to deal with these on a conventional basis. It is sensible to review the likely maximum sum insured required on a quarterly basis, until the expansion has settled down to a level sustainable within the usual 33.3% margin for inflation.

2. Declining businesses

This will be a fairly rare occurrence as the purchase of BI may be questionable anyway. However, if a business is in decline rather than expansion, there is no need for the inflation factor and there may be insufficient return premium available should the decline be beyond 50%. In these rather extreme circumstances it would be appropriate to review the cover required on a regular basis, cutting off cover entirely when it becomes obvious that an Insured incident will no longer affect earnings, as there will be no business to support.

3. Covers placed on a first loss basis

If a first loss basis is used the inflation factor may be meaningless in a total loss situation for a policy covering a single location as the policy limit will be the maximum amount claimable, irrespective of inflation. However, for multiple location risks Insurers will continue to apply the 33.3% uplift to individual declarations so there is value in maintaining the declaration linked basis, as long as the phrases used reflect the terms “limit” rather than “sum insured” as so often happens.

Chapter 8 Additional Costs

As we saw in Chapter 3, Additional Costs (or Increase in Cost of Working) are already included as an option in the settlement of both a Gross Profit and a Gross Revenue Loss. This makes sense as there will be inevitable increased costs arising following a serious Incident, which the Insured will need to consider and, when agreed, implement, to mitigate the loss. Some examples of such increased costs are as follows:

Overtime costs

One of the easiest ways of maintaining turnover is to ask employees to do more than usual, perhaps in helping clear up the mess, or in assisting with the move and setting up the new location. All this will undoubtedly incur overtime costs, especially during the initial and concluding part of the Indemnity Period, which will form part of the claim.

The gross rental cost of alternative accommodation

It is more than likely that following a major Incident, the insured will need to move, at least temporarily, to alternative accommodation to maintain the business. Assuming the original costs continue, the alternative accommodation is an extra expense.

Removal or additional storage costs

There will inevitably be removal costs associated with moving to the alternative accommodation or in setting up temporary warehousing off site to which goods can be re-directed.

The cost of internal alterations to the alternative accommodation

Sometimes the new accommodation is unsuitable for running the business and additional costs have to be incurred in fitting out the premises to suit the insured's normal operations. This may mean erecting temporary partitions and suchlike.

The additional costs of telephone, fax and other communication systems

The Insured already incurs a standing charge for communications, but new telephony, fax, e-mail; facilities etc will be needed in the new premises, so these will be additional costs.

Cost of advertising "business as normal"

The Insured will need to advertise the new location and attempt to persuade customers that the business will perform as usual, to avoid loss of custom.

Additional travel, transport and expense costs

Travelling expenses incurred by staff and additional transport costs either to do with the move in either direction or extra expense of, say, overnight accommodation or subsistence allowances are all part of the cost. If goods have to be re-directed or re-distributed there will be considerable extra transport costs involved.

Additional rates and taxes

There will be additional (or at least different) rates and taxes associated with any temporary move. The adjuster will need to see what savings, if any, can be made on these costs for the damaged premises, but they are prima facie additional cost.

Hire and installation of furniture and other fixtures and fittings

The insured may need to hire in temporary furniture and other equipment whilst their permanent replacement needs are assessed and prior to the installation of those replacements in the repaired or replaced building.

Additional printing or over printing costs of stationery, including advertising

Clearly the move will demand an expenditure on fresh or overprinted stationery and most claimants will have the need to advertise their new location, redirect mail and so on.

Cost of any additional staff required, albeit on a temporary basis.

On occasions it may be necessary to hire temporary additional staff. A common example is the hire of additional security to replace the temporarily destroyed alarm systems to avoid further loss or damage. Naturally, this will have to be seen to be temporary (days or weeks rather than months) to qualify.

Premium costs incurred in the reinstatement of deeds, documents, plans, drawings, computer software and the like.

What we mean by this is that lawyers and others often load the normal cost of reproduction of documents, particularly when these are required quickly. The cost cannot have any bearing on the preparation of the claim, as this is an excluded cost, although the policy will pay the accountants charges for verifying the particulars of the claim, which may well include certain such premium costs.

Costs of outsourcing work By this we mean the need to subcontract certain of the operations that cannot now be carried on because that part of the plant is no longer there. It allows the continued production of the normal product or service, albeit at increased cost, so the turnover is maintained.

Economic Limit

As we saw in Chapter 3, the Increase in Cost of Working Item is limited to an amount “not exceeding the amount of reduction thereby avoided.” The principle here is that as the cover is all part of the loss of turnover item the insured cannot in equity spend more than a pound to save a pound: Consider the following

1. ICoW incurred £50,000. Loss avoided £200,000. Policy pays the full £50,000
 - 2. ICoW incurred £100,000. Loss avoided £30,000. Policy only pays £30,000
- Many insured's are completely unaware of this important settlement feature.

The best advice to an Insured involved in a BI loss is to make sure that all anticipated Increased Costs are agreed beforehand with the adjuster – this is sensible anyway, as they need to determine whether or not they are “reasonable” and “necessarily incurred” and can also take a view as to the economics.

However, there are many trades where, if the Insured cannot sell the product today, their customer will move elsewhere and may stay there. Such trades could be sole trading food suppliers, newspaper publishers, laundries, small component suppliers to the motor trade and so on. On a longer-term basis, weeks rather than days, then almost any Insured would probably be in the position of potentially losing custom forever if something were not done about it quickly.

The traditional ICOW item may not be adequate, as they may well have to spend more than the economic limit to rectify the situation. Fortunately, there is a solution,

which we call Additional Increase in Cost of Working (AICOW), usually defined as follows,

The insurance under Item X is limited to the amount of the Additional Expenditure (in excess of the amount payable under paragraph Item 1 (b) of Gross Profit, (Gross Revenue, Advance Profit or Advance Revenue) necessarily and reasonably incurred by the Insured during the Indemnity Period in consequence of the Incident for the sole purpose of avoiding or diminishing a reduction in Turnover or resuming or maintaining normal business.

You will note that the cover still has to be necessarily and reasonably incurred but is in addition to the usual cover under Item 1b. This is very helpful to loss adjusters as they can then readily agree expenditure of AICOW, within any pre-agreed limit, without worrying whether it will turn out to be economic or not. If it should transpire to fall within the economic limit then the expense can be moved from the AICOW item to the ICOW item, releasing more expenditure, if necessary, to the AICOW item.

Some businesses may need a longer indemnity period – costs could continue after resumption of activities. This is particularly true where it has been necessary to sign a long lease on replacement “temporary” premises.

AICOW covers are all written on a first loss basis, perhaps 5/10% of the total sum insured on Revenue or Gross Profit.

ICOW only covers

Such covers are bought by those Insured who cannot envisage a loss of profit or revenue from an interruption, but do anticipate a degree of increased costs. Large office-type businesses with a good spread of risk e.g. banks, lawyers, accountants and insurance companies are traditional buyers of ICOW only

Schools and colleges often feel that they can move to temporary premises and continue business without the possibility of loss of income. It does seem strange, however, that parents would continue to pay the same level of fees if their child were forced to use a temporary portacabin rather than, say, a fully fitted out chemistry laboratory, so one should challenge any presumption that income is fully protected.

Most ICOW only policies incorporate some form of restriction of the amount that can be spent – perhaps 25% in the first three months of the Indemnity Period, which is reflected in the reduced rating for this type of policy. However, most claimants will want to spend as much as they can whenever they need to spend it so this is a major deduction for those that should be considering fuller cover.

Flexible Limit of loss

This is a relatively new form of BI cover (i.e. no more than 20 years old!) An example of the basic form is shown in appendix 5.

The form is constructed in a similar way to conventional covers so the loss still has to be reasonably and necessarily incurred to prevent interruption of or interference with the turnover but there is no economic limit or uninsured variable costs. As a result the Insured can claim loss of Revenue, ICOW or AICOW (or any combination of the three) but the overall claim is limited to the loss limit. Few insurers bother to set a maximum indemnity period as the loss limit effectively does that for them.

It is best suited to an insured who cannot, as yet, be persuaded to buy full revenue or profits cover but who is, or may be, exposed to a potential loss in that area. If the first loss limit selected is well within EML then it should be possible to achieve a premium saving over conventional cover. The reason being, as you will see in the chapter on rating, is that such covers are rated conventionally and then discounted to reflect the degree of self-insurance being undertaken by the Insured.

For some proposers it may be possible to develop a blend of daily rate plus flexible limit of loss, perhaps topped up by an excess of loss cover where perhaps full cover for terrorism is required.

Chapter 9 Advance Gross Profits and Advance Gross Revenue

What is Advance Loss of Profits or Revenue?

Advance Profits or Revenue cover protects the Insured for loss of anticipated earnings from a new installation/plant/business process (operating from structures yet to be built) as a result of a delay in the construction/installation/implementation caused by an insured event.

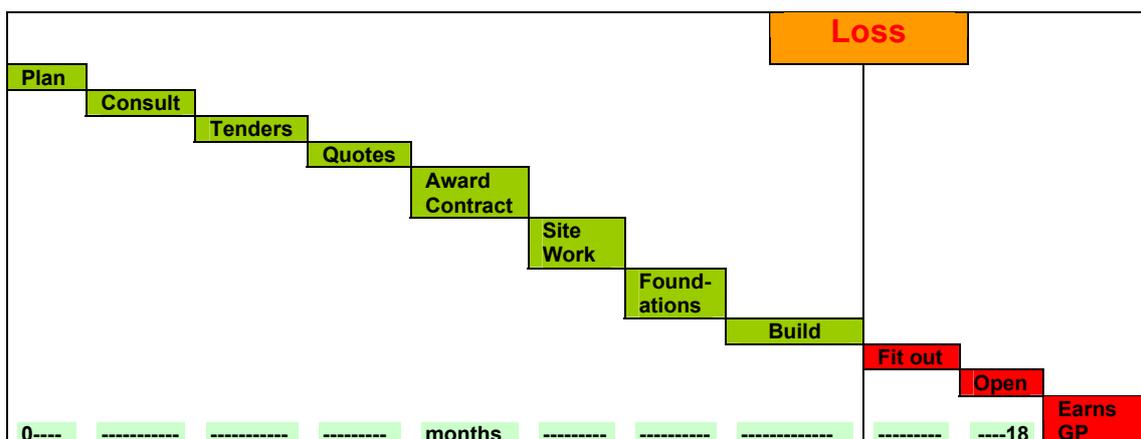
The cover is intended for entirely new streams of business or new locations – development of existing streams of business can usually be catered for in the standard cover, as the budget that is declared on a Declaration Linked basis should include the projected increased turnover for the expansion.

What do we need to provide a quotation?

An underwriter will want to know the likely “hot spots” in the development plans so he will need detailed information on the entire build project.

- The planned phases of development, what equipment is involved, what are the delivery and installation dates and are suppliers extensions required (home/overseas including transits)
 - What could affect the start up date?
 - Where damage can arise to affect the new facility (e.g. do we need marine BI if critical plant/materials/ components are coming from abroad?)
 - What indemnity period is required?
 - Gross profit / revenue at risk?
 - Include loading, unloading, testing, commissioning, cold/warm/hot start risks, breakdown
- This information will be freely available from the GAANT charts built up by the project managers to get approval for the project in the first place.

How does the cover operate?



In the simplified schematic above we are imagining the opening of a new fashion ware outlet on a greenfield site. The project will take 18 months from start to finish, so the store will start earning money in 18 months time. However, if an insured incident occurs when shown that start date will be delayed and the Insured will need to protect projected future earnings during that period.

It is usual to take out cover from the beginning of the contract, although it can be taken out any time before the anticipated date of completion. Any insured incident occurring during the build phase is likely to delay the anticipated earnings, so the Indemnity Period has to be set bearing in mind the longest likely delay flowing from any pre handover incident(s) The policy responds to an incident in the same way as standard cover but Loss of Revenue/Profits payments can only be made from the anticipated start date, not the date of the incident.

However, ICOW payments can, and should, be made from the date of the incident. In our example, as damage occurs sometime towards the end of the “build” phase, it will probably necessitate demolition and rebuild. It will be in the Insurer’s interests to mitigate the interruption and so they will authorise ICOW payments (or AICOW if covered) from the time of the damage to limit their exposure in the period after intended handover from when the insured anticipated earning turnover. There will inevitably be a delay in business start up whatever money is thrown at the problem, so the policy will support the business by paying Gross Profit or Revenue losses from the anticipated start up date during the agreed Indemnity Period until the business is actually earning its full anticipated level of turnover.

The only change needed to the wording is the **trends clause**, which usually reads as follows:

<p>Rate of Gross Profit The Rate of Gross Profit that but for the Incident would have been earned on the Turnover during the Indemnity Period</p>	<p><i>)based upon the estimated production programme/earnings of the Business, and costs and prices relating thereto, to which such adjustments shall be made as may be necessary to provide for the trend of the Business either before or after the Incident or which would have affected the Business had the Incident not occurred so that the figures thus adjusted shall represent as nearly as may be practicable the results which but for the Incident would have been obtained during the relative period after the Incident.</i></p>
<p>Standard Turnover The turnover that but for the Incident would have been earned during the Indemnity Period</p>	<p><i>)Business either before or after the Incident or which would have affected the Business had the Incident not occurred so that the figures thus adjusted shall represent as nearly as may be practicable the results which but for the Incident would have been obtained during the relative period after the Incident.</i></p>
<p>Standard Gross Revenue The Gross Revenue which but for the incident would have been earned during the Indemnity Period</p>	<p><i>)Business either before or after the Incident or which would have affected the Business had the Incident not occurred so that the figures thus adjusted shall represent as nearly as may be practicable the results which but for the Incident would have been obtained during the relative period after the Incident.</i></p>

Clearly it is very much a negotiating point as to what earnings would have been made had the business started up as planned and hence the need for solid budgets on which to base the cover.

Traditional Gross Profit or Gross Revenue settlement will not suit all businesses. A highly innovative business may just fail to get off the ground in the first place or, with a just in time business, the window of opportunity may have been lost altogether due to the delay. For these less predictable exposures it may be more sensible to consider an agreed “daily rate” basis or possibly just insure a loss of interest item to allow the Insured to borrow more money to invest in a different business stream should the original plan fail due to the interruption.

Advance Revenue or Advance Profits cover best suits the Insured who can pretty well guarantee the business will perform to plan, despite the delay, once the interruption has ceased.

Chapter 10 Programme design

Perils

So far we have reviewed the core covers available to look at their broad application to the risk posed by the Business. The next step is to design a programme to specifically suit the insured's exposures or "demands and needs".

When discussing risk potential with any insured, we will have already decided with them the range of perils that they may be exposed to – maybe just fire and explosion for a major petrochemical risk to full broad form "all risks" for a typical large manufacturing company. Normally they will have a consequential loss exposure from that same range of perils so invariably the choice of perils is already made – occasionally individual circumstances may suggest that there is little or no consequential loss exposure from certain perils, perhaps theft or breakdown, for example, so specific perils may be deleted from the design if it is economically viable to do so. Where there is little or no premium saving to be had then it is clearly safer from the Insured's point of view to maintain full cover.

When underwriting the risk the insurer will need to take into account the likely consequential loss that could flow from each of the perils covered. As we have already discovered, the explosion peril for a standard BI policy is interesting in that it *includes* consequential loss flowing from the explosion of boilers or vessels under steam pressure – provided, of course that an underlying inspection and insurance contract is in force. This peril could have serious consequences for a manufacturing concern in that the explosion of a boiler or vessel under steam pressure will not just destroy the plant but also surrounding property, leading to an interruption potential of many months.

It is not usually possible to cover a broader range of perils for BI than the insured covers for PD, albeit, as above, in a different specialist policy. You will remember that a prime concern for insurers is that the physical damage be reinstated as soon as possible to mitigate their exposure from a prolonged period of interruption (material damage proviso.)

An underwriter will want to limit his liability for unknown or unquantifiable perils exposure. For example, most standard UK BI policies will have a combined PD/BI loss limit for storm, tempest and flood damage. However, if an insured has a spread of property at risk of damage by the same storm system, for example, then this may be inadequate and will need uplifting.

In addition an underwriter will need to impose a lower loss limit for breakdown because of treaty/underwriting control limitations, which may override the catastrophe cover necessary for steam explosion BI if the policy is written on an American style boiler and machinery basis. As always, the devil is in the detail and it is important for any insured to understand the potential effect of any limitation to cover.

Naturally, it is always possible for underwriters to give higher limits at a price, provided the appropriate underwriting information is available. This would normally take the form of a full business impact study showing the effects of each of the major perils on the business at the premises concerned, together with any cumulative exposure generated by inter site dependencies as between "sister" facilities of the same group of companies.

Extensions

As we learned in Chapter 2, the definitions of *The Insured*, *The Business* and *The Premises* are all key to triggering a business interruption claim. When designing a BI programme we need to particularly investigate the business and any premises used, as unless they are correctly specified the policy cannot respond. Often we need to *extend* the definitions to provide the full cover that the Insured requires. The wordings for these extensions can be found in the model policy wording in appendix 1

Suppliers

Most manufacturing or assembly businesses will be dependent on a supply chain to produce the final product or service. If the supplier's business suffers damage as insured by the policy, then the interruption could actually be more serious than an interruption at the insured's own premises. Let's look at Go Faster Bicycles again:

Currently they operate from a single site premises in Nottingham – but is their entire turnover dependent on that site? They will be sourcing a whole range of raw materials (steel/aluminium/carbon fibre tubing for the handle bars, frames and forks, sheet steel/aluminium to make wheel rims, wire for the spokes etc.) In addition they will buy in a multitude of components from specialist suppliers (saddles, gears, chains, pedals, tyres, and so on) In addition, Go Faster subcontract some of their work, paint spraying and transfer fixing, to a third party operator.

If any of these materials or services were unavailable to them, then production would be affected. To what extent would depend upon the amount of "buffer" stock of finished goods that they hold prior to despatch, the potential alternative suppliers available and the additional cost that that would involve. As a rule of thumb, it is important to investigate any single source of supply that affects more than 5% of the turnover – any lesser dependencies can generally be swept up in a generic non-specified suppliers' extension.

Any one of these supplies may affect turnover completely – it is not unusual to come up with an initial list that totals considerably more than 100%, and which would produce a premium far greater than the original premium based upon the exposure at the original premises. However, we do need to ask some further questions to try to establish the likely effect of an interruption at the suppliers' premises:

- The name and production address of the supplier concerned?
- What underwriting details are available or where could these be obtained? – Construction, occupation, hazardous exposures, protection, claims history, tested business continuity plans and so on.
- The actual percentage of turnover dependent on the product? Is there a knock on or cumulative effect to other members of the group where the policy covers a group of companies?
- The extent to which a supplier's flow of goods could be interrupted by insured damage at their premises and the period for which supplies could be interrupted?
- Is there any marine or transit exposure involved?
- Are there any alternative sources of supply? – If so how long would it take to set up fresh supplies and what additional costs would be involved?
- Does the alternative supplier have sufficient capacity to meet all the insured's requirements or would there be a need to supplement these fresh supplies? Again, when could that happen and at what cost?

- Does the insured or the supplier hold any buffer stocks and where?
- Could production at the Insured's factory be maintained by buying in a completed product and selling that in a "re-badged" format – if so what would be the additional cost?

Let us look at some of these questions in more detail:

Name and production address

This is needed for two reasons: Firstly it identifies the plant and territory concerned, which may have a bearing on the rating or extent of cover available – maybe it is in an earthquake zone for example. Secondly, the insurer may already be insuring the supplier concerned as a "first party" risk and would therefore be aggregating his exposure and may need to place some reinsurance.

Underwriting details

An extension is just that – the insurer is extending his cover to another premises and will therefore need to know just as much about the supplier's premises and claims history as he would the original insured location. Frequently all this information is already available, albeit in the hands of another party, the insurer or broker to the supplier concerned. It would seem sensible if the market had a means of sharing this basic information to prevent the unnecessary waste of time and effort in duplicating surveys that seems to be the case at present.

Interruption potential

The exposure at the supplier's premises could be just as important as that at the insured's own premises – and in some cases more important, as the supplier may be a much worse property damage risk with a longer period required for recovery than our own Insured. Sometimes it is necessary to arrange a longer Indemnity Period for certain suppliers than that existing for the main policy, such covers often being arranged on an excess of loss basis.

Marine risk

Property insurers treaties generally exclude marine transit exposures so whilst they are able to provide inland transit cover and extensions they are unable cover "blue water" risks without specific facultative reinsurer. This cover could be important for some insured as the product they are manufacturing or assembling may consist of vital components that need to be shipped by sea or air. Consider the case of the manufacture of the rolling stock for the Virgin Pendolino trains.

The shells of the carriages were made in Savigliano in Italy and were initially due to be transported singly by road transport through the Mont Blanc tunnel, on through France, under the Channel by train and then onwards by road to their final assembly point of Washford Heath near Birmingham. The project policy was arranged accordingly with UK property insurers, including transit for both PD and BI risks, as there was no "blue water" involved. The BI exposure did not attract any additional rate, as the loss of any one shell was not thought to be a major interruption risk.

However, as often happens, an extraneous event, a serious fire in the Mont Blanc tunnel, put paid to these plans and a revised routing had to be arranged. As there was no longer any quick road route to the UK it was decided to ship the shells, up to 36 at a time, to the UK by boat from Rome, through the straits of Gibraltar, up through the Bay of Biscay and on to Avonmouth where they would be transhipped to road transport. Clearly the BI exposure was now considerable. 36 shells (four complete trains) were now at risk on any one freighter and the property insurers could not cover the sea transit.

Enter the marine market. Unknown to many insurance professionals working outside the realm of multinational construction projects, there is a very healthy marine transit BI market in Lloyd's and other specialist marine underwriters in London, who were able to accept the risk within the original policy conditions, although not without a considerable additional premium!

This example helps illustrate the need to fully explore the "supply" exposures and not just cover the premises themselves when a considerable interruption potential is possible by damage to an item or items in transit.

Alternative sources of supply

Many businesses will be actively sourcing alternative suppliers to ensure they are getting the best deal. The difficulty is that whilst these alternative suppliers may quote to supply, they may need a considerable length of time to set up the necessary production process, and will undoubtedly be charging more for the product as otherwise they would have been awarded the contract in the first place. Any delay factor and extra cost will need to be taken into account when setting an appropriate limit for the extension.

In addition, sometimes no one alternative supplier would have the capacity to supply sufficient quantity of the product so it would be necessary to go to two or more new suppliers, perhaps for varying periods. Again, any delays and additional costs all need to be taken into account.

Buffer stocks

On occasions, the insured or the supplier will hold perhaps three months supply of the finished article(s) on site or in storage elsewhere prior to despatch. This would give some leeway as these stocks could be used up first to maintain turnover, whilst the alternative supplier is gearing up his production. In some cases, where items vary in price, the adjusters will allow the Insured to charge the price of a lesser item which is in demand for a higher quality product which is in stock but not required, just to ensure turnover is maintained. The final adjustment of the claim would take any discrepancy in profit levels into account.

Many modern retailers work on the basis of being able to call off stock "on demand" so buffer stocks held by suppliers in external storage is becoming quite common place whereas accountants would normally dissuade most "front line" assemblers or retailers from holding buffer stocks as this is a waste of capital.

Buying in completed items

This is, of course, essentially what the retailer would do but a manufacturer, such as Go Faster, could probably make a case for buying in ready-made bicycles with a similar specification, re-badge them and sell them on as their own product, albeit not making any profit from the deal. However, it may well be that savings made at the factory which is no longer working will considerably assist in reducing any loss of profits claim on the insurers so this is a worthwhile way of maintaining turnover.

Calculating a supplier's extension limit

Supplier's extension limits are traditionally expressed as a percentage of the Gross Profit or Gross Revenue Sum Insured/Limit over the indemnity period. As we suggested previously, the initial list of suppliers may throw up many suppliers who, at face value, affect the business totally, and so their limit may appear to be 100%, say, of a 12 month IP. However, it is important to investigate the reality before agreeing on a percentage for any one supplier.

Consider the following:

Supply of carbon fibre tubes to Go Faster:

On interrogation the following facts were elicited from the financial director:

1. The supplier has to hold three months supply of the product off site under their contract.
2. Alternative supplies are available after five months from another manufacturer, but at 10% additional cost.
3. The supplier will be back in full production after six months.

Calculation (24 months Sum Insured £13,162,000 - see page 17)

1. Months 1 – 3	3 months Buffer stocks –	=	£	Nil
2. Month 4	1 month at full exposure -	=	£548,417	
3. Months 5 & 6	2 months at 10% additional cost =		£109,683	
4. Month 7	Back to normal		<u>£</u>	<u>Nil</u>
				<u>£658,100</u>

$$\text{Exposure} = \frac{\text{£ } 658,100}{\text{£ } 13,162,000} \times 100 = 5\%$$

Clearly this is a very simplistic example, but does demonstrate that what might have been declared as a 100% turnover “stopper”, eventually turns out to be within the unspecified limit, largely due to the Insured's foresight in demanding the supplier holds 3 months buffer stocks of site.

In practice, we would add back a percentage to allow for potential delays and inflationary trends and might perhaps agree on a figure of 7.5%. Certainly the premium charge for this limit will be far less than if the programme was designed with the initial prospect of a 50% limit representing total interruption for 12 months.

As we have suggested, the exposure to a supplier needs just as much investigation as for the original proposer. In many cases the suppliers concerned may exhibit a higher loss potential than the Insured's own premises. A classic example of this is demonstrated by the modern trend to project manage and outsource, rather than actually manufacture the product or service. Consider a bespoke pharmaceutical company, based in the southeast that develop and sell high value prescription medicines for the US market. Their “premises” is an office complex where the technical development and project management is undertaken. All the rest of the operation is outsourced – the manufacture of the base chemicals, the mixing and compounding of the chemicals into tablets, the packaging and distribution - all are outsourced and managed from the office premises.

Their gross margin is around 95% and whilst clearly there is a heavy research and development and “people” risk in the UK, their business depends 100% on their suppliers. This is a true, but extreme example, of where supplier dependency is a key issue. As it happens, they are working towards 100% dual sourcing capability, and thus self-insuring, but in the meantime their risk is huge.

So how do we set about investigating a company’s exposure to their suppliers? Essentially we need to develop a total business impact analysis, geared to the potential exposure from insured perils damage to any supplier generating (or influencing) more than 5% of turnover. This can be a huge task and essentially would need high level buy in from the company concerned as we would need to talk to at least the FD, the risk manager, the chief buyer, the plant engineer(s) and the transport manager to establish their interpretation of the threats posed by each supplier, the likely alternatives and additional costs involved.

Many formulaic models have been produced to gather this information and an example is shown as appendix....

As discussed earlier, in addition to this important management information, we shall need to see credible risk information (plans and reports) with splits of turnover by premises or zone in the case of very large suppliers to be able to fully evaluate the risk exposure.

Only at this point can an insurer begin to assess the perils he is prepared to give and the sort of rating structure required.

One feature of modern business practice, as we have mentioned before, is outsourcing. This process is not limited to manufacturing companies. Many IT service providers outsource their data processing work, frequently to overseas territories that can perform far more cheaply than their UK counterpart. When assessing such exposures, the outsourcing location becomes a supplier to the main business and we will require to gather information not only about the overseas premises but also the supply lines and alternatives.

Customers

In many cases an Insured may act as an outsourced company, perhaps working in the premises of their customer. In this case, modern practice is to treat the customer’s premises as if it were belonging to the Insured, as this is where the risk to the business resides. There will be property at the premises (probably not belonging to the Insured) that can be damaged and cause an interruption. The Insurer will need as much information about the customer’s premises as he would about the Insured’s own property.

In this case a “customer’s” extension is unnecessary. However, should the Insured be the supplier of a product or services to a customer’s premises, then there will genuinely be a “customer’s” exposure to the business. If the customer can no longer take delivery of the product or service because of damage, then the insured’s business will suffer. This frequently occurs when the Insured is a small enterprise compared to the customer, as in the example of a local sandwich supplier to a supermarket, for example. Contracts are rarely in the Insured’s favour in these cases and the customer will “switch off” revenue as soon as they are unable to take delivery of the product or service, for whatever reason.

Whilst the exposure is much easier to identify, gathering the information necessary to rate the risk is far more difficult due to the dominant relationship of the customer, who may just refuse point blank to assist. In these circumstances, the original insured may well take the view that his business is so dependent on the existence of the customer that any suitable cover would either be prohibitively expensive or just not respond, as the insured would be bankrupted very early on in then interruption.

Looking at the other extreme, if a manufacturer, like Go Faster, is supplying to a large number of outlets then it matters little in the scheme of things if any one of them is not trading for a time – usually the other outlets will take up the slack as people will still want bicycles and will travel to get the one they want.

Customer's extensions are more beneficial to the manufacturer or service provider with a limited number of customers who each account for a relatively high proportion of turnover.

Third party storage premises

Third party storage premises are frequently used by businesses, particularly when they have a supply contract to a customer that demands some form of automatic "take" off facility for the item(s) concerned. Should damage occur at the premises then turnover may be lost due to the inability to meet the supply demands of the customer. Hence insurers will offer an extension to third party storage premises, treating them as if they were occupied by the Insured. In reality, some locations may well be a worse risk, particularly if they are general storage warehouses where any thing could be stored so full underwriting details will again be required to establish the exposure.

Utilities

Most businesses are dependent to some degree on the supply of electricity, gas, water or telecoms to maintain their turnover. Cover is available as an extension either in respect of damage to the land based generating station supplying the service or in respect of failure of supply anywhere up to the terminal ends of the supply lines to the Insured's premises – the latter is the more beneficial, and therefore the more expensive, extension as supply is frequently interrupted due to contractors inadvertently digging up cables and the like and interrupting supply.

Prior to the privatisation of the utilities, most insurers were able to grant full cover for these extensions as electricity supply in particular was usually guaranteed by an over engineered, resilient national supply system with plenty of readily switchable spare capacity. Since privatisation the resilience has decreased remarkably, as any normally redundant plant has been mothballed and would no longer be available to provide instant spare capacity at the flick of a switch. As a result insurers now look to limit their liability, sub limiting the cover appropriately in a range from £500k to perhaps £5m or £10m, depending on the size of risk concerned.

The fire in the BT tunnel in Manchester highlighted the vulnerability of landline telecoms. Sometimes other exposures are in the almost "inevitable" category. There could be a chemical factory operating on Merseyside that would suffer an 18 months shut down if it loses power for more than one hour and 20 minutes - clearly that is too close for comfort for any insurer and the only answer to that problem would be to install a totally independent overhead supply to the plant. Aluminium smelting plants

are in a similar situation in that the smelting pots will “freeze” when supply is switched off and the solidified mess then has to be dug out for them to be re-useable.

Research and development costs

Research and development (R & D) is clearly part of almost any business and if it is conducted in a separate building then it is easier to isolate both the risk of exposure and its effect on the business. Some R& D is essential for ongoing production, and would be included as part of the cost of the business. What we are concerned about here is one-off experimental work that cannot be directly related to current turnover. No one knows what effect, if any, such work may have on future turnover so any loss is unquantifiable. However, in the event of “damage” to the R & D building or contents, clearly the insured will have lost something. Sometimes this can be addressed by designing an appropriate reimbursement under the property damage section – here we look at what could be covered under the BI policy.

- 1) Additional expenditure will probably be incurred in obtaining, occupying and equipping temporary premises and in paying appropriate overtime to staff to reinstate the work lost quickly.
- 2) Most of the normal costs of running the department will continue as salaries are the predominant part, but if research work is suspended or retarded the Insured will be paying for unproductive, wasted time to retain their key staff and will then have to incur further salary cost to get back on track.
- 3) If records of partially or wholly completed R & D projects are lost further time and labour will need to be expended in re-working the projects to verify the results.

Contingent losses of this nature can be covered under the BI policy in a separate first loss amount, usually payable as 1/50th per working week expended on reworking R & D projects. The first loss limit recognises the fact that the loss is unrelated to current turnover and therefore needs to be paid in addition to any R & D loss related to current production.

Fines And damages

In certain trades, the delivery of goods to the customer by a due date is a very important feature and in the contract of sale or services, a provision is made for the payment of a fine or damages in the event of non-fulfilment by the agreed date. Although a loss of this nature may be a consequence of damage, it is normally excluded from the cover (liquidated damages.)

This position often applies in sections of the engineering, printing, textiles, clothing and similar industries, in building construction and in certain government contracts. Where there is a liability of this kind and there is no 'force majeure' clause in the contract providing for its cancellation in the event of fire or other perils under an insured's policy or even damage beyond the insured's control, it is possible to arrange a special sub limited item on fines or damages for breach of contract.

The sum insured for such an item is calculated on a first loss basis and should represent the maximum liability that might arise at any one point of time from any one particular incident. In estimating what this loss might be, allowance can be made for the possibility of getting work done by other firms in order to fulfil contracts. The additional cost of doing so will be met under the increase in cost of working section of

the insurance on gross profit/revenue within the terms and limitations of that section because it will produce turnover which otherwise would have been lost.

In the reverse direction, cover can be expanded to include fines or damages, etc. which the insured shall be legally liable to pay, for breach of contract. This would arise in consequence of the damage in respect of contracts for the purchase of goods or services (say supply of milk to a creamery,, for example) that cannot be utilised by the business during the indemnity period.

Denial of access

This extension protects the Insured against the resulting interruption loss if access to their premises is restricted, or their use is otherwise affected, because of damage in the 'vicinity'. For example, a fire in a nearby building may give rise to:-

- (1) Debris blocking the approach to the premises.
- (2) Drifting smoke making it impossible to work in the premises.
- (3) The damaged building being declared unsafe, causing the Local Authority to prohibit access to neighbouring buildings.
- (4) A risk of explosion causing the evacuation of the premises.

Some insurers have decided to define "in the vicinity" as being perhaps within one mile of the premises. Certainly the original intention was to limit cover to "neighbouring" property, so to stretch the cover to many miles, as might be the case with terrorist damage occurring in a city centre, for example, clearly multiplies the aggregation potential to any one incident. The radius limitation does at least provide contract certainty to all parties.

The cover is limited, as usual, to damage by an insured peril and, therefore, excludes non damage incidents such as blocking of roads purely due to adverse weather conditions and, of course, incidents such as bomb hoaxes or criminal activities that may cause the police to restrict access within the area. However, some "non-damage" cover for, say, terrorism, can sometimes be negotiated for smaller sub limits at extra cost, depending on the insurer's underlying treaty arrangements. If they have managed to secure "back to back" or "mirrored" terrorism exclusions in their treaty to the Pool Re inclusions, then they should be comfortable in granting some limited non damage terrorism cover as it will be picked up under their treaty. For many global insurers, whose treaty has an absolute terrorism exclusion, non damage terrorism becomes untenable due to the unknown accumulation factor for multiple hit events.

Loss of attraction

This extension is vital for retailers who rely upon "passing trade" to other larger shops, particularly within a shopping mall. Insurers are also willing to consider cover for shops not located within shopping precincts provided they agree a suitable description of the premises to which the extension relates.

The policy recognises the reduction in turnover due to a fall in custom that has resulted from damage elsewhere – the Manchester terrorist bomb and the July 2005 transport incidents in London are a good example of when such cover is necessary.

Murder suicide and human contagious disease

For some considerable time it has been possible to purchase a standard extension for a BI policy commonly known as the “murder, suicide and disease” extension. The original intention was to provide business interruption cover for hotels and restaurants suffering loss of business due to “the fear and apprehension” of potential clients (and hence downturn in bookings) following either a tragic event such as murder or suicide or the closure of the premises by the authorities due to an outbreak of notifiable contagious human disease - (smallpox, cholera etc.) In its original form, the cover was considered low risk and rarely charged for.

As is often the case, the modern day equivalent has been broadened and now often includes closure of the premises due to Food Safety Act requirements as well as other more spurious events such as non potable water, closure of the beaches etc. As applied to hotels, this is still a reasonably well contained cover, although it is interesting that brokers and underwriters have overridden many standard property damage exclusions (such as contamination, pollution, vermin etc) in their quest for providing cover for remote, but potentially serious, “non damage” events.

In the soft market conditions prior to 2002 underwriters freely gave this extension, albeit in a sub limited form, for other risks in the food and drink industry, as well as the hotels and restaurants for which it was originally intended. Indeed, such is the degree of standardisation in the insurance industry that the cover probably now appears on most BI policies, irrespective of their trade.

When considering any application of the extension to potential pandemics, such as avian flu for example, we need to consider:

1. The disease cover is only for notifiable human disease. In a non-mutated form avian flu for example, is therefore excluded, as is foot and mouth disease.
2. If the disease is not on the list of “notifiable” contagious diseases the policy could not respond because the authorities would not seek to close the premises.

What a client will be really concerned about in a pandemic situation is the possible temporary closure, or reduction in output of their businesses due to lack of staff or customers ill with ‘flu, or the breakdown of the transport infrastructure. However, the “damage” is to human beings, and as such, cannot be picked up by a BI policy, which is only designed to respond to interruption caused by damage to property. The only conventional insurance product intended to respond to the staff issue would be a group personal accident and sickness contract perhaps designed on a “key man” basis, where the client could use the proceeds to pay for additional staff and/or loss of profit.

Rating Considerations

Gross Profit and Gross Revenue Policies

The traditional starting point is the average contents rate for material damage. This is because the insured may or may not own the buildings in which they operate, but they are almost certainly going to own and control the contents which will have the most bearing on the likely inception hazard of losses.

Fire and “dry” perils (lightning, explosion, aircraft, earthquake, riot, malicious damage) will have the most impact on the business and the rates for these are taken in full. Wet perils (storm, flood, burst pipes and impact and the accidental damage element of “all risks) are not so likely to result in a severe interruption to the Business so a reduced rate is usually applied for consequential loss[d3].

Hence the make up of a consequential loss rate for Gross Profits or Revenue would consist of the following:

Fire rate – less any fire extinguishing appliances or sprinkler discount as given for the material damage cover. In addition insurers traditionally allow a further discount for sprinklers as this method of protection has been proven to dramatically reduce the impact of consequential loss from fire in the range 33.3% to 50%.

Plus: dry perils: the full material damage rate

Plus: wet perils: usually 50% of the material damage rate.

An underwriter would then look at the interruption features of the particular risk to see if there any positive features that make it attractive and could justify further discounts, such as:

Spread of premises?

If the client occupies a large number of premises, as perhaps in a supermarket chain, or a banking group, the likely hood of a severe loss is diminished by the sheer number of premises, only one or two of which could be affected by an incident at any one time.

Internal assistance?

Perhaps not all locations are working at full capacity so in the event of an interruption it might be possible to move production elsewhere to mitigate the loss.

Duplication of process?

Similar to the above, but more usually on the same site, where in the event of a partial loss, the Insured could invoke overtime arrangements and make up production from a duplicate line.

Buffer stocks?

If the insured hold several months supply of buffer stocks of finished goods which are unaffected by the incident, they could draw these off and use them to bolster sales to mitigate the loss during the interruption. However, modern business practice makes this less likely as accountants regard buffer stocks as wasted assets, and will do their best to make sure they are maintained at minimum levels, if at all.

Adjustment for the Indemnity Period

Whatever rate is eventually arrived at, it is then adjusted for the length of the Indemnity Period and applied to the sum insured, which is the appropriate multiple of the annual budget figure. The longer the Indemnity Period the less chance of a total interruption and hence the rate is reduced. Some typical examples are:

12 months I.P - 100%
18 months I.P – 85%
24 months I.P – 70%
36 months I.P – 60%

An Indemnity Period of less than 12 months is not normally viable as insurers invariably use the full 12 months figure and apply a small discount to the rate, so usually it is more economic to stick with a minimum of 12 months Indemnity Period on conventional policies.

Deductibles

For larger risks a combined deductible is often requested which will apply to both the material damage and business interruption loss. In practice any combined deductible such as this is likely to be absorbed by the material damage settlement so underwriters rarely consider it justifiable to further discount the business interruption premium for combined deductibles.

A separate time deductible is much more attractive and is often the preferred method when an underwriter needs to impose a deductible to eliminate minor losses.

Increase in Cost of Working (ICOW)

Businesses operating entirely as offices (increase office expenses)

These will be the businesses of professional people whose activities are restricted to the selling of a service such as building societies, banks, insurance companies, solicitors and so on.

For Increased Costs only the rates will often be pre-set by the Insurer concerned and will not necessarily appear to be linked to the particular material damage risk features, although rates will be modified according to the Maximum Indemnity Period.

Unlike full value covers discounts for sprinklered risks are not normally given and set coverage is given for the full range of perils so often no reductions are available for a limited selection. As the insurer could suffer a loss at any time at any one of the premises the rate is applied to the Limit of Liability multiplied by the number of premises covered.

Ordinarily, the base rate will be calculated in accordance with the methods described above for Gross Profit or Gross Revenue, etc) multiplied by the ICW rating factor.

ICW rating factor

Where restricted settlement provisions apply (for example, the maximum payable in the first three months of the MIP is 25%) and there is a division of amount between separate buildings the Rating Factor might be 3.0

i.e. if the base rate arrived at on a standard Gross Profit basis is .15%; the rate for ICW only is $.15\% \times 3.0 = .45\%$ applied to the limit of loss. As stated above the resultant premium should apply per premises.

Additional Increase in Cost of Working (AICOW)

As you will remember, this is a separate item available as an addition to a main earnings item (e.g. Gross Profit, etc) covering recoverable costs that exceed the economic limit.

The same rate, inclusive of discounts and loadings that are applied to the main item are also applied to the AICOW limit without any further adjustment. At first glance this appears to be in contradiction to the rating shown above imposed on ICOW items only but it reflects the view that the item may not be called upon to pay as most increased costs will fall within Item 1b of the policy, which has already been taken into account in the policy rating.

Flexible Limit of Loss Covers

Initially, the same procedure as described in rating full value (e.g. Gross Profit, etc) covers is followed to produce a full value premium when applied to the sum insured. The premium is then discounted for the first loss element dependant upon the percentage of the loss limit in relation to the EML / PML.

e.g. Total 12 months Sum Insured £250M
EML/PML is £75M
Limit of Loss is £10M
Limit of Loss as a percentage to the EML / PML is 13.33%.

The discount to be given from the full value premium in the above case may be in the range of 40/50%. The closer the first loss limit gets to the PML, the less the discount, although underwriter's rarely give away more than 50% of the premium required for the full value risk.

Advance profits

Rating for advance profits depends on the complexity of the work and the length of the contract. The longer the time until handover of the construction the more time is available to repair damage to reduce delay and any consequent loss of profit.

All risks cover is standard, made up of fire, dry perils, wet perils and accidental damage rates.

Illustration of possible Advance Profits Rates

Period	Fire: complexity of construction			Dry Perils	Wet Perils and AD
	A	B	C		
To 6 months	.15%	.20%	.25%	.030%	.080%
6 - 12 months	.125%	.135%	.20%	.027%	.072%
12 – 18 months	.10%	.120%	.140%	.020%	.050%

Fire rates are graded according to the complexity and fire potential of the construction. In reality, insurers may wish to have several different grades of construction complexity in their rating tables. The fire (and sometimes, explosion) rates are highest because there is a possibility of a large damage loss and a relatively long delay period whereas perils rates are lower because actual damage losses are likely to be smaller, and be repaired more quickly, thus causing less delay to the build programme.

Some UK claims examples

1. Fire in a dry cleaning machine at a laundry premises

The Insured is a commercial laundry operator providing rented “personalised” overalls and towels to a range of customers in the southeast of England. The overalls and towels are collected weekly from each customer, cleaned and re-allocated on a rolling basis. The Insured operate four similarly equipped premises covering the home counties, all working two shifts, seven days a week.

A fire occurred in a large, purpose built, dry cleaning machine at one of the premises due to a faulty thermostatic control allowing heat to build up sufficient to ignite the garments and the chemicals in the machine. The fire effectively destroyed the machine, one of two in the premises, together with a quantity of garments and there was considerable smoke and water damage to the rest of the laundry and garments at the location.

The Insured immediately put into effect their BCP which was to prioritise garment/towel delivery to key customers by working a third overtime shift in the other three locations and putting on extra collection and delivery runs to ensure the customer’s received the contracted deliveries of their personalised garments and towels. This involved considerable additional cost such as

1. Overtime payments
2. Hiring in extra drivers and vehicles to re-route the garments
3. Bussing staff to the other locations
4. Subsistence costs for meals etc for the overtime shift workers.

This all went on for a number of months, pending the clean up of the damage and removal and installation of a replacement machine, which had a three month delivery time.

Whilst very few contracts were actually lost, the Insured was able to demonstrate with reference to past and future activity, that there was a “dip” in their anticipated new customer acquisition. They contended that this could only be due to the effect of the fire, and was probably caused by the increased management time expended in dealing with the day-to-day problems arising from the temporary arrangements rather than pursuing new customers. Adjusters looked to find any “savings” that could be deducted but were satisfied that whilst power and chemicals etc were clearly not used at the original premises, they were consumed in roughly similar quantities at the other 3 locations that were working the overtime shifts.

Fortunately the client had an item relating to Additional Cost of Working, because, in the event, the costs involved clearly outweighed the actual turnover saved, and so a proportion would have been “uneconomic.” However, adjusters agreed with the Insured that the methods adopted were the best protection for the business and were therefore able to allocate the “excess” amount to the AICOW item.

Result: The business recovered fully and was back to normal in around nine months, albeit with a demonstrable lack of new business for the period of the loss that did not get made up in the Indemnity Period (18 months).

2. Fire in an office

The insured is a double-glazing company occupying extensive premises in North London comprising factory and associated office accommodation on the first floor. Intruders overcame the intruder alarm, broke into the first floor office and not being able to find anything of value set fire to the offices and made their escape.

There was extensive damage to the first floor office accommodation, which included the destruction of all the reply slips to a recent advertising campaign. The business had recently been acquired by a UK conglomerate that had instigated the sales campaign as a means of boosting falling figures.

Whilst it is unusual to lose income from damage to an office, the insured lodged a BI claim for loss of profit in the contention that these slips represented “hot” leads, which could be readily converted to sales. The adjusters were not unnaturally a little sceptical, particularly as the budgeted amount of extra income from the sales campaign amounted to several hundred’s of thousand pounds. Unfortunately the insured had no other record of the reply slips as they were in boxes awaiting sorting at the time of the fire. Using the “trends” clause to attempt to achieve an indemnity, the adjusters made extensive enquiries amongst the insured’s peer group as to the success of similar mail shot reply slips and came up with a ratio which could then be applied to the known total number of original adverts sent out by the firm contracted to do so.

This then had to be set against any enquiries originating from customers who replied to a local advertising campaign requesting them to complete a further slip. Further adjustments had to be made to reflect the continuing downward trend of the business, amid discussion as to how much of this was due to salesmen being unable to operate properly due to lack of office facilities. The BI claim was eventually settled, but for a far lesser amount than had originally been anticipated by the Insured.

One further complication was that the company secretary had immediately employed a security firm to guard the premises, which was an allowable ICOW item as the alarm system had been destroyed in the fire. However, it seems the contract was not made simultaneous with the normal time to re-install an alarm system and there was a lengthy dispute with adjusters over the claim for the overrun due to the alleged undue delay in getting the work done.

This claim probably illustrates better than most the following:

1. The need to agree with the adjusters at the beginning of the claim what is and is not allowable as extra expense. Had the insured done so, there would have been no doubt about the security guarding expenses.
2. That a fire in an office can generate a substantial BI loss – this is recognised in the “Blundell Spence” letter, a document somewhat lost in the mists of time which allows insurers to treat offices as part of the business, and not just as a stand alone ICOW only item.
3. There is no exact science to BI loss settlement – unless the policy is drafted on a per diem rate basis, there will always be claims and counter claims looking at “trends,” often not just in the business itself, but at others in a similar trade, all to attempt to arrive at an “indemnity.”

3. Rented premises

The insured in this case is in the food industry; the division concerned supplying ready-made salad stuff to the major supermarket chains. They occupied a block of unsprinklered rented premises, part of a large estate of similar property to the north of London. Their portion had been extensively refitted to comply with the rules of the Food Safety Act and other legislation.

The premises were on a long-term lease, with over 20 years to run.

A fire originated in a storage bay, supposedly due to an electrical fault, and spread quite rapidly to the remainder of their block, causing partial damage but with extensive smoke and water damage.

Whilst the BI claim was relatively straight forward, largely consisting of increased costs in rapidly re-locating operations to temporary accommodation, a difficulty arose over the insured's change of plans initiated by the fire. As we suggested in Chapter 6 an incident can often lead to an Insured reviewing their business plans. In this case, the Insured owned other premises for a separate division which had plenty of space for expansion so they obtained planning permission to build a purpose built factory to house the affected salad preparation unit.

The rent cessor clause in their lease freed them from payment of the rent for the damaged accommodation, but once this was rebuilt, they then again became responsible for payment. The difficulty was that by this time they had transferred to the new accommodation that had been built so the rent became an "additional cost" for the remainder of the Indemnity Period.

The adjusters, quite rightly, balked at paying such costs, as they did not think they were reasonably or necessarily incurred. What may have been possible would have been to agree, upfront, a penalty payment for early redemption of the lease but indemnity was not going to be satisfied by merely paying continuing costs that could, and should, have been avoided when the decision to move location had been made. In these circumstances, the insured should act as if uninsured and take the same action that they would have done had the move been a normal commercial proposition.

Result: A rather dissatisfied insured who felt somewhat "cheated." They may have benefited from prior counselling from either the adjusters or their insurance advisers as to exactly what elements of additional costs would be allowable as a true indemnity.

Global Practice

Overview

As companies grow, they often expand into other territories, either by acquisition or by setting up first sales and then perhaps distribution or regional centres, growing the business such that it duplicates the UK model. They may develop their own manufacturing or processing centres either adding value to a UK product or service or perhaps producing a unique set of products or services for the new territory.

Clearly these new entities require BI protection, both in their start up and development mode. Many companies allow their local management to purchase local insurance to meet their needs – the more astute, however, will realise there is an economy of scale and certainty of contract to be had by purchasing global protection. A global programme gives the parent company control over the insurance arrangements of its foreign subsidiaries, such that an agreed level of cover, limits and deductibles are provided worldwide, rather than having the possibility of deficient cover or limits that could affect the overall company balance sheet. The spread of risk and premium volume available usually results in considerable discounts being available from the global carrier compared to the aggregate of the individual local premiums, so most financial directors recognise the control over bottom line function that global arrangements provide.

Global property damage and business interruption policies are generally written as a “master” policy in the country of domicile of the parent organisation with “local” policies issued in each territory either where necessary by law or where the Insured requires them, perhaps for language considerations.

The “master” policy form will reflect the insurance practice and law of the “home” territory, usually either UK or US, whereas the “local” policies will be issued on the basis closest to that of the “master” that is permissible in the territory concerned. Any differences in form are usually brought back to the “master” cover by a Difference in Conditions and Difference in Limits (DIC/DIL) endorsement, which often becomes the operative clause of the contract. Any payments due under the endorsement can only be paid in the country of origin of the “master” as such payments may be illegal in the “local” territory and could affect the Insurer’s licence to trade.

To underwrite global BI risks the practice is to ask the insured to supply declarations of Gross Revenue or Gross Profit by territory, which can then be set against the underwriting information on exposure gathered by the insurer to arrive at a rating structure per territory. This is all consolidated into a global premium, which can then be allocated to the insured to pay in each territory, subject to any local taxes or charges.

It is frequently the case that the “master” policy is placed on a scheduled or perhaps “layered” basis whereas to simplify administration the individual “local” policies are often issued by the lead insurer only, on behalf of the “panel”, with facultative re-insurance being placed back to the panel on the master policy or policies. There is often a captive company involvement for the larger multinationals, which may be as a stand-alone self-retention layered placement, a coinsurance with the panel or a reinsurance of the panel.

Some differences in approach to normal UK practice

US Gross Earnings definition – (see Appendix 3)

Where a subsidiary is based in the US the local form will often be on a Gross Earnings basis. The fundamental difference between this and its UK Gross Profit counterpart is that the Gross Earnings form only makes payment up until the business is restored, whereas the UK form, as we have learned, can continue to make payments during the Indemnity Period until the business returns to the anticipated pre-loss trading position.

It is possible to convert to the UK basis of cover to some extent by buying an extension called “Extended Period of Liability” but clearly without such an extension the US form is deficient. It is therefore important, particularly when dealing with UK “local” policies issued on behalf of an American parent, to ensure the cover is clearly understood by the Insured and the appropriate extra cover purchased if necessary.

The standard form often only gives BI coverage resulting directly from the damaged property. Where it is necessary to consider consequent interruption to other lines or to other plants or locations then the standard form needs to be extended – it is not automatic.

One other important difference is that the standard form does not allow any BI coverage for damage to finished stock – i.e. it will not pay for loss of the profit that would have been made had the stock not been damaged. The remedy is to buy such cover under the material damage item.

Terminology, as one might expect, frequently differs from UK to US. For example, BI is usually referred to as “time element” coverage and our suppliers’ and customers’ extensions are normally labelled as “contingent business interruption” whereas ICOW is called extra expense. Wages is often labelled as “ordinary payroll” and denial of access is called “ingress and egress.”

Boiler and machinery

Boiler and machinery is a generic US term standing for boiler explosion and mechanical breakdown insurance. The cover is given as part of a “broad form all risks” policy, including BI, usually by referencing the items insured as the “object” to avoid constant streams of detailed description. The term “object” can then be used to bring back cover that would otherwise be deleted by the standard all risks form.

One important point to watch from a programme design point of view is the limit of cover available. As the cover is often given without full engineering surveys the limits available are combined and quite low so where it is clear that the explosion of a boiler might cause a major BI loss it may be better to revert to a standard form where the BI boiler explosion cover is freely granted to policy limits providing a material damage insurance is in force.

Inter-group dependency

Many insureds operate in such a way that value is added to the end product as it travels from operation to operation. A simple example is a UK manufacturer exporting finished goods to a sales operation overseas. If a loss occurs at the manufacturing

location then not only will the profits of the factory be affected but also the sales income of the overseas outlet.

A more complex example would be a manufacturer of aircraft where wings might be made in one location, the fuselage in another, electronics and hydraulics either made or sourced elsewhere and the whole lot assembled and tested in another location altogether, possibly overseas, as is the case with the European Airbus consortium, for example.

In either case, the declarations will show the total Gross Profit earnings, including any mark ups, but global programmes, as with UK forms these days, will invariably have a fairly small automatic limit for such cover.

The remedy to achieve the correct level of cover for either example is the same, albeit the second one producing more complex loss scenarios and calculations. Essentially it is necessary to establish the precise contribution made to the overall “group” profit by each step of the process.

In the first example this is quite straightforward: The manufacturing location will have a known turnover in manufacturing the finished product for export, from which can be calculated its individual gross profit sum insured. When the product is exported to the sales operation and sold on to the final customer, value is added by the sales operation reflected by the individual turnover of that outlet. This may be in repackaging or possibly the after sales service provided. In any event there will need to be a mark up of some sort to pay for the sales operation’s costs.

As long as there is no possibility of double counting (i.e. the “wholesale” value of the goods does not appear as turnover in the sales outlet’s accounts) then it is very easy to assess the interdependence that the sales outlet has on the parent manufacturing company and express this as a limit of loss. It is unlikely that the same level of interdependence exists in reverse, as a fresh sales office would not take long to acquire and the finished product could be sent direct to customers in the meantime.

You will note that in this example it is possible to insure the BI arising from the loss of damaged finished goods, despite the fact that “purchases” are excluded from the gross profit calculation as a variable expense. This is because the “purchases” only reflect raw materials, which are readily replaceable and not the “value added” finished goods which cannot be made again until the damaged factory is reinstated and in production, with the consequent long term potential damage to sales.

The second example involves far more complexity in data acquisition. In such situations it is necessary to plot the route of each item involved in the manufacture to establish where it may be vulnerable to loss, and what its added value would be at that time. When considering a major manufacturer many items could criss-cross each other in different zones of the same or differing locations on their route to final assembly. The interdependency charts for such companies are very complex, and form a major part of the Insurer’s assessment of the EML.

Marine business interruption

We mentioned marine business interruption in our discussions on programme design in chapter 10. Many major global manufacturers have an ongoing marine BI risk in that if the components being shipped from place to place get destroyed or lost in

transit, then not only is the turnover earned up that point at risk but also the added value from the next part or parts of the operation.

An example was the installation of a new under sea cable from Australia to Jakarta. The fibre optic cable was specially made in Japan and loaded on board a vessel to transport it to the terminal facility in Perth. En route the vessel encountered rough seas, with the result that the cargo shifted, so altering the balance of the vessel that it listed severely and quite quickly took on water and sank, with the loss of all the cable.

Whilst the cable was fully insured, the consequent delays in re manufacturing it ran to several months and incurred not only loss of interest on servicing loans of the installer for longer than anticipated, but also fines and penalties under contract for the delayed installation, both of which could have been insured under a marine BI contract.

Certainly when discussing interdependency with an Insured it is important to make sure any such exposure is fully explored and either dealt with under contract or quotations obtained for the appropriate cover to enable the Insured to take a view on the expense versus exposure issues.

Earthquake

Many global companies have exposures in earthquake zones, so it is important to determine whether they are frontline manufacturing or added value exposures. The reason is that combined PD and BI capacity is very limited and pricing expensive so the exposures need accurate definition (by zip code) to take best advantage of the limited covers available. Sometimes it is necessary to take an alternative route to obtain coverage.

When a major leisure park operator decided to expand into Japan, they were highly conscious that an earthquake event anywhere in the region would have an immediate effect on the visitors willing to travel there, irrespective of whether the actual leisure park was damaged or not.

The eventual remedy lay with the bond market with a series of on demand repayable bonds being put on the market with concentric rings of exposure, using the park as the epicentre. The FD could call on these bonds (or not, as circumstances dictated) if an earthquake event occurred in (any of) the rings of exposure. The bond was then repayable over a set period at a fixed rate so essentially providing an off balance sheet line of credit to maintain the business. Clearly this is a different, and potentially more costly way of providing a solution, as the bonds are repayable, as opposed to insurance monies, which are not. A higher price would enable non-repayable bonds to be used for the same purpose. The cost is way above that demanded by insurers, but the capacity available is only limited by the insured's ability to pay, so sometimes such measures are essential to assist maintain the business when the traditional insurance market is unable to do so.

Windstorm and flood

Whilst the UK does suffer severe storm conditions from time to time, they are nothing in comparison to the weather patterns that are quite normal for many places around the globe. The hurricane seasons of 2004 and 2005 in the Gulf of Mexico were devastating, with losses running into billions of dollars. The damage at New Orleans

in 2005 was made the more severe by the breaching of a levy (or dyke) caused by a storm surge, flooding the city twice in subsequent hurricanes.

Global insurers need a lot of information on zip codes and zoning to look at their potential aggregation exposures and that of their reinsurers. Consequently, when contemplating exposure information gathering for a global insured it is very important to consider their geographical spread of their subsidiaries and suppliers and allow sufficient time to obtain the detailed information required to accurately assess the risk.

Other issues

Clearly, when contemplating global programmes one needs to have the ability to “think outside the box.” Whilst UK experience is a good starting point, each individual territory will have its own unique difficulties to consider, including language and custom.

The most common problem associated with global BI is the definition of Gross Profit. Many local operations will not have the ability to interpret this correctly, unless they can be presented with a form clearly expressing exactly what has to be declared, in their own language. For this reason, it may be more practicable for global clients to request turnover details, which they would know in any event, and then separately delete the main variable which would be raw stock purchases, again a fairly freely known amount. If that proves to be impossible then it may be better to go for Gross Revenue cover and see what rate reduction can be negotiated between the parties for an assumed level of variable.

Other problems revolve around the intrinsically different modes of operation, particularly in “third world” territories. Some time ago, a major UK company had a large BI loss in India resulting from the loss of delicate electronic equipment intended for installation in a new power station. Two losses were probably unique to India, or at least, to countries with less advanced infrastructure than the UK.

The first was the then lack of adequate warehousing at the importation point, leading to large quantities of goods being left in the open awaiting transport during the monsoon season and suffering corrosion damage from water ingress to the cases. Whilst there was an attempt to claim under the marine policy this could only cover water damage at sea due to the Indian insurance regulations prescribing local coverage for commercial risks. The chemical analysis clearly showed that the corrosion had been due to fresh water rather than salt and the extent of the corrosion meant it had to happen on the dockside. This part of the BI claim therefore failed.

The second was the mode of inland transit by the freight forwarders. Due to the terrain, the best method was apparently by elephant. Unfortunately, the trail taken turned into a bog (presumably due to the afore mentioned monsoons) with the result that the elephants had severe difficulty in maintaining a footing. In an effort to assist the animals, the bearers threw off all the cargo and left it to sink in the bog! Again the claim failed, as unlike losses at sea, there is no inland equivalent of “general average.”

Another completely different issue is the economic stability of the territory. In 2004 hurricanes hit Grenada with subsequent damage to some furniture sales warehouses. On the face of it, a valid claim existed – property used by the Insured – the warehouse – had been damaged by a covered peril – storm. So far so good.

When reviewing the BI claim, the local management decided that they would claim for the reduction in sales caused by the storm damage, including the subsequent fall in sales due to a dramatic downturn in the local economy following the storm. What they failed to appreciate was that the policy could only respond to losses directly flowing from the insured damage to their premises, and not the “inevitable” downturn in the local economy. The business would have suffered this loss without any damage to the premises so this is outside of the scope of the policy - the trends and special circumstances clause specifically picks up the point to achieve an indemnity.

Result: A somewhat unhappy insured, who felt “cheated” by the insurers as the cover trigger had been activated but his expectations had not been managed.

Appendix 1 – UK “All Risks” Form

Consequential Loss “All Risks” Policy

The Insurer agrees (subject to the terms, definitions, exclusions, provisions 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 (such accidental loss, destruction or damage being hereinafter termed Damage) other than by an excluded cause during the period of insurance (or any subsequent period for which the Insurer accepts a renewal premium) and the business carried on by the Insured at the premises be in consequence thereof interrupted or interfered with

then the Insurer will pay to the Insured in respect of each item in the schedule hereto the amount of loss resulting from such interruption or interference in accordance with the provisions therein contained

provided that

- A. 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 Damage and that
 - (i) payment shall have been made or liability admitted therefor,
 - (ii) or payment would have been made or liability admitted therefor but for the provision of a proviso in such insurance excluding losses below a specified amount

- B. the liability of the Insurer in any one period of insurance under this policy shall in no case exceed
 - (i) in respect of each item the sum expressed in the schedule to be insured thereon or in the whole the total sum insured hereby
 - (ii) any limit of liability shown in the schedule

This policy incorporates the Schedule, Specification and Endorsements, which shall be read together as one contract. Words and expressions to which specific meaning is given in any part of this policy shall have the same meaning wherever they appear

Signed on behalf of the Insurer

The Schedule

Policy Number		
The Insurer		
The Insured		
The Business		
Items	As detailed in the specification attached hereto which is declared to be incorporated in and to form an integral part of the schedule.	
Total specification Sum Insured and/or Estimated Gross Profit	£ Being % of the total Specification sums insured and/or Estimated Gross Profit	
Insurer's Liability	The Insurer's liability under this policy is limited to % of the amounts otherwise payable under the provisions of the Specification and this Schedule	
Period of Insurance	From	
Renewal Date	To	
First Premium	£	
Insurance Premium Tax	£	
Total	£	
Annual Premium	£	
Insurance Premium Tax	£	
Total	£ £ £	
Limit of Liability and Deductible		
	Limit of liability.	Deductible
(1) Damage by fire lightning explosion aircraft earthquake riot civil commotion locked out workers persons taking part in labour disturbances or malicious persons	The sum insured	the first £
(2) Damage by storm tempest flood bursting or overflowing discharging or leaking of water tanks apparatus or pipes impact by any road vehicle or animal	£	the first £
(3) all other Damage	£	the first £

Excluded causes

This policy does not cover loss resulting from

1. Damage caused by or consisting of
 - 1.1. inherent vice, latent defect, gradual deterioration, wear and tear, frost,
 - 1.2 change in the water table, the bursting by steam pressure of any vessel, machine or apparatus (not being a boiler or economiser on the premises) in which internal pressure is due to steam only and belonging to or under the control of the Insured
 - 1.3 pressure waves caused by aircraft or other aerial devices travelling at sonic or supersonic speedsbut this shall not exclude subsequent Damage which itself results from a cause not otherwise excluded.

2. Damage caused by or consisting of
 - 2.1. faulty or defective workmanship, operational error or omission, on the part of the Insured or any of his employees
but this shall not exclude
 - (a) such Damage not otherwise excluded which itself results from a Defined Peril
 - (b) subsequent Damage which itself results from a cause not otherwise excluded
 - 2.2. acts of fraud or dishonesty by the Insured's employees
but this shall not exclude such Damage not otherwise excluded which itself results from a defined peril.

- 3 Damage caused by or consisting of
 - 3.1 corrosion, rust, wet or dry rot, shrinkage, evaporation, loss of weight, dryness, marring, scratching, vermin or insects
 - 3.2 change in temperature, colour, flavour, texture or finish
 - 3.3 theft or attempted theft not accompanied by forcible and violent breaking into or out of the Premises
Damage consisting of
 - 3.4 . joint leakage, failure of welds, cracking, fracturing, collapse or overheating of boilers, economisers, superheaters, pressure vessels or any range of steam piping in connection therewith
 - 3.5 mechanical or electrical breakdown or derangement of the particular machine or apparatus or equipment in which such breakdown or derangement originates
 - 3.6. the deliberate act of a supply undertaking in withholding the supply of water, gas, electricity, fuel or telecommunications services.

but this shall not exclude

- (a) such Damage not otherwise excluded which itself results from a Defined Peril
 - (b) subsequent Damage which itself results from a cause not otherwise excluded
- 4 loss resulting from pollution or contamination but this shall not exclude loss resulting from destruction or damage to property used by the Insured at the Premises for the purposes of the Business, not otherwise excluded, caused by
 - (a) pollution or contamination at the Premises which itself results from a Defined Peril
 - (b) a Defined Peril which itself results from pollution or contamination

- 5 Damage caused by or consisting of
 - 5.1 subsidence, ground heave or landslip
 - 5.2 normal settlement or bedding down of new structures
 - 5.3 disappearance, unexplained or inventory shortage, misfiling or misplacing of information.
 - 5.4 (a) erasure, loss, distortion or corruption of information on computer systems or other records programmes or software caused deliberately by rioters, strikers,

locked out worker, persons taking part in labour disturbances or malicious persons.

(b) other erasure, loss, distortion or corruption of information on computer systems or other records programmes or software unless resulting from a Defined Peril in so far as it is not otherwise excluded.

- 6 loss resulting from destruction or damage to a building or structure used by the Insured at the Premises caused by its own collapse or cracking

unless resulting from a Defined Peril in so far as it is otherwise not excluded

- 7 Damage in respect of movable property in the open, fences and gates caused by wind, rain, hail, sleet, snow, flood or dust

- 8 Damage

8.1 caused by fire resulting from its undergoing any process involving the application of heat

8.2 (other than by fire or explosion) resulting from its undergoing any process of production, packing, treatment, testing, commissioning, service or repair

but this shall not exclude

(c) such Damage not otherwise excluded which itself results from a Defined Peril

(d) subsequent Damage which itself results from a cause not otherwise excluded

- 9 Damage

9.1 caused by freezing

9.2 caused by the escape of water from any tank, apparatus or pipe

9.3 caused (other than by fire or explosion) by malicious persons not acting on behalf of or in connection with any political organisation

in respect of any building which is empty or not in use

- 10 Damage to

10.1 fixed glass

10.2 glass (other than fixed glass,) china, earthenware, marble or other fragile or brittle objects

10.3 computers or data processing equipment

other than such Damage caused by a Defined Peril in so far as it is not otherwise excluded.

- 11 Damage in respect of

11.1 jewellery, precious stones, precious metals, bullion, furs, curiosities, works of art or rare books.

11.2 property in transit

11.3 money, cheques, stamps, bonds, credit cards or securities of any description other than such DAMAGE caused by a Defined Peril in so far as it is not otherwise excluded.

- 12 Damage to

12.1 vehicles licensed for road use (including accessories thereon) caravans, trailers, railway locomotives, rolling stock, watercraft or aircraft.

12.2 Property of structures in the course of construction or erection and materials and supplies in connection with all such property in the course of construction or erection

12.3 Land, roads, pavements, piers, jetties, bridges, culverts or excavations

12.4 Livestock, growing crops or trees.

12.5 property which at the time of the happening of the DAMAGE is insured by, or would but for the existence of this policy be insured by, any marine policy or policies except in respect of any excess beyond the amount which would have

been payable under the marine policy or policies had this insurance not been effected.

12.6 any property more specifically insured by or on behalf of the Insured.

- 13 Any Damage or consequential loss directly or indirectly arising out of or relating to mould, mildew, fungus, spores or other micro-organism of any type or nature or description including but not limited to any substance whose presence poses an actual or potential threat to human health.
- 14 A. Damage or consequential loss to Data arising out of but not limited to
- (1) Loss destruction or corruption of Data whether in whole or part
 - (1) Unauthorised appropriation use access or modification of Data
 - (2) Unauthorised transmission of Data to any third parties
 - (3) Misinterpretation use or misuse of Data
 - (4) Operator error
- B Damage or consequential loss arising directly or indirectly from
- (1) The transmission or impact of any Virus
 - (2) Unauthorised access to a system
 - (3) Interruption of or interference with electronic means of communication used in the conduct of the Business including but not limited to diminution in the performance of any website or electronic means of communication
 - (4) Failure of a system
 - (5) Anything described in paragraph (A) above

But in respect of B (1) B (2) B (3) and B (4) this shall not exclude subsequent Damage or consequential loss which itself results from a Defined Peril not otherwise excluded provided that such Damage does not arise by reason of any malicious act or omission by the Insured or their employees.

Definitions for the purpose of this Exclusion

Data

Data means information represented or stored electronically including but not limited to code or series of instructions operating systems software programs and firmware

Failure of a System

Failure of a System means the complete or partial failure or inability whether in terms of availability functionality and/or performance or otherwise of a System whether or not owned by the Insured to operate at any time as desired as specified or as required in the circumstances of the Business

System

System includes computers other computing and electronic equipment linked to computer hardware electronic data processing equipment Microchips and anything which relies on a Microchip for any part of its operation and includes for the avoidance of doubt any computer installation

Microchip

Microchip means a unit of packaged computer circuitry manufactured in a small scale and made for program logic and/pr computer memory purposes and expressly including integrated circuits and microcontrollers

Virus

Virus means programming code designed to achieve an unexpected unauthorised and/or undesirable effect or operation when loaded onto a System transmitted between Systems by

transfer between computer systems via networks extranets and internet or electronic mail or attachments thereto or via floppy diskettes or CD-ROMs or otherwise and whether involving self replication or not

- 15 Damage or consequential loss of whatsoever nature directly or indirectly caused by contributed to by or arising from:
- a) any actual or alleged failure or inability of any computer Equipment whether or not owned by or in the possession of the Insured:
 - (i) to correctly recognise or to correctly process (including but not limited to capture save retain calculate compare interpret record retrieve sequence read store manipulate write to media determine distinguish convert transfer or execute) Date/Time Material;
 - (ii) to correctly recognise or to correctly process (including but not limited to capture save retain calculate compare interpret record retrieve sequence read store manipulate write to media determine distinguish convert transfer or execute) any data or information as the result of the treatment of any Date/Time Material by such equipment or by any command or instruction which is or has been programmed or in any other manner entered into it;
 - b) any actual or alleged failure to provide or inadequacy of any services whether provided by the insured or any other person or persons due to any actual or alleged failure or inability described at paragraph a) above;
 - c) any advice consultation design evaluation inspection maintenance alteration repair replacement or supervision provided or done by the Insured or for or on behalf of the Insured to determine rectify or test any potential or actual problem described at paragraph a) above.

For the purposes of this exclusion:

1. Computer Equipment means:
- a) computer hardware, including microprocessors
 - b) computer application software
 - c) computer operating systems or related software
 - d) computer networks
 - e) microprocessors (computer chips) not part of any computer system
 - f) any other computerised or electronic equipment
 - g) any other equipment which directly or indirectly contains uses or relies upon in any manner any or the items referred to in a) to f) above
- 2 Date/Time Material means dates times or data or information or command or instruction that in any manner depends upon is contingent upon is derived from or incorporates any date or time irrespective of the manner by which it is stored recorded or entered.
16. DAMAGE or CONSEQUENTIAL LOSS caused by any consequence of war invasion act of foreign enemy hostilities or warlike operations (whether war be declared or not) civil war rebellion revolution insurrection or military or usurped power; nationalisation, confiscation, requisition, seizure or destruction by the government or any public authority.

- 17 Damage to any property whatsoever or any loss or expense whatsoever resulting or arising therefrom or any consequential loss directly or indirectly caused by or contributed to or arising from
- (a) ionising radiations or contamination by radioactivity from any nuclear fuel or from any waste from the combustion of nuclear fuel
 - (b) the radioactive, toxic, explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof.
- 18 Damage to any property whatsoever or any loss or expense whatsoever resulting or arising therefrom or any consequential loss of whatsoever nature directly or indirectly caused by or contributed to by or arising from:
- (A) Terrorism regardless of any other cause or event contributing concurrently or in any other sequence to the loss
- and
- (B) in Northern Ireland

Damage or Consequential Loss caused by

- (1) riot or civil commotion
- (2) strikers locked out workers or persons taking part in labour disturbances or malicious persons but this shall not apply to DAMAGE caused by fire or explosion

This policy also excludes Damage or consequential loss directly or indirectly caused by resulting from or in connection with any action taken in controlling preventing or suppressing or in any way relating to any act of Terrorism

For the purposes of this Exclusion Terrorism shall mean any act including but not limited to the use of force or violence or the threat thereof of any person or group of persons whether acting alone or on behalf of or in connection with any organisation or government committed for political ideological or similar purposes including the intention to influence any government or to put the public or any section of the public in fear.

Specification

Item no	Description	Sum Insured/Limit
1.	Gross Profit	£
2.	Gross Revenue	£
3.	Advance Profit	£
4	Advance Revenue	£
5	Additional Increased cost of Working	£
6	Research and Development Costs	£
7	Fines and Penalties	£/ %
8	Prevention of Access and Loss of Attraction	£ /%
8	Public Utilities	£/ %
9	Contagious Human Diseases	£/ %
10	Suppliers Premises	£ /%
11	Customers Premises	£ /%

Item 1 Gross Profit (Declaration linked basis)

The insurance under Item 1 is limited to loss of Gross Profit due to

- (a) **Reduction in Turnover** and
- (b) **Increase in Cost of Working**

and the amount payable as indemnity hereunder shall be :-

- 1(a) In respect of reduction in turnover the sum produced by applying the Rate of Gross Profit to the amount by which the Turnover during the Indemnity Period shall fall short of the Standard Turnover
- 1(b) In respect of Increase in Cost of Working the Additional Expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of Gross Profit 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 reduction thereby avoided.

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Profit as may cease or be reduced in consequence of the Incident.

Item 2 Gross Revenue

The insurance under Item no 2 is limited to (a) Loss of Gross Revenue and (b) Increase in Cost of Working and the amount payable as indemnity thereunder shall be

- 2(a) In respect of Loss of Gross Revenue the amount by which the Gross Revenue shall fall short of the Standard Gross Revenue in consequence of the Incident.
- 2(b) In respect of Increase in Cost of Working the Additional Expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of Gross Revenue which but for that expenditure would have taken place during the Indemnity Period in consequence of the Incident, but not exceeding the amount of reduction thereby avoided.

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Revenue as may cease or be reduced in consequence of the Incident.

Item 3 Advance Profit

The insurance under Item 3 is limited to loss of Gross Profit due to

(a) **Reduction in Turnover** and

(b) **Increase in Cost of Working**

and the amount payable as indemnity hereunder shall be :-

3(a) In respect of reduction in turnover the sum produced by applying the Rate of Gross Profit to the amount by which the Turnover during the Indemnity Period shall fall short of the Standard Turnover

3(b) In respect of Increase in Cost of Working the Additional Expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of Gross Profit which but for that expenditure would have taken place during the Indemnity Period in consequence of the DAMAGE, but not exceeding the sum produced by applying the Rate of Gross profit to the amount of reduction thereby avoided.

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Profit as may cease or be reduced in consequence of the Incident.

Provided that if the sum insured by this Item be less than the sum provided by applying the Rate of Gross Profit to the comparative Turnover, the amount payable shall be proportionately reduced.

Item 4 Advance Revenue

The insurance under Item 4 is limited to loss of Gross Revenue due to (a) Loss of Gross Revenue and (b) Increase in Cost of Working and the amount payable as indemnity thereunder shall be

4(a) In respect of Loss of Gross Revenue the amount by which the Gross Revenue shall fall short of the Standard Gross Revenue in consequence of the Incident.

4(b) In respect of Increase in Cost of Working the Additional Expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of Gross Revenue which but for that expenditure would have taken place during the Indemnity Period in consequence of the Incident, but not exceeding the amount of reduction thereby avoided.

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Revenue as may cease or be reduced in consequence of the Incident.

Provided that if the sum insured by this item be less than the comparative Revenue the amount payable shall be proportionately reduced.

Item 5 Additional increase in Cost of Working

The insurance under Item 5 is limited to the amount of the Additional Expenditure (in excess of the amount payable under paragraph Item (b) of Gross Revenue, Gross Profit, Advance Profit or Advance Revenue) necessarily and reasonably incurred by the Insured during the Indemnity Period in consequence of the Incident for the sole purpose of avoiding or diminishing a reduction in Turnover or resuming or maintaining normal business.

Limits of liability

Notwithstanding proviso B in the Insuring Clause to this policy

- (i) the liability of the Insurers shall in no case exceed in respect of Gross Profit and Gross Revenue 133.3% of the Estimated Gross Profit and Gross Revenue stated herein, in respect of each other item 100% of the of the sum insured stated herein, nor in the whole the sum of 133.3% of the Estimated Gross Profit and Gross Revenue and 100% of the sums insured by other Items, or such other amounts as may be substituted therefor by memorandum signed by and on behalf of the Insurers.
- (ii) In the absence of written notice by the Insured or the Insurer to the contrary the Insurers' liability shall not stand reduced by the amount of any loss, the Insured undertaking to pay the appropriate additional premium for such automatic reinstatement of cover.

Definitions

Notes:

- 1 To the extent that the Insured is accountable to the tax authorities for Value Added Tax, all terms in this policy shall be exclusive of such tax
- 2 For the purpose of these definitions, any adjustment implemented in current cost accounting shall be disregarded.

Incident

Loss or destruction or damage to property used by the Insured at the Premises for the purpose of the Business.

Indemnity Period

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

In respect of Advance Profit and Advance Revenue the Indemnity Period shall be the period beginning with the date upon which, but for the Incident, the Business would have commenced and ending not later than the Maximum Indemnity Period thereafter during which the results of the Business shall be affected in consequence of the Incident.

Maximum Indemnity Period

.....months

Turnover

The money paid or payable to or earned by the Insured for goods sold and delivered or services rendered in the course of the Business at the Premises

Gross Profit

The amount by which

- (a) the sum of the amount of the Turnover and the amounts of the closing stock and work in progress shall exceed
- (b) the sum of the amount of the opening stock and work in progress and the amount of the uninsured standing charges

Note: The amounts of the opening stock and closing stocks and work in progress will be arrived at in accordance with the insured's normal accountancy methods, due provision being made for depreciation.

Uninsured standing charges

Purchases net of discounts received
Bad debts

Note: The words and expressions used in this definition shall have the meaning usually attached to them in the books and accounts of the Insured.

Rate of Gross Profit

The Rate of Gross Profit earned on the Turnover during the financial year immediately before the date of the occurrence of the Incident

)to which such adjustments shall be made
)as may be necessary to provide for the
)trend of the Business either before or after
)the Incident or which would have affected
)the Business had the Incident not occurred
)so that the figures thus adjusted shall
)represent as nearly as may be practicable
)the results which but for the Incident would
)have been obtained during the relative
)period after the Incident.

Standard Turnover

The turnover during that period in the twelve months immediately before the date of the occurrence of the Incident which corresponds with the Maximum Indemnity Period

Estimated Gross Profit

The amount declared by the Insured to the Insurer as representing not less than the Gross Profit which it is anticipated will be earned by the Business during the financial year most nearly concurrent with the period of insurance (or a proportionately increased multiple thereof where the Maximum Indemnity Period exceeds 12 months)

Gross Revenue

The money paid or payable to or earned by the Insured for services rendered in the course of the Business at the Premises..

Standard Gross Revenue

The Gross Revenue during that period in the twelve months immediately before the date of the occurrence of the Incident which corresponds with the Maximum Indemnity Period

)to which such adjustments shall be made as
)may be necessary to provide for the trend of
)the Business either before or after the
)Incident or which would have affected the
)Business had the Incident not occurred so
)that the figures thus adjusted shall represent
)as nearly as may be practicable the results
)which but for the Incident would have been
)obtained during the relative period after the
)Incident.

Estimated Gross Revenue

The amount declared by the Insured to the Insurer as representing not less than the Gross Revenue which it is anticipated will be earned by the Business during the financial year most nearly concurrent with the period of insurance (or a proportionately increased multiple thereof where the Maximum Indemnity Period exceeds 12 months)

Advance Profit

The amount by which

- (a) the sum of the amount of the Turnover and the amounts of the closing stock and work in progress shall exceed
- (b) the sum of the amount of the opening stock and work in progress and the amount of the uninsured standing charges

Note: The amounts of the opening stock and closing stocks and work in progress will be arrived at in accordance with the insured's normal accountancy methods, due provision being made for depreciation.

Uninsured standing charges

Purchases net of discounts received
Bad debts

Note: The words and expressions used in this definition shall have the meaning usually attached to them in the books and accounts of the Insured.

Rate of Gross Profit

The Rate of Gross Profit that but for the Incident would have been earned on the Turnover during the Indemnity Period

)based upon the estimated production
)programme of the Business, and costs and
)prices relating thereto, to which such
)adjustments shall be made as may be
)necessary to provide for the trend of the
)Business either before or after the Incident
)or which would have affected the Business
)had the Incident not occurred so that the
)figures thus adjusted shall represent as
)nearly as may be practicable the results
)which but for the Incident would have been
)obtained during the relative period after the
)Incident.

Standard Turnover

The turnover that but for the Incident would have been earned during the Indemnity Period

Comparative Turnover

The turnover which but for the Incident would have been earned during the Indemnity Period immediately following the date on which turnover would have commenced to be earned

Advance Revenue

The money paid or payable to or earned by the Insured for services rendered in the course of the Business at the Premises. .

Standard Gross Revenue

The Gross Revenue which but for the incident would have been earned during the Indemnity Period

)based upon the estimated earnings of the
)Business, and costs and prices relative
)thereto, to which such adjustments shall be
)made as may be necessary to provide for
)the trend of the Business either before or
)after the Incident or which would have
)affected the Business had the Incident not
)occurred so that the figures thus adjusted
)shall represent as nearly as may be
)practicable the results which but for the
)Incident)would have been obtained during
)the relative period after the Incident.

Comparative Revenue

The Revenue which but for the Incident would have been earned during the Indemnity Period immediately following the date on which Revenue would have been commenced to be earned

Memoranda

Alternative Trading clause

If during the Indemnity Period goods shall be sold or services shall be rendered elsewhere than at the Premises, either by the Insured or by others on their behalf, the money paid or payable in respect of such sales or services shall be brought into account at arriving at the Turnover during the Indemnity Period.

Accumulated Stocks clause

In adjusting any loss, account shall be taken, and equitable allowance made, if any reduction in Turnover due to the DAMAGE is postponed by reason of the Turnover being temporarily maintained from accumulated stocks of finished goods.

Departmental Clause

If the Business be conducted in departments, the independent trading results of which are ascertainable, the provisions of Items a) and b) of Item 1 shall apply separately to each department affected by the Incident (except that if the sum insured by the said Item be less than the aggregate of the sums produced by applying the Rate of Gross Profit for each Department of the Business (whether affected by the Incident or not) to its relative Annual turnover (or to a proportionately increased multiple thereof where the Maximum Indemnity Period exceeds 12 months) the amount payable shall be proportionately reduced.

Salvage Sale Clause

If, following any Incident giving rise to a claim under this Section, the insured shall hold a salvage sale during the Indemnity Period, clause a) of the Item 1 shall for the purpose of the claim, read as follows:

a) **In respect of Reduction in Turnover** the sum produced by applying the Rate of Gross Profit to the amount by which the Turnover during the Indemnity Period (less the Turnover for the period of the Salvage Sale) shall in consequence of the Incident fall short of the Standard Turnover, from which shall be deducted the Gross Profit actually earned during the period of the Salvage Sale.

Professional Accountants Charges Clause

Any particulars or details in the Insured's books of account or other business books or documents which may be required by the Insurers for the purpose of investigating or verifying any claim under this Section may be produced by professional accountants if at the time they are acting regularly as such for the Insured and their report shall be prima facie evidence of the particulars and details to which such report relates.

The Insurers will pay to the Insured the reasonable charges payable by the Insured to their professional accountants for producing such particulars or details or any other proofs, information or evidence as may be required by the Insurers under the terms or conditions of this Policy and reporting that such particulars or details are in accordance with the Insured's books or accounts or other business books or documents provided that the sum of the amount payable under this Memorandum and the amount otherwise payable under the Policy shall in no case exceed the Limit of Liability Insured by the Policy.

Renewal clause

The Insured shall prior to each renewal provide the Insurer with the Estimated Gross Profit or Estimated Gross Revenue for the financial year most nearly concurrent with the ensuing years of insurance.

Premium Adjustment Clause

The first and annual premiums in respect of Item 1 and 2 are provisional and are based on the Estimated Gross Profit and/or Estimated Gross Revenue

The Insured shall provide to the Insurers not later than six months after the expiry of each period of insurance a declaration confirmed by the insured's accountants of the Gross Profit and/or Gross Revenue earned during the financial year most nearly concurrent with the period of insurance.

If any Incident shall have occurred giving rise to a claim for loss of Gross Profit and/or Gross Revenue the above mentioned declaration shall be increased by the Insurers for the purpose of premium adjustment by the amount by which the Gross Profit and/or Gross Revenue was reduced during the financial year solely in consequence of the Incident.

If the declaration (adjusted as above and proportionately increased where the Maximum Indemnity Period exceeds 12 months)

- a) is less than the Estimated Gross Profit and/or Gross Revenue for the relative period of insurance the Insurers will allow a pro rata return of premium paid on the Estimated Gross Profit and/or Gross Revenue (but not exceeding 50% of such premium(s))
- b) is greater than the Estimated Gross Profit and/or Gross Revenue for the relative period of insurance the Insured shall pay a pro rata addition to the premium(s) paid on the Estimated Gross Profit and/or Gross Revenue

Payments on Account

Payments on account may be made monthly to the insured during the Indemnity Period if desired.

Extensions

Incident for the purpose of this policy. shall include the following where a limit is shown in the Schedule to the Specification:-

Research and Development Costs

The amount of the expenditure necessarily and reasonably incurred to re-constitute records and re-work projects to restore Research and Development Projects to a state substantially similar to that which existed before the date of the Incident

Fines and Penalties

The amount of fines and damages incurred by the Insured during the Indemnity Period for late or non-completion or breach of contracts following the Incident

Prevention of Access and Loss of Attraction

- (a) DAMAGE to property in the vicinity of the Premises;
- (b) unlawful occupation of the Premises by any person but excluding occupation of the Premises by any person or persons taking part in a labour dispute;
- (c) the presence of, or suspected presence of, a harmful device in, or in the vicinity of, the Premises provided that the police or other appropriate statutory authorities are notified immediately;
- (d) closure or sealing off of the Premises or any right of way by the police or other statutory authority

which
- (e) prevents or hinders the use of the Premises or access thereto or, where the Premises forms part of a larger complex development or shopping centre, prevents or hinders the use of the entire complex development or shopping centre or access thereto, causes a reduction in the number of people using the Premises or, where the Premises forms part of a larger complex development or shopping centre, causes a reduction in the number of people using the same.
- (g) *the threat, or fear of imminent DAMAGE or apprehension of the staff of the Insured or persons normally visiting the Premises resulting from the occurrence of DAMAGE*

which shall prevent or hinder the use of the Premises and, where relevant, access thereto or result in loss of attraction to the Insured's Business by customers or potential customers.

Public Utilities

The failure of the public supply of electricity, gas water or any telecommunications network at the terminal ends of the service feeders, gas pipes or water pipes from any cause other than

Exclusions:

- (1) failure due to the deliberate act of the supplier unless done to save life or to safeguard against loss, destruction or damage in the vicinity of such property;

- (2) the failure of any satellite prior to its obtaining its full operating function or whilst in or beyond the final year of its design life;
- (3) atmospheric solar or lunar conditions causing temporary interference with transmission to or from satellites;
- (4) interruption or interference of less than 30 minutes duration in respect of any failure other than telecommunications which shall be four hours
- (5) the deliberate act of a supplier of such services unless done to safeguard human life, to safeguard the property of the supplier or as a result of DAMAGE to the property of the supplier or DAMAGE in the vicinity of such property
- (6) due to default on the part of the Insured;
- (7) due to cessation of work

Contagious Human Disease, Food Poisoning and Other Health Risks

- (a) contagious or infectious or notifiable human illness or disease or the imposition of quarantine restrictions;
- (b) ptomaine or food or drink poisoning or any other food related illness;
- (c) breach of any regulations applying to safety food safety hygiene or fire;
- (d) defective sanitary arrangements;
- (e) death, murder, rape, assault or suicide;
- (f) the impotability of the public drinking water supply;
- (g) accidental or malicious contamination at the Premises of food or drink or food or drink storage systems, air conditioning, heating or ventilation systems or water or sanitary systems;
- (h) the recall of food or drink which is contaminated or which is deemed unfit for human consumption;
- (i) any other accidental occurrence which shall give rise to adverse publicity

and the indemnity provided by this policy is extended to include costs incurred by the Insured in:

- (j) investigating and rectifying any of the above risks
- (k) any programme of crisis management or public relations in connection with such risks.

Premises for the purpose of this policy shall include the following where a limit is shown against the item in the Schedule to the Specification.

- (a) The premises of any of the Insured's suppliers of components materials goods or services

but excluding the premises of suppliers of Public Utilities telecommunication and satellite services.
- (b) The premises of any of the Insured's customers.

General Conditions

1. Policy Voidable

This policy shall be voidable in the event of misrepresentation, misdescription or non-disclosure in any material particular.

2. Alteration

this policy shall be avoided if after the commencement of this insurance

- (i) the Business be wound up or carried on by a liquidator or receiver or permanently discontinued or
- (ii) the interest of the Insured ceases other than by death or
- (iii) any alteration be made either in the business or in the Premises or property therein whereby the risk of loss, destruction or damage is increased

at any time after the commencement of this insurance, unless its continuance be admitted by the Insurers in writing.

3 Warranties

Every warranty to which this policy or any item thereof is or may be made subject shall from the time the warranty attaches apply and continue to be in force during the whole currency of this policy. Non-compliance with any such warranty under Section 1 in so far as it increases the risk of DAMAGE shall be a bar to any claim in respect of such DAMAGE provided that whenever this policy is renewed a claim in respect of DAMAGE occurring during the renewal period shall not be barred by reason of a warranty not having been complied with at any time before the commencement of such period.

4 Reasonable Precautions

The insured shall take all reasonable precautions to prevent DAMAGE.

5 Cancellation

This Policy may be cancelled by the Insured, or by the Insurers only, by sending by registered mail written notice to the Insured when not less than (60) sixty days thereafter such cancellation shall be effective. The mailing of notice as aforesaid shall be sufficient proof of notice. The time of surrender or the effective date and hour of cancellation stated in the notice shall become the end of the period of Indemnity. Delivery of such written notice either by the Insured or by the Insurers shall be equivalent to mailing. If the Insured cancels, earned premium shall be computed in accordance with the customary short period rate table and procedure. If the Insurers cancel, earned premium shall be computed pro rata. Premium adjustment may be made either at the time cancellation is effected or as soon as practicable after cancellation becomes effective, but payment or tender of unearned premium is not a condition of cancellation.

6 Inspections

The Insurers shall be permitted but not obligated to inspect the Insured's property and operations at any time. Neither the Insurers' right to make inspections nor the making thereof nor any report thereon shall constitute an undertaking on behalf of or for the benefit of the Insured or others, to determine or warrant that such property or operations are safe. The Insurers may examine and audit the Insured's books and records at any time during the Period of Indemnity and extensions thereof and within three years after the final termination of this Policy, as far as they relate to the subject matter of this insurance.

Claims Conditions

1. Action by the Insured

- (a) In the event of any loss, destruction or damage in consequence of which a claim is or may be made under this policy the Insured shall
 - notify the insurers immediately
 - deliver to the Insurers at the Insured's expense within 7 days of its happening full details of the loss, destruction or damage caused by riot, civil commotion, strikers, locked out workers, persons taking part in labour disturbances or malicious persons
 - with due diligence carry out and permit to be taken any action which may be reasonably practicable to minimise or check any interruption or interference with the Business or to avoid or diminish the loss
 -
- (b) In the event of a claim being made under this policy the Insured at his own expense shall
 - not later than 30 days after the expiry of the Indemnity Period or within such further time as the Insurer may in writing allow, at his own expense deliver to the Insurer in writing particulars of his claim together with details of all other insurances covering the Damage or any part of it or consequential loss of any kind resulting therefrom. The Insured shall at his own expense also produce and furnish to the Insurer such books of account and other business books, vouchers, invoices, balance sheets, and other documents, proofs, information, explanation and other evidence as may reasonably be required by the Insurers for the purpose of investigating or verifying the claim together with, if demanded, a statutory declaration of the truth of the claim and of any matters connected with it
 -
- (c) If the terms of this condition have not been complied with:
 - no claim under this policy shall be payable and
 - any payment on account of the claim already made shall be repaid to the Insurer forthwith

2 Fraud

If any claim is in any respect fraudulent or if any fraudulent means or devices be used by the Insured or anyone acting on his behalf to obtain any benefit under this policy or if any Damage be occasioned by the wilful act or with the connivance of the Insured all benefit under this policy shall be forfeited.

3 Contribution

If at the time of any loss, destruction or damage resulting in a loss under Section 2 of this policy there be any other insurance effected by or on behalf of the Insured covering such loss or part of it the liability of the Insurers shall be limited to their rateable proportion of such loss.

5 Subrogation

Any claimant under this policy shall at the request and expense of the Insurer do and concur in doing and permit to be done all such acts and things as may be reasonably necessary for the purpose of enforcing any rights and remedies or of obtaining relief or indemnity from any other party to which the Insurer shall or would become entitled to be subrogated upon its paying for or making good any loss under this policy, whether such acts or things be or become necessary or required before or after his indemnification by the Insurer.

7 Arbitration

If any difference arises as to the amount to be paid under this policy (liability being otherwise admitted) such difference will be referred to an arbitrator to be appointed by the parties in accordance with statutory provisions. Where any difference is by this condition to be referred to an arbitrator, the making of an award shall be a condition precedent to any right of action against the Insurer

Appendix 2 – Global Master Policy operative clause

Difference in Conditions and Difference in Limits

This Policy shall not apply to any cover that is the subject of any more specific insurance or to the amount of any retained deductible or excess in any such policy other than in respect of:

- (i) any cover for which an indemnity is not afforded by such policies because of limitations in cover;
- (ii) any excess cover beyond the amount payable by such policy provided that the Limits of Indemnity under this Policy shall be reduced by the Limits of Indemnity afforded by such more specific insurance.

This Policy is primary with respect to any other insurance available to the Insured if such other insurance was purchased by and issued to the Insured specifically to apply in excess hereof. This Policy shall apply in excess of all other insurance available to the Insured and then shall apply only in the amount by which the applicable Limits of Indemnity of this Policy exceeds the sum of the applicable limits of all such other insurance including any deductible provisions thereof.

Without waiving any of the foregoing, if any Insurers affording other insurance to the Insured denies primary liability under its policy, the Insurer hereunder will respond under this Policy as though such other insurance were not available provided that they shall be subrogated to all rights of the Insured to such other insurance and the Insured shall do all things necessary to enforce such rights.

The insurance afforded by this Policy is to apply as difference in limits over and difference in conditions to the limits and cover afforded by any other valid and collectible primary insurance purchased locally as cover underlying this Policy.

Where any amounts paid by the Insurer under policies attaching to and forming part of this Policy exceed the aggregate Limits of Indemnity stated in the Schedule all such excess amounts shall be recoverable from the Insured.

The Insured hereby undertakes to keep in full effect during the currency of this policy any local primary insurance policies declared to insurers at inception or renewal hereof.

Appendix 3 US Gross Earnings definition and extension

Gross Earnings

Gross Earnings is limited to loss due to reduction in Gross Earnings and the amount payable as indemnity thereunder shall be the actual loss sustained by the Insured during the Period of Restoration and resulting directly from interruption of or interference with the Business solely in consequence of Damage (other than Damage to finished Stock) but not exceeding the reduction in Gross Earnings less charges and expenses which do not necessarily continue during the interruption or interference with the Business, due consideration being given to the continuation of normal charges and expenses, including payroll expenses, to the extent necessary to resume operations of the Insured's Business with the same quality of service which existed immediately preceding the date of the Damage.

Extension

Extended Period of liability

The Gross Earnings coverage is extended to cover the reduction in sales from:

1. The interruption of business as covered by Gross Earnings
2. for such additional length of time as would be required with the exercise of due diligence and dispatch to restore the Insured's business to the condition that would have existed had no loss occurred, and
3. commencing with the date on which the liability of the Insurers for loss resulting from interruption of business would terminate if this extension had not been included herein.

However, this extension does not apply to Gross Earnings loss resulting from physical loss or damage caused by or resulting from Terrorism.

As respects Extended Period of Liability, the Time Element Exclusions B of this section does not apply and the following applies instead:

This policy does not insure against any increase in loss due to fines or damages for breach of contract or for late or non-completion of orders, or penalties of any nature.

Coverage under this Extension for the reduction in sales due to contract cancellation will include only those sales that would have been earned under the contract during the extended period of liability.

Coverage under this extension does not apply for more than the number of consecutive days shown in the Limits of liability clause of the Declarations section.

Appendix 4. Flexible Limit of Loss specification

<u>Item No.</u>		<u>Loss limit</u>
1.	Maximum Amount Payable under this policy	£

The Insurance under this policy is limited to

- (a) Loss of Gross Revenue
- and
- (b) Increase in cost of Working

and the amount payable as indemnity hereunder shall be :-

(a) **In respect of Loss of Gross Revenue** the amount by which the Gross revenue shall fall short of the Standard Gross Revenue in consequence of the Damage

(b) **In respect of Increase in Cost of Working** the Additional Expenses necessarily and reasonably incurred in consequence of any interruption or interference with the business in consequence of the Damage

Less any sum saved in respect of such of the charges and expenses of the business payable out of Gross Revenue as may cease or be reduced in consequence of the Damage.

Deductible

The Insurers shall not be liable for the first £ of any loss as ascertained after the application of all other terms and conditions of this Policy.

DEFINITIONS

The Business

The Premises

Any premises owned occupied or utilised by the Insured in Great Britain, Northern Ireland, Isle of Man or Channel Islands for the purposes of the Business.

Gross Revenue

The money paid, payable to or earned by the Insured for services rendered in the course of the Business at the Premises.

Standard Gross Revenue

The Gross Revenue during the period)
in the twelve months immediately)
before the date of)the occurrence of)
the Damage)

to which such adjustments shall be made as may be necessary to provide for the trend of the Business either before or after the Damage or which would have affected the Business had the Damage not occurred so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which but for the Damage would have been obtained during the relative period after the Damage

CLAUSES

Professional Accountants Clause

Any particulars or details contained in the Insured's books of account or other business books or documents which may be required by the Insurer under the terms of *claims condition 1* of this policy for the purpose of investigating or verifying any claim hereunder may be produced by professional accountants if at the time they are regularly acting as such for the Insured and their report shall be prima facie evidence of the particulars to which such report relates.

The Insurer will pay to the Insured the reasonable charges payable by the Insured to their professional accountants for producing such particulars or details or any other proofs information or evidence as may be required by the Insurer under the terms of *claims condition 1* of this policy and reporting that such particulars and details are in accordance with the Insured's books of account or other business books or documents.

provided that the sum of the amount payable under this clause and the amount otherwise payable under the policy shall in no case exceed the maximum liability of the Insured as stated.

Departmental Clause

If the Business be conducted in departments the independent trading results of which are ascertainable the provisions of clauses 1a) and 1b) of this policy shall apply separately to each department affected by the damage, subject always to the maximum limit payable.

Automatic Reinstatement of Loss Clause

In the absence of written notice by the Insurers or the Insured to the contrary the insurance by this section shall not be reduced by the amount of any loss and in consideration the Insured shall pay the appropriate extra premium on the amount of the loss from the date thereof to the expiry of the period of insurance.

Payments on Account Clause

Payments on account may be made to the Insured during the period of loss if required.

Public Relations Expenses Clause

The insurance by this section extends to include reasonable expenses incurred by the Insured to sustain good public relations or public or market confidence which but for that expenditure could be prejudiced following damage as insured by this policy.

Appendix 5 Specimen Gross Profit declaration Form

<u>Annual Turnover</u>	£	
Plus Closing Stock and Work in Progress	£ _____	
		£
Less Opening Stock and Work in Progress	£	
plus		
<u>Uninsured Variable Costs</u>		
1. Purchases (net of discounts)	£	
2.	£	
3.	£	
4.	£	
5	£ _____	
		£ _____
Annual Gross Profit for the purposes of the policy		£ _____
Pro rata for Indemnity Periods in excess of 12 months		£ _____
(Rate of Gross Profit (GP divided by Turnover x 100) =	%)	