THE BASIC BUSINESS INTERRUPTION BOOK

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Foreword

This book fills a gap that has existed for too long now. Introductory books and manuals are almost an endangered species. In house guidance produced by employers to assist in the development and training of staff exists, but this material is kept in house.

This manual has been written by BI practitioners as a practical guide for practitioners. Most BI claims are relatively straightforward and are not beset with a series of heffalump traps. Armed with a sound understanding of the fundamental principles of BI, such as this book provides, the vast majority of BI claims can be settled to the satisfaction of all interested parties. At the same time the book flags up those issues where additional research and experience may need to be brought to bear.

Sources of additional analysis, such as Riley on Business Interruption Insurance and Business Interruption Policy Wordings – Challenges Highlighted by Claims Experience, provide in depth coverage of the topic of BI. The latter, recently republished, concentrates on recurring issues surrounding policy wordings but it presupposes a detailed knowledge and experience of matters pertaining to BI. This book does not assume any prior BI knowledge – the reader is, however, expected to be familiar with the fundamental principles of insurance, in particular commercial property coverage.

The authors and contributors to this book are to be applauded for producing this excellent introduction to Business Interruption. And let no one be under any illusion, a short and concise introduction to any topic, not least BI, is far more difficult to compose than a detailed lengthy study. After all it was Mark Twain who said, “I didn’t have time to write a short letter, so I wrote a long one instead.” This book is a short letter that has been worth the wait.

Harry Roberts
Associate, Camford Sutton

ABBREVIATIONS

Common abbreviations used throughout this book are as follows:

Abbreviation	Term
AICW	Additional Increase in Cost of Working
ALOP	Advance Loss of Profits
BI	Business Interruption
CBI	Contingent Business Interruption
CILA	Chartered Institute of Loss Adjusters
DSU	Delay in Start-up
GP	Gross Profit
ICW	Increase in Cost of Working
IP	Indemnity Period
MIP	Maximum Indemnity Period
P	Policyholder
PD	Property Damage
ROGP	Rate of Gross Profit
SP	Selling Price
VAR	Value at Risk
VAT	Value Added Tax
WAD	Wide Area Damage

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1

INTRODUCTION TO BUSINESS INTERRUPTION INSURANCE

1. Introduction to Business Interruption Insurance

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The main purpose of this book is to provide a practical insight into dealing with claims, rather than arranging policy cover.

The content assumes a basic familiarity with PD claims, albeit not with BI.

BI insurance aims to put the P back into the position that they would have been in BUT FOR the Damage or loss that has occurred to P's physical assets.

Hopefully, P will have arranged sufficient insurance for their physical assets – Buildings, Plant/Contents, and Stock – to allow repairs/ replacement to be carried out. Business Interruption ('BI') insurance is needed to pay for:

- Period of repair: the Revenue/Gross Profit (depending on the cover in place) that the damaged assets would have otherwise produced
- Period of recovery: any ongoing covered impact after repair/ replacement until the business is in the same position that it would have been in if the Damage had not occurred.

1.1 Property Damage and Business Interruption

Before handling BI losses, many practitioners have experience of dealing with PD claims. While BI and PD are inextricably linked – BI is the significant and inevitable financial consequence of PD – there are some differences between the two that it is useful to highlight:

Business Interruption

Addresses future loss (that can be mitigated)

Is intangible (and is therefore perceived as complex)

Can increase if P does nothing (and is therefore perceived as more onerous to deal with)

Property Damage

Primarily deals with historic Damage

Relates to physical things that can be assessed and measured

Is largely a fixed amount that needs to be measured and agreed

1.2 Core Cover

BI cover is typically triggered by Damage to physical assets used (but not necessarily owned) by P at P's Premises. There is usually a requirement that such Damage is covered by an insurance policy.

Over and above that, cover has evolved to reflect the fact that there are many things that can cause a loss of profit, in addition to Damage at the Premises such as:

- Denial of access: customers unable to visit P because of damage near the Premises
- Loss of an attraction that draws customers to P
- Failure of power supplies or telecommunications to the Premises
- Damage at suppliers' or customers' premises
- Notifiable disease.

These are still commonly referred to as extensions, although in reality many of these are now universally seen in policies and are in effect part of the core cover.

Addressing the issues above, the first part of this book deals with the triggers for cover.

The second part addresses how the cover works once it has been triggered and how the loss is quantified.

While policies usually insure profit, or revenue, rather than cash flow, the scope of cover typically mirrors the cash impacts that do arise:

Impact of Damage	Typical BI policy cover caption
Revenue reduces	Gross Profit or Gross Revenue
Costs increase	Increase in Cost of Working
Costs decrease	Savings

There is nothing complex about the intention of BI cover.

1.3 Gross Profit

The most common form of BI cover is for loss of Gross Profit, setting out steps as follows:

- Agree the revenue that would have been earned in the period affected by the Damage
- Deduct the actual revenue earned (if any) to produce a shortfall
- Apply to that shortfall the Rate of Gross Profit as defined in the policy
- Add any increased costs incurred to avoid a reduction in revenue
- Deduct any costs that P has not incurred, but which would normally have been incurred, to generate the lost revenue, had the Damage not occurred
- Apply any proportionate reduction (average) in accordance with the terms of the policy.

1.4 Increase in Cost of Working

The cover for ICW is arguably the most important element of a BI policy, as it supports mitigation, for the benefit of all.

If P can avoid losing or reduce the extent of any loss of revenue, say by subcontracting or arranging overtime working, then when the Damage is repaired, the loss should abate.

This contrasts sharply with a situation where there is no opportunity to mitigate and customers go elsewhere – even after the repairs are completed, the loss will continue, potentially for years.

P needs to understand that there is cover for increased costs, as it may be the opposite of what they expect. Insurers want money to be spent to mitigate loss. It is in the interests of *both* insurers and P to maintain revenue and keep the customer base intact.

1.5 Indemnity Period/ Maximum Indemnity Period

Insurers cannot provide unlimited coverage for a BI loss, as that could continue for years. They need a cut-off point to allow amounts at risk to be estimated and premiums to be set.

So, P can choose for how long after the Damage has happened they want to be able to claim BI losses. This period is known as the MIP.

The IP (almost always) starts at the date of Damage and ends when the business is no longer affected by it, or when the end of the MIP is reached.

The actual period affected is known as the IP and the MIP is the point at which the policy ceases to respond.

1.6 Consequences and Policy Cover

It is important to appreciate that **not all impacts of an incident are covered**. Just because something is not covered by the PD section of a policy does not mean that it will be automatically form part of a BI claim. BI cover is not there to act as a 'sweeper' for anything not covered elsewhere.

BI insurance used to be called consequential loss cover – that caused expectation issues, as it implied that all consequences are covered. They are not.

1.7 Policy Wordings

Historically, policies used similar words, drawing on the recommended Practices and Wordings issued by the Association of British Insurers in 1986. BI texts have commonly quoted these as a reference. While that may have been useful, as it provides a reference point for commentary, there is now sufficient divergence in wordings, both intentional and otherwise, that there is no longer a standard form of words that can be assumed.

Therefore, example policy wordings are not included in this book, but instead attention is drawn to specific core features that most policy wordings will incorporate.

For any claim, it is essential to consult the actual policy wording that has been issued. It is not advisable to assume what a policy wording says.

1.8 Cash Flow and Interim Payments

BI policies cover Gross Profit (or sometimes Gross Revenue), rather than cash flow. There are some things that policies cannot assist with, such as the timing of payment of indirect tax liabilities (VAT in the UK).

Notwithstanding that, consideration should always be given to recommending interim payments (often called payments on account), particularly early in a claim (after liability has been admitted). This should inspire P to mitigate the loss generally.

2

IS IT COVERED?

2. Is it covered?

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2.4 Not All Consequences are Covered

2.1 The Operative Clause

All policies will contain a clause setting out the trigger for cover – generally referred to as an 'Operative Clause'. Those words are not universally adopted and terms such as 'Cover', 'Insuring Clause', 'Insuring Agreement', etc are also used.

The operative clause is included at different points in different policies, but the key requirements commonly required are:

- Damage
- To property owned or used by the Insured
- At the Premises
- For the purpose of the Business
- And confirmation of indemnity under a PD cover and payment made under that (although PD loss within an excess usually does still trigger the BI cover).

It is necessary to relate all elements of a BI claim back to the operative clause, rather than sweeping up all impacts of an incident.

As discussed below, not all consequences of an incident are covered.

2.1.1 Damage

Definition

Many policies define Damage as 'Damage or loss'. That is not always helpful as a definition, and in particular it does not clarify whether temporary loss of use of an asset satisfies the terms of the policy.

'Damage' does not have to be permanent – for example, smoke contamination affecting assets is temporary if it can be cleaned off. In contrast, 'loss' *does* have to be permanent – seizure of assets by a government agency, foreign government or any third party, where those assets are subsequently returned, would not constitute loss, even if the loss of use of the assets causes a reduction in revenue.

In the case of theft, it is reasonable to assume that there is an intention to permanently deprive P of the assets taken, in most circumstances. Only rarely is it necessary to take specific instructions from insurers (removal of assets by a related party where ownership is disputed would be an example of where that might be required).

In practice, this can be a difficult issue. It may be reasonable to accept that loss is permanent in the absence of any indication of the potential return of assets.

A common dictionary definition of the word Damage would be 'injury or harm impairing the function or condition of a person or thing'.

BI policies do not usually cover loss flowing from injury to people, only loss flowing from Damage to insured property.

For example, if a gun explodes at a gunsmith, injuring the hand of the sales director, there may be chauffeur charges because he can't drive and a revenue loss because he can't shake hands with customers and avoids introductions. In such a case, loss flows from injury to a person, not from Damage to Insured property.

It has been suggested that it would be useful if policies explicitly clarified whether or not temporary impairment of use constituted Damage, albeit few wordings do so.

Frozen water pipes at a hotel might be undamaged but could render the business inoperable. For domestic policies, it is an accepted principle that a blocked pipe is a pipe that has suffered Damage. That does not necessarily apply to a *commercial* P.

The BI loss must flow from the Damage

For the BI cover to respond, it is not enough for there to merely have been Damage; the loss that has been suffered must flow from that Damage. Sometimes, there has been Damage, but the loss flows from something else and is not covered by the policy.

For example, consider two sandwich shops where neighbouring offices have suffered explosion damage. The explosion creates a small crack in the bottom corner of the front window of one of the shops and the other suffers no direct damage. Both are likely to suffer significant Gross Profit losses.

In reality, it is not the cracked window that will cause the BI loss in this instance. Losses at both shops will occur because the neighbouring office buildings have been damaged and the customer base is temporarily absent. There is no causal link between the window Damage and reduction in turnover. The BI loss will not be covered (subject to discussion about extensions below).

Again, P's Premises could be damaged by fire just before a new bypass around the town opens – there may have been a reduction in revenue even had the fire not happened. Not all of the reduction would necessarily flow from the Damage.

Concurrent causes of Damage/loss

It may be the case that loss flowing from Damage is difficult to separate from loss flowing from other causes, or loss may be exacerbated by other factors.

The legal position (in England and Wales) with regard to concurrent causes of loss (where the impact of each cannot be separately assessed) is as follows:

Causes	Scenario	Policy response
Insured and uninsured	Fire Damage at P's premises (insured) Competitors contact customers advising that P cannot supply product (uninsured)	Insurers pay the full amount
Insured and excluded	A machine head falls onto the bed (insured) This follows a failure of a bearing which takes longer to repair than the impact Damage (wear and tear excluded)	Insurers pay nothing

Exacerbation of loss may arise through the agency of the Health and Safety Executive, for example, or the police declaring P's premises a crime scene – perhaps a body has been deposited and a fire started to hide this. Technically, such exacerbation is not covered.

In practice, if there has been Damage, insurers will not seek to exclude elements of loss for reasonable periods of delay. However, if a year after the Damage, P still has not commenced repairs that should take say four months, then it may be unreasonable to expect the policy to address the full amount of the BI loss.

The key task in complicated circumstances is to identify the *dominant* cause of loss. This need not be the thing that happened most recently.

While not a modern case, *Leyland v NU (1918)* summarises this perfectly.

During the First World War, a boat was torpedoed on the way to Le Havre. The harbour was full and the boat had to anchor outside, where it subsequently sank as a consequence of very bad weather.

While the proximate cause was storm, the dominant cause was war perils; war was an excluded cause and the BI loss was not covered.

Wide Area Damage (WAD)

WAD refers to instances of widespread damage, predominantly caused by flooding, to P's property at the premises and damage to buildings and infrastructure (including roads) in the surrounding area.

Where WAD occurs, policy wordings (in the UK) technically require any BI loss to be calculated on the presumption of there being no Damage at the premises but damage still impacting everywhere else. In other words, loss should be calculated as if there was an invisible force field surrounding the premises.

The seminal case that confirmed this principle is *Orient Express Hotels v Generali (2010)*. This case related to hurricane Katrina in 2005 and the key points are as follows:

- The 23-storey Windsor Court Hotel was physically damaged by hurricanes Katrina and Rita in August/September 2005, reopening on 1st November 2005
- Simultaneously, widespread flooding occurred in New Orleans. There was a mandatory evacuation and a curfew imposed from late August to the end of September
- Insurers/loss adjusters took the view that, even if the hotel had not suffered Damage, it would not have had any guests due to the general impact on the city, including the curfew that had been imposed
- Orient Express challenged that position, observing that:
  - The assumption of flooding stopping at an invisible wall around the premises is artificial
  - The insurers' argument reduced their exposure as a consequence of the scale of damage increasing
  - The general principle of concurrent causes was being ignored.

The dispute was arbitrated, with the arbitrators supporting the position of the insurers. Even if there had been no Damage at the Premises, the BI loss that impacted the hotel would still have arisen.

The arbitration tribunal finding was challenged by Orient Express under the Arbitration Act 1996 (English law was specified in the policy).

The case was heard in the Royal Courts of Justice in London, which essentially agreed with the insurers' position. The Damage at the Premises did not cause any additional loss to that already presenting itself (due to the flooding across the city).

From a technical perspective, the court correctly applied the policy wording, given that the cover is predicated on there being Damage at the Premises.

However, the outcome satisfies nobody. P may have suffered Damage, but their BI cover is nullified by damage suffered by everybody else. So, the greater the amount of damage in an area, the less insurers pay in respect of BI losses suffered.

In practice, this is a difficult message to deliver and insurers' input is likely to be required. Insurers' responses vary.

2.1.2 Owned or Used By

Not all policies use these actual words. In relation to 'Property Insured', some policies use the term 'property *owned* by P' and many are more expansive and refer to 'property *owned or used* by P'.

It should be appreciated that restricting cover to BI loss flowing from Damage to property *owned* by P is a significant reduction in cover compared to 'owned or used by'. For example, if a building suffers Damage, but not the contents, any BI loss suffered by the tenant would not be covered if 'used by' did not form part of the wording, as they do not own the building. Claims handlers should consult the actual policy wording that has been issued.

Ownership is usually an uncontentious issue, albeit some forms of lease can cause confusion (such as whether a lessee is required to insure and whether that is required on a reinstatement or indemnity basis).

The term 'used by' can be less straightforward. It does not mean 'in use at the time of an incident' – otherwise, many businesses would have no cover when closed at weekends (and many significant fires have arisen and developed at weekends).

Wordings do not specify that the usage has to be profitable or state the regularity of use required to satisfy cover. In some cases, the property damaged may never have been used.

Consider the following:

- P purchases a 5-year-old production line at auction and stores it in their factory building, intending to install it in the near future. The plant and machinery sum insured is increased to take account of it. There is a flood which only affects the production line, writing it off. Should any business interruption loss be payable?

In that case, the insurer treated the property as being 'used by' P. It was being stored for the benefit of the business, and the insurer was influenced by the fact that the contents sum insured had been increased at the time of its purchase.

The onus was still on P to evidence when the plant would have been installed and commissioned, and was only able to claim for BI loss from that point.

In some cases, P's business may be the provision of services to customers' assets, e.g. boats, cars or other plant/ contents, and there can be Damage to the customers' assets at the Premises without there being Damage to the property of P. The customers' insurers may require the damaged assets to be taken elsewhere for repair. In the interim, they will not need to be stored or maintained, and P may suffer a reduction in revenue.

Technically, P is not using the assets of the customers (although they do derive income from those), but rather P's tools and facilities may be used in conjunction with or in relation to services connected with the customers' assets. Unless express provision is made in the policy to address customer assets, or assets in the care, custody and control of P, cover may not be in place for BI losses flowing from Damage to those. It would be for insurers to make a commercial decision as to whether they will deem Damage (solely to customers' assets) to be a trigger for any BI cover.

2.1.3 The Insured

P will be a legal entity – an individual, partnership, charity or limited company.

Legal status is not always properly disclosed. For example, what is presented to insurers as a limited company may in fact be a partnership. In many cases, this may be a technical matter rather than something that alters the risk profile, but that is not always the case. If one or more partners (which insurers may be unaware of) have criminal convictions or historic insolvency issues, that might be viewed as a moral hazard or fraud.

It is not possible to insure as undisclosed agent on behalf of somebody else. It is possible to arrange insurance for somebody else as a *disclosed* agent – that is what insurance brokers do.

Sometimes, it might be considered that the scope of the entities that constitute P has not been fairly presented at inception/ renewal. For example:

- P makes components as a sole trader and takes out policy cover in that capacity

- P's only customer is a partnership between them and their spouse. The partnership stores the components before selling them on to external customers
- There may be a fire that prevents manufacturing for say six months, within which time P does not sell to the partnership. In that period, the partnership maintains external sales as a consequence of having previously held excessive levels of stock (which are not subsequently rebuilt).

P has suffered a reduction in revenue. However, the fact that sales are all made to a related party is something for insurers to consider. Had they known this, would they have been willing to insure only P? Should the business insured have included the partnership also?

It might be considered artificial for P to claim lost sales to themselves (as in this example the partnership will enjoy a cost reduction equal to the lost sales).

Insurers would want to consider such instances on their merits.

It is worth noting that not all related party transactions are a problem. Post loss, P might own other property into which an insured business is able to relocate, and it is uncontentious for the insured business to pay a market (but not excessive) rent to P, claimable as an increased cost. The fact that they have available property will make occupation faster and assist mitigation.

A final observation about the identity of 'the insured' relates to groups of companies. It is necessary to ensure that the schedule reflects the current group structure. Many group policies identify P as 'X Ltd and subsidiary and associated companies'. In fact, group restructuring may result in a new holding company, Y, that owns X and also directly owns other operating subsidiary companies.

A fire at one of those other subsidiaries may not trigger business interruption cover if the identity of P has not been updated to 'Y Ltd and subsidiary and associated companies'.

2.1.4 At the Premises

Many policies do not define the term 'premises' at all. Sometimes, 'Premises' has a capital letter but remains undefined. Where it is a defined term, this is often merely a reference to an address in the schedule.

That produces uncertainty as to whether BI cover flows from Damage to property within the entire site or just the buildings on it.

A surveyor would understand the term 'premises' to mean a demised site. This includes car parks, outhouses, fences, etc, as well as the buildings on the premises.

That is consistent with many dictionary definitions, for example: *Building and the grounds/Land and the buildings on it/a piece of real estate.*

However, there is an insurance complication as that definition has already been applied to a different term – 'Buildings'. Note that this is part of the PD cover only and not the whole policy (or the BI section).

The fact that the BI cover does not use the same terminology in relation to the structural assets as the PD is an anachronism. Historically, P would have had separate insurance policies covering their PD and BI risks. The former referred to 'Buildings' and the latter to 'Premises'. It is now near universal for one commercial combined policy to insure all of the risks, and confusion can arise in a number of instances:

- For a fourth floor office, is the Premises just that floor, that floor and the other common areas (such as ground floor reception) or the whole building?
- For a unit in a shopping centre, is the Premises the unit only or the whole mall?
- Does Damage to stock outside the buildings but within the curtilage constitute Damage at the Premises?
- What are the Premises for concessions within supermarkets/department stores, fitness clubs or third party operated restaurants in hotels?

Some policies define Premises precisely. From the perspective of contract certainty, all should. Or the term 'Buildings' could apply to the whole policy rather than simply the property damage section.

Not all businesses generate revenue at their Premises. Contractors, for example, may generate their income on construction sites. A wider definition of Premises is likely to be of benefit to P in this case.

P might outsource all of its manufacturing operations, but have an insurance policy that identifies P's office accommodation as the Premises. A fire at the outsource contractor could produce significant loss to P that would not be covered (subject to discussion about policy extensions below).

2.1.5 For the Purpose of the Business

The business operations/activities of P need to be accurately described in the policy wording and schedule. This is unlikely to be an issue for the main business operation, but there have been incidents where the full scope of activities, services and operations have not been comprehensively defined.

It is not uncommon to encounter problems in respect of ancillary operations. For example, outbuildings may have been let to tenants, but the need to advise insurers that P is now a landlord with a rental income stream may have been overlooked. If P is described as a component manufacturer, any loss of rental income flowing from Damage would not be covered. The description of P as a landlord should have been added to the policy schedule.

2.1.6 Material Damage Proviso

Most business interruption covers require Damage to have occurred and for the loss to flow from that Damage.

Additionally, there is a requirement for there to have been a payment in respect of that Damage. Most policies state that, where the loss falls below the level of an excess or deductible and liability would otherwise have been admitted, then the BI cover will still respond. This is known as ‘the material damage proviso’ (although that term almost never appears in policy wordings).

The proviso is not qualified but merely requires some quantifiable damage – £1 of damage will satisfy it as much as £1,000,000. Consequently, it is possible for modest PD to give rise to significant BI losses.

A promotions company offering to add customer logos to marketing gifts may have samples stolen or damaged and be unable to secure significant contracts. In the run-up to major sporting events, those losses could be substantial.

Once the material damage proviso is satisfied, the operative clause will respond to BI losses flowing from any of the Damage, not just the Damage that satisfied the proviso.

P may be a retail tenant in a shop that has flooded. P’s wet carpet might be replaceable within a few days, but the underlying concrete floor (owned by the landlord but clearly used by P) might take a month to dry out properly.

Damage to the carpet satisfies the proviso, but the policy would respond to BI losses flowing from all Damage caused by the peril. The BI cover would not be restricted to the replacement period of the carpet only.

The proviso needs to be satisfied only once. It does not have to be satisfied repeatedly for each element of the BI loss flowing from the Damage.

The need for the proviso to be included in modern policies could be questioned. Its existence was essential when BI and PD insurance was purchased separately, the BI insurer essentially following the position of the PD insurer. This avoided duplication of investigation and cost. That is not an issue where the same insurer is covering both aspects.

A second objective of the proviso has been to ensure that funds are available to carry out repair/reinstatement, thereby mitigating any BI loss. That is not always the case, as there is no requirement for the property insurance to be adequate.

Very severe PD underinsurance fundamentally undermines the presumption of funds being available from insurance.

In some cases, PD underinsurance is so significant that assets are not replaced in a reasonable time and the BI loss is exacerbated. In those cases, the additional element of BI loss would not be covered (albeit in practice it is often difficult to quantify that).

On the other hand, regardless of any underinsurance, if P has funds available to carry out repairs without delay, there would be no impact on the BI loss.

2.2 Extensions

The core BI cover is based on Damage at the Premises. However, recognising the increasingly complex dependencies and exposures away from the Premises, extensions to the core cover are now standard across many policies. It is misleading to view these as unusual extras, as they have become part of the core cover.

Extensions to the core cover (Damage at the Premises) are often referred to as contingent BI covers (or ‘CBI’).

The most commonly seen are:

- Denial of access
- Loss of attraction
- Failure of utilities
- Damage at suppliers/customers
- Notifiable disease.

The operation of cover is the same for extensions as that flowing from Damage at the Premises – they just represent different triggers for cover.

One technical point is that the term 'Damage', while having a capital letter and therefore being a defined term in respect of Damage at the Premises (notwithstanding the imperfect definition of that term discussed above), tends not to be a defined term in extension wordings. Extensions often refer to damage (not Damage).

Potentially, this means that a wider scope of damage is covered by the extensions than at the Premises themselves. It is unlikely that this is the intention. Some policies require the damage triggering cover under extensions to constitute Damage that would be covered if it occurred at the Premises themselves.

2.2.1 Denial of Access

Denial of access cover is offered both in terms of damage to property in the vicinity of P's Premises (that impacts on their business) and also non-damage restrictions (by the local authority or police).

Damage Denial of Access

This extension acknowledges that damage to the property of others, close to P's property, can have a significant impact on P's business.

The name of the extension is misleading, as very few wordings require an absolute denial of access – a hindrance or sometimes merely a restriction on operations at P's Premises due to damage in the vicinity is covered.

Typical aspects of this cover are:

- Prevention or hindrance of access to the Premises
- Or loss of use of the premises
- Due to damage to property
- In the vicinity.

Hindrance is rarely a defined term. Damage in the vicinity could cause a hindrance of access to vehicles but not pedestrians, for example. If vehicle access is important for P, that would still trigger cover.

It should be borne in mind that the policy cover still requires fortuitous Damage – roadworks may cause a hindrance of access but would not trigger policy cover (unless explicitly covered).

The majority of wordings cover denial/hindrance of access to, but not explicitly denial/hindrance of egress from, P's premises. Some businesses operate one-way systems on their sites, with a view to health and safety or efficiency, and would see few customers entering the site if they could not subsequently leave.

Technically, that is not a denial of access, but the policy would respond if the wording included cover for loss of use of the premises due to damage in the vicinity.

The requirement for the denial/hindrance to flow from damage in the vicinity is important – this cover is intended to respond to a physical hindrance/denial due to actual damage in the vicinity. A disinclination to travel on the part of customers, perhaps caused by anticipated congestion or fear of future events, is not an insured cause (albeit quantifying the impact of that could be challenging).

Some wordings are wider and respond to incidents in the vicinity that cause damage or endanger life (such as toxic chemical spills). Policy wordings can lack clarity in this respect and there have been claims submitted for occurrences at the Premises that endanger life in the vicinity. It is unlikely to be underwriters' intention to cover that.

Vicinity is often undefined. Where it is defined, the most common distance cited is a 1 mile radius. Defining a distance brings contract certainty (although few policies specify how that distance is to be measured – by road or as the crow flies for example), whereas the absence of a prescribed distance allows more flexibility, depending on the circumstances.

Generally, the greater the number of alternative access options, the shorter the distance constituting vicinity will be. It could be argued that vicinity is self-defining; if something occurs nearby that produces a reduction in revenue for P, it might be reasonable to conclude that it is in the vicinity.

A time deductible/franchise is often included, in terms of hours or days (either running chronologically from the time of Damage or as the period in which loss accrues (there would only be a difference between those two if the BI loss was intermittent)) rather than a fixed monetary amount.

Non-Damage Denial of Access

It is possible to obtain cover for a denial of access due to the instruction of the police or a government authority. Many of the points made above remain relevant, but two observations need to be made.

Firstly, these wordings typically only respond to a complete denial of access (a hindrance may not suffice).

Secondly, most wordings require the instructions of the police/government authority to arise due to an incident/event/commotion in the vicinity rather than at the Premises.

This form of cover would typically respond to rioting or hoax bomb threats in the vicinity.

2.2.2 Loss of Attraction

This extension is related to denial of access and concerns neighbouring property close to P's Premises that draws customers to P and could, if damaged, produce a significant impact on P's business. For example, a café immediately adjacent to a cathedral, primarily serving cathedral visitors, would be in difficulty if the cathedral was destroyed by fire and there were no visitors.

Typical aspects of wordings include:

- Damage to property in the vicinity
- Causing loss of custom to P.

While *property* is generally undefined (and the attraction in respect of which the cover was taken out is seldom explicitly listed), the intention is to respond to BI loss flowing from PD, as opposed to the loss of a tourist attraction such as a mountain or lake.

There are a few wordings that do not require damage as the trigger for cover, but the majority do.

2.2.3 Failure of Utilities

This extension responds to BI losses (not PD) arising from utility failures and typically covers water (including sewerage), gas and electricity supplies, often explicitly excluding telecommunications. Stock spoilage, for example, resulting from utility failure would not be insured under this BI extension (that might be covered under separate PD extensions).

Time franchises are often included, typically up to 48 hours. Losses flowing from supply failure in excess of the franchise period are paid in full, but excluded entirely if the failure falls within it. Some wordings adopt time excesses rather than franchises.

It can be assumed that franchise or excess periods run chronologically from the point of failure, although some policies frame them as the first x hours of loss, which could extend over a longer period in the case of intermittent BI loss flowing from the same damage.

Two distinct forms of the utility extension are available, the first requiring damage at the generating site and the second responding to failure of the supply at P's terminal ends.

Damage at the generating site

This, the more common form of extension, will respond if a cessation of supply is caused by damage at a generating site, subject to the following key requirements:

- There needs to be physical damage at the generating site
- Cover may be restricted to named perils (as opposed to all risks); flooding in particular is often not included
- The deliberate cessation of supply by the utility provider is typically excluded
- Cover normally relates to public not privately generated supplies.

Establishing damage at a generating site can be difficult, and the generating entity may be reluctant to discuss causation due to the fear of potential litigation.

Additionally, as part of a risk management strategy, providers are likely to isolate supplies if there is an awareness of potential damage. A loss of supply resulting from such a decision would not be covered.

Consequently, losses are rarely successfully pursued under this form of extension.

Failure of supply at P's terminal ends

This is a wider cover, potentially responding to damage both at the generating site and to the supply infrastructure between there and P's terminal ends. Not all insurers offer this form of extension.

Wordings vary significantly. In some cases, any accidental (as opposed to planned) failure triggers cover. In others, the onus is on the insured to evidence damage, and that can often be very difficult to achieve.

It should be noted that locating the terminal ends is not always easy. The position can be complicated by supplier substations on the Premises. This extension will not respond to damage after the terminal ends, and there is no need for it to do so. Damage after that point would be dealt with as Damage at the Premises, potentially triggering cover under the PD and BI sections of the policy.

2.2.4 Suppliers/Customers

These extensions reflect the importance of the supply chain to modern businesses. Damage at the location of a key supplier could be just as, or more, significant to P as Damage at P's Premises.

Therefore, these extensions cover BI losses arising from damage at the premises of suppliers or customers, with that damage triggering cover as if there was Damage at P's Premises.

The terms 'suppliers' and 'customers' are frequently undefined. Many policies refer to 'direct' suppliers, intending to rule out suppliers of suppliers, although that term may not bring sufficient clarity – the direct supplier may entirely subcontract manufacturing to its own supplier. While damage at that manufacturing location represents the real risk, P's policy might not extend to suppliers of suppliers.

It is often not the intention to cover suppliers of suppliers (or customers of customers), often referred to as tier 2 suppliers, or tier 3 and beyond (suppliers of suppliers of suppliers).

Cover is typically offered in one of two forms and the key features are as follows:

Specified/direct customers or suppliers

- Specifically named supplier
- Maximum limits of claim (monetary limit or percentage of sum insured)
- Territorial restrictions
- Must be an actual customer/supplier at the time of the incident (not a prospect)
- Cover is for restricted perils (not all risks)
- Cover may not be offered for all suppliers (utilities and/or telecoms/internet service providers may be excluded)
- Often a shorter MIP than the main cover

Unspecified customers/suppliers

- Generic cover for all customers or suppliers within the territorial limits
- More restricted limits are likely to apply
- This cover is often included in package commercial policies.

Suppliers are frequently understood to be manufacturers or processors of components, goods or materials, rather than suppliers of services, and care should be taken to understand the precise policy cover offered.

While these extensions require the supplier/customer to have suffered damage, they rarely require the supplier/customer to satisfy the material damage proviso, and will usually respond even if the supplier's own cover does not.

2.2.5 Notifiable Disease

This cover is commonly required by hotels and restaurants. Those businesses can suffer significant loss if they have to close due to the outbreak of disease, although this often damages people rather than property insured.

The cover provided frequently also includes suicide and murder/attempted murder, and may be broad enough to include crime and incident investigation.

Key features of cover are as follows:

- Murder/suicide/disease must occur at the actual Premises or within a defined vicinity rather than further afield
- Notifiable disease must occur at the actual Premises or within a specified radius
- The notifiable disease must usually be contagious or infectious to humans, as opposed to animals
- 'Notifiable' may be defined by a list of diseases in the policy or alternatively be legally notifiable (for example by the Health Protection Regulations (2010)) at the time of an incident.

The latter definition is likely to provide wider cover, as it will respond to diseases notifiable at the time of the incident, rather than a list of diseases notifiable at the time when the policy was drafted.

2.3 Specialist BI Covers

In addition to the cover provided by the core BI and extensions, there may be additional but complementary covers in place. These may be purchased as standalone policies, such as a Delay in Start-Up ('DSU') policy, or as extensions to the core cover, such as Advanced Loss of Profits ('ALOP') endorsement.

Three common examples are:

- Engineering BI
- Cyber BI
- DSU covers (the latter can also be seen as ALOP extensions in the main PD BI policy).

2.3.1 Engineering BI

Engineering BI cover typically covers BI loss flowing from three distinct causations:

- Accidental Damage (generally defined as sudden and unforeseen, or just unforeseen, damage) to insured plant and machinery
- Machinery Breakdown (not requiring an insured incident external to the machine)
- Loss of Utilities to insured plant and machinery.

Accidental Damage is likely to already be insured under a commercial combined All Risks policy.

Breakdown cover is an additional cover to an All Risks policy and is particularly useful to manufacturers. It should be noted that this is a BI cover – the loss of the parts that have broken down is unlikely to be covered, but if that has caused subsequent Damage to other assets, that subsequent Damage probably would be.

Loss of utility cover relates to failure of power/services (and in some cases telecommunications) to the insured plant, as opposed to failure to the premises as an extension to P's main policy. This would respond to a utility failure within the premises, from the main incoming supply to the insured machinery. That would not be covered under a commercial combined policy if the main incoming supply was unaffected and the failure represented a supply failure *within* the premises.

Two other aspects of Engineering BI cover are worth noting.

Firstly, excesses are often included in the form of a time deductible, rather than as a monetary amount. Alternatively, there may be a franchise period. Franchise/excess periods are normally included for a minimum of 48 hours.

Some policies allow for the time period to commence at the point of damage/breakdown, others for it to relate to the specified number of hours of loss. These forms will produce different results in the case of an incident producing intermittent loss until repaired, or one occurring before a period when no production would have otherwise taken place (perhaps over a weekend).

Secondly, exclusions will include wear and tear and lack of maintenance, so causation, particularly in respect of breakdown, needs to be clearly established.

2.3.2 Cyber BI

For many years, computer systems and data records have been included in the definition of All Other Contents in the PD section of commercial combined policies. BI losses flowing from insured Damage/loss to those (typically by theft) were paid.

There was widespread concern preceding the year 2000 with regard to the robustness of systems to cope with millennial date changes, such that exclusions flowing from date change events were widely adopted.

As the significance of the internet has increased exponentially to the current time, new cyber exposures present themselves. Given the difficulty in understanding and assessing the risk of loss flowing from those new exposures, commercial combined policies have generally sought to exclude hacking attacks and losses flowing from viruses, corruption of data, etc.

The incorporation of these cyber exclusions in traditional BI policies raises a number of issues. Many are absolute, excluding even subsequent physical Damage, for example, following a cyber event. Some policy wordings will cover subsequent Damage (as with non-cyber exclusions, such as wear and tear), but others do not.

Issues such as these, caused by including absolute exclusions in traditional policies, along with concern about the scale and nature of cyber

risks, have resulted in the appearance of separate cyber policies to fill the gap in cover that would otherwise exist.

It is important to be aware of differences between cyber and traditional cover. Cyber policies do not adopt terminology generally seen in 'Damage'-based BI policy wordings. They may not address or define ICW cover or address P's loss of revenue in the anticipated way.

Cyber MIPs are usually very short compared to traditional BI policies and cover can intermingle first and third party exposures.

Cyber policies adopt time excesses and franchises to a greater extent and, if these are too long, they can significantly reduce the benefit of cover provided (particularly given the on-demand nature and need for immediate delivery expected in the digital market).

In the context set out above, it is important to appreciate that Cyber BI insurance is still in its infancy and is constantly evolving, with the result that no two wordings are the same. Moreover, many are framed in the context of US BI cover, rather than UK, and therefore the specific policy wording must be consulted.

2.3.3 Advanced Loss of Profits

BI cover is normally triggered by Damage to property owned or used by P, and the MIP commences from the day on which that Damage occurs.

ALOP extends this cover in two key respects:

- It defers commencement of the MIP (normally starting on the date of the damage) to the date on which, but for the Damage, Turnover would have commenced
- It allows loss to be claimed in respect of assets that P does not yet own/use – they may still be under construction by third parties.

If a new hotel is being built for example, a standard BI cover would not respond, as the material damage proviso would not be satisfied.

From a quantum perspective, the onus remains with P to evidence when turnover would have commenced but for the damage, and at what level.

ALOP can be taken out as a separate policy rather than an extension to the core cover. It will then be known as Delay in Start-Up cover ('DSU'), but the features of the cover are the same.

2.3.4 Other Specialist Covers

Other BI covers are available (beyond the scope of this book) and these include:

Policy	Trigger for cover
Event cancellation	Incident beyond P’s control
Pluvius	Prescribed depth of rainfall
Supply chain	Failure for prescribed raw materials to arrive at P’s premises (howsoever caused)
Mass resignation	Lottery win

2.4 Not All Consequences are Covered

When dealing with PD claims, there can be a tendency to defer any element of claim that does not represent property damage for consideration as a BI loss. This is often inappropriate, as it creates the expectation that there is cover potentially available when that is not the case.

Insurance policies do not cover every eventuality that may befall P. Risks need to be identified, scoped and evaluated, and an appropriate premium charged for covering them.

Examples of losses that are not covered as standard include:

- Contractual fines and penalties. The primary reason for paying these is the requirement of a historic contract, rather than solely or necessarily to avoid a future reduction in turnover. Cover for contractual penalties can be purchased separately
- Wasted costs, including advertising expenditure incurred just before Damage occurs

- PD underinsurance (or absence of insurance) and any exacerbation of BI loss caused by that
- Increased BI losses due to delay caused by risk improvement/ future loss avoidance work. Examples of the latter include a requirement for in-rack sprinklers to be installed, the incorporation of a sprinkler system throughout the premises or extensive redesign of CCTV/alarm coverage throughout the premises
- General loss of reputation or economic downturn of an area/town (often referred to as 'blemishing').

3

HOW DOES THE COVER WORK?

3. How does the cover work?

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3.1 Overview

Once policy liability is triggered, whether that relates to Damage at the Premises or the operation of an extension, the cover operates the same way.

The IP will continue while P's financial results are affected, usually from the day of Damage, subject to that cover ceasing no later than the expiry date of the MIP, even if the business continues to be affected beyond that point.

As noted in the Introduction, after an incident, there are usually three impacts that businesses may experience, and policy covers reflect that:

Impact	BI cover
Revenue reduces	Loss of Gross Profit or Revenue
Costs increase	Increase in Cost of Working
Costs decrease	Savings

Policies respond to the *movement* in costs or revenue as compared to what they would have been but for the Damage. Costs that continue as they would have been but for the Damage are irrelevant to a claim.

Policies rarely define the IP as the period during which P's results are depressed. Therefore, in the unusual cases where the revenue is higher than would have been the case without an incident, the indemnity period will run until that effect ceases, and the claim will need to be credited for it. This is often referred to as a 'clawback' of revenue.

The MIP is a backstop. Policy cover ceases at the end of the MIP, regardless of whether the results of P's business continue to be affected after that point.

3.2 Indemnity Period

Almost all policies define the IP as beginning on the date of the Damage (and not on any other date, such as the date when policy liability is accepted) and ending either:

- When the results of the business are no longer affected
- *Or* at the end of the MIP.

For as long as either revenue or costs are higher or lower than would have been the case but for the Damage, the IP continues.

If P moves to bigger (more expensive) alternative premises after a fire, to avoid any ongoing loss of revenue, the IP will still continue if ongoing increased rent has to be paid.

A BI policy will generally not respond to losses after the end of the MIP, but there are specific exceptions to this.

One example is application of the Accumulated Stocks clause. That clause (if included in a policy) will state that insurers will pay for the recreation of stock *after the end of the MIP* if stock levels have been run down to avoid a loss within the MIP. This only applies if stock levels are lower than they would have been at the end of the MIP. This is to avoid P mitigating loss for insurers in good faith, but then being exposed to (otherwise uninsured) losses after the end of the MIP.

Additionally, increased costs that are paid after the end of the MIP, solely to mitigate Gross Profit or Gross Revenue losses within the MIP, may be covered. It is the timing of the reduction in revenue avoided that is important, not the timing of costs being incurred (this is not the case for ICW only covers, where the costs do need to be incurred within the MIP).

In some cases, while the IP begins at the date of Damage, the impact on P's business might be deferred. This is most commonly seen in commercial subsidence claims, where monitoring of the movement of a building after cracking is discovered may be required before repairs can be effected.

When the monitoring period is complete (potentially as long as a year after discovery), P may need to move out. At that point, the results of the business start to be affected, but that does not defer the start of the MIP (without insurer's consent).

Loss within an IP can typically be characterised in two phases:

- The period during which physical repairs/replacement are being carried out
- Subsequently, the period during which P's business recovers to the level that it would have been at had the Damage not occurred.

There is frequently a disproportionate relationship between the two, and the latter might grow exponentially if there is avoidable delay with the former.

Reducing the reinstatement period is key to the financial recovery.

It is important to appreciate that the IP continues until P resumes the level of trading that would have been achieved had there been no Damage, not when the level of trading is the same as that at the time of Damage. In other words, if P's business was growing (or shrinking), the IP ends when actual trading is the same as that projected growth or decline.

3.3 Calculation of the BI Indemnity

The two most common forms of BI cover are for loss of Gross Profit or loss of Gross Revenue. Sometimes, P will arrange cover for ICW only, either in the belief that any reduction in revenue can be avoided or alternatively because evidencing a loss might be so difficult in practical terms that a claim would never succeed.

Both Gross Profit and Gross Revenue policies start by identifying a reduction in turnover. The subsequent steps can be summarised as follows:

Gross Revenue	**Gross Profit**
Expected turnover	Expected turnover
Deduct actual turnover	Deduct actual turnover
Reduction in turnover	Reduction in turnover
	Apply Rate of Gross Profit (as defined in the policy)
	Loss of Gross Profit
Add increased costs	Add increased costs
Deduct savings	Deduct savings
BI Loss	**BI Loss**

It will be apparent from the comparison above that the only difference between Gross Profit and Gross Revenue losses is that Gross Profit policies deduct costs in two stages:

- Uninsured costs are the costs that P *assumed* would reduce in line with turnover when they took out cover. They will be specified in the policy or on the schedule
- Savings are the costs that *actually* reduce (other than those that are uninsured).

If P's assumption proves to be correct, and those costs do reduce in direct proportion to the turnover reduction, then a Gross Profit cover will produce the same indemnity as a Gross Revenue policy.

3.3.1 Reduction in Turnover

A point on terminology.

For all intents and purposes, the words *revenue*, *turnover*, *sales* and *income* all mean the same thing. No technical nuance is intended where one term is used rather than another.

Policies generally use the term *turnover* (although P may not).

The terms discussed below are those commonly seen in policies over the last few decades. These precise terms may not necessarily appear in more recently developed wordings, but the principles discussed will be the same.

Care should always be taken to ensure that turnover is net of VAT (indirect tax). If retailers are asked how much the till takes in a day, the answer is very likely to be gross of VAT.

Policies do not include payment for recoverable VAT as that is recovered by P through the process of submitting regular VAT returns (albeit there can be an unavoidable cash flow challenge implicit in that).

Additionally, for all but the smallest businesses, basic accounting principles need to be established regarding how turnover is reflected by P in their accounts.

It may be summarised on a calendar month basis, but not necessarily so – months are of different lengths and it could be misleading to compare them directly.

P may therefore decide to have thirteen four-week periods in the financial year; in other cases, P may allocate the first four weeks of the year to the first month in the financial year, four to the next and then five to the third. That pattern is then repeated for the following three quarters of the year.

This is important to understand, to avoid false trends being calculated for short periods of loss.

Standard Turnover

Most policies take the turnover in the period corresponding with the IP from the previous year as the starting point for calculating loss. This is referred to as the Standard Turnover.

So, if Damage that occurred on 1st January 2019 was repaired in the middle of February 2019, and the business fully recovered by the end of April 2019, Standard Turnover would be the turnover from 1st January to 30th April 2018.

This deals with annual seasonality, comparing the same months of the year before and after Damage.

The business (and/or industry sector) may have changed in the intervening period, and there may be trends or variations that need to be made so that the loss paid by insurers reflects as accurately as reasonably practical what would have happened had there been no Damage.

Most policies not only allow for, but require, such variations to be made. The actual words used vary and the clause may be referred to as the 'trends', 'variations' or 'other circumstances' clause.

In cases where there are no variations, the Standard Turnover will be the same as the Adjusted Standard Turnover.

Adjusted Standard Turnover

The definition of Standard Turnover provides a common starting point for P and insurers.

From that position, the party wishing to apply a trend or variation needs to evidence the extent of that. This could be on the basis of financial performance pre and post incident, or supported by non-financial evidence such as customer correspondence or publicly available data about the performance of P's business sector generally.

In the aftermath of Damage, the turnover generated by P will usually reduce. However, following reinstatement and reopening, it is also possible for there to be a short period of catch-up, where sales are greater than they would have been but for the Damage (customers being prepared to wait for their order to be completed). This will depend upon the nature of the business and its market.

In such circumstances, restricting the IP only to that period where sales are depressed would result in P being over indemnified.

In the following example, P suffers Damage at the start of week 2 in 2019:

	2017 £	2018 £	2019 £
Week 1	5001	5001	5001
Week 2	5002	5002	Nil
Week 3	5003	5003	3500
Week 4	5004	5004	7000
Week 5	5005	5005	5005

Week 1 in 2019 is at a similar level to the two previous years (and they show similar results throughout the period). By week 5, P is performing at the level of the two previous years again.

If the turnover loss is restricted to the weeks in which turnover is depressed, and only weeks 2 and 3 in 2018 are included, the turnover reduction would be as follows:

	Weeks	£
Standard Turnover	2–3	10,005
Trend – none required		Nil
Adjusted Standard Turnover		10,005
Actual Turnover	3	(3,500)
Reduction in Turnover		6,505

However, it is obvious that week 4 is higher than would have been expected but for the Damage (in this case, all parties agreed that turnover in 2019 would have been the same as the previous year). The results in week 4 are higher than would have been expected; they are affected by the Damage and therefore the IP must be extended to include that week.

The loss should be calculated as follows:

	Weeks	£
Standard Turnover	2–4	15,009
Trend – none required		Nil
Adjusted Standard Turnover		15,009
Actual Turnover	2–4	(10,500)
Reduction in Turnover		4,509

In the above example, there was no trend in the business to adjust for, but in reality there usually is.

The Oxford English Dictionary defines trend as "*general direction and tendency*". In the context of business interruption, trend is calculated by reference to changes (whether positive or negative) in turnover between one year and the next, using comparable periods within each year.

It is important to be mindful of other influences, such as seasonality, or one-off events that would not be repeated.

While Standard Turnover will be based on the same period of the immediately preceding year, in practice it is sensible to obtain monthly turnover for two or three years pre-incident to properly consider trends (with the exception of very short periods of interruption). This will identify recurring seasonal variations, and it would normally be reasonable to expect any seasonality to have been experienced but for the Damage.

Here are some further salient observations about trends:

- Trends do not carry on for ever. Businesses cannot grow or decline indefinitely
- There is no requirement to use the same trend for each month of an IP. Disagreement over average trends over the whole IP can sometimes be resolved by more detailed review of the most significant loss months
- Just because an amount can be calculated does not mean that it makes sense. All calculations should be sense checked. P's factory may not have been large enough to physically produce enough goods to produce theoretically calculated turnover levels. On the other hand, Adjusted Standard Turnover will not usually be lower than that actually achieved
- Price rises will not necessarily result in proportionately increased turnover for P. Some customers may go elsewhere if the price rise is not considered reasonable
- Any turnover trend should only be applied to the turnover element of the indemnity calculation (rather than the expected Gross Profit or the Rate of Gross Profit – trends affecting those elements of the indemnity should be considered independently).

Understanding how the business operates, why customers buy P's product or service, whether they compete on price/service or quality or something unique is essential to properly adjusting Standard Turnover.

There are various sources of information and factors to take into account when trying to establish the performance of the business but for the Damage:

- Historic financial documentation, such as monthly management accounts and VAT returns (it is useful to review historical performance in the form of graphs)
- Detailed profit and loss accounts, rather than just relying on the publicly available accounts (which will show very limited detail)
- Budgets, if prepared pre-incident
- Recent capital investments

- Technological or efficiency improvements pre-loss or planned to happen during the IP
- Anticipated obsolescence/process redundancy
- Any other developments that would have changed the performance of the business
- Changes in the market sector
- Changed circumstances of competitors or customers
- Performance of other sites P operates.

Two final points should be made in respect of adjustments to Standard Turnover:

- Almost all of the preceding discussion relates to a review of turnover *before* Damage occurs (pre-incident). At the start of an IP, this is inevitable, as that is all that exists. However, in due course, actual turnover after the end of the IP will be available and that may indicate the reasonableness of the Adjusted Standard Turnover to be used in the claim
- New businesses will have no turnover in the period in the previous year that corresponds with the IP. In those cases, Standard Turnover is instead based on what would most reasonably have been expected but for the Damage. Words to that effect appear in most policies and are often captioned as a New Business Clause.

Actual Turnover

All businesses will record the actual turnover they achieve – generally this should be net of VAT (indirect tax).

What needs to be deducted from the Adjusted Standard Turnover is not only any actual turnover at the Premises that have suffered Damage, but also any turnover made good at other sites.

Most policies make this explicitly clear by including a clause confirming that. This is commonly referred to as an Alternative Trading Clause.

Such a clause will state that, if turnover is generated by P elsewhere (or by others on P's behalf), then it needs to be included as actual turnover when calculating the loss.

That can include customers ordering online if their local outlet is unavailable.

Alternatively, if P is a bespoke manufacturer of luxury goods, customers may wait until P is producing again, meaning turnover will be deferred rather than lost.

Two further observations need to be made in respect of actual turnover.

Firstly, the MIP is a backstop. There may be customers who will wait for P to deliver products, and in reality the turnover they provide is not lost. However, if that turnover is not generated until after the end of the MIP, it has been lost in terms of policy cover and the policy will therefore provide indemnity for turnover that would have been generated within the MIP but has unavoidably been pushed beyond it.

Deliberate concealment of, or inappropriate deferment of, actual turnover would be fraudulent.

Secondly, there needs to be consistency between the calculation of Adjusted Standard and Actual Turnover. If P operates in a sector where there is a basic price and then a surcharge, then both the

Adjusted Standard and Actual Turnover calculations need to include the basic price and the surcharge. Similarly, extra charges to customers for delivery etc will also need to be included.

Reduction in Turnover

This is calculated by deducting Actual Turnover from Adjusted Standard Turnover.

To calculate a Gross Profit loss, the Rate of Gross Profit, as defined in the policy, is applied to the reduction in turnover.

3.3.2 Gross Profit

This is invariably a defined term that can be found in the policy or sometimes the Schedule. Care should be taken to establish the definition in the actual policy issued, in two respects:

- What is the reference period from which the Gross Profit should be extracted?
- What costs does the policy say should be deducted from turnover to calculate the Gross Profit?

Reference Period

Most commonly, this will be based on the last set of (annual) accounts for the period ended most recently before the Damage. This should not be confused with the reference period on which the declared Gross Profit for a Declaration Linked policy may be based. Declaration Linked policies are discussed later in this book.

Gross Profit Calculation

It is necessary to calculate the amount of the Gross Profit as defined by a policy so that the Rate of Gross Profit ('ROGP') can be calculated and applied to any reduction in turnover.

Smaller businesses may not be required to disclose gross profit in their accounts. Not all businesses use that term. Professional service providers (insurance brokers, solicitors and accountants for example) are unlikely to, whereas most retailers and manufacturers will.

Where P does disclose gross profit in their accounts, it very often does not follow the definition of Gross Profit included in the policy wording.

The fact that there is a definition at all can come as a surprise to P.

This is a cause of very considerable misunderstanding. Gross profit is an accountancy term that has been used in business for several centuries. There is no accounting or statutory definition of it. This provides flexibility for P to deduct the most appropriate costs for their business from turnover. The costs deducted from turnover will often (almost always for manufacturers) include wages, which will not usually be deducted to calculate policy Gross Profit.

P is likely to be confused by the fact that policies adopt the same words routinely used by them as a technical term, with a specific meaning not observed outside the remit of insurance policies.

P is likely to assume that the policy, when adopting the term Gross Profit, means the same thing as they do when using that term in their accounts. In many cases, P's assumption will be wrong.

The fact that more costs are likely to be deducted in calculating gross profit in a set of accounts than will be included in an insurance policy definition means that gross profit per the accounts could potentially be significantly lower than the amount produced by the policy definition.

Failure to appreciate that 'Gross Profit' is a technical term with a specific definition in insurance policies is the single biggest cause of underdeclaration of Gross Profit to insurers.

Historically, Gross Profit has been defined as turnover, less uninsured working expenses, adjusted for the movement in stock.

The uninsured working expenses (sometimes called 'specified working expenses') are the costs that P anticipates will reduce directly in line with turnover, in every circumstance that may present itself.

These are the costs that are deducted from turnover to calculate Gross Profit.

Many policies now specify what the uninsured working expenses are, typically:

- Purchases (adjusted for movement in stock)
- Carriage, packing and freight
- Bad debts.

There is usually a facility for P to deduct further costs if they believe those will also vary directly in line with turnover in all circumstances.

Given the wide variety of policy wordings currently available, it is essential to establish from the outset the costs uninsured in each case.

There can be uncertainty over what these terms actually mean. For example, the word 'purchases' may generally be understood by insurers to be the purchase of raw materials, but P may presume that the word is wide enough to include purchases of goods and services generally, including plant and machinery.

Consider the following example, in which P is a restaurateur, Café Co Ltd.

P have recorded a gross profit of £838,589, set out in the following detailed profit and loss account.

Note that accounts showing this level of detail are unlikely to be available on the public record. Annual accounts such as these are primarily prepared to support tax submissions rather than for public filing.

Publicly available accounts do not generally disclose sufficient detail to allow a calculation of the ROGP. It is necessary to refer to more detailed accounts to identify precisely which costs P has deducted to calculate gross profit in their accounts.

The Café Co Ltd

Detailed Profit and Loss Account for the year ended 31st March 2019

	£	£
Sales		2,562,500
Opening Stock	15,048	
Purchases	917,775	
Cleaning	65,000	
Other Costs	26,136	
Wages	724,952	
Less Closing Stock	(25,000)	
Cost of Sales		(1,723,911)
Gross profit		**838,589**
Admin Costs		(306,040)
Net Profit		532,549

However, assuming that the policy definition is just turnover less purchases adjusted for the movement in stock, the policy Gross Profit would be:

	£	£
Sales		2,562,500
Opening Stock	15,048	
Purchases	917,775	
Less Closing Stock	(25,000)	
Cost of Sales		907,823
(Policy) Gross Profit		**1,654,677**

The insurance Gross Profit needs to be expressed as a ROGP, which is to be applied to the agreed reduction in turnover.

In the above example, the ROGP amounts to 64.57%, as follows:

$$\frac{£1{,}654{,}677 \times 100}{£2{,}562{,}500} = 64.57\%$$

Many policies re-order the layout of revenue and costs, a matter of further confusion for P. Gross Profit may be defined as the difference between turnover and closing stock, and opening stock and uninsured working expenses. This is commonly referred to as a ‘difference basis’ wording.

In the above example, that would be:

	£	£
Turnover	2,562,500	
Closing Stock	25,000	
		2,587,500
Opening Stock	15,048	
Uninsured Working Expenses	917,775	
		(932,823)
Gross Profit		**1,654,677**

The Gross Profit calculated is the same as the previous page, but the layout will be totally unfamiliar to P.

Note that the Rate of Gross Profit is calculated by expressing £1.654m as a percentage of £2.562m, not £2.587m.

Departmental Clause

The above example calculated an average ROGP for the whole business. However, P may sell different products or services each of which might earn substantially different rates. If Damage affects only one product or service, indemnity might be better achieved using a more specific rate for that part of the business.

Most policies use the term ‘departments’ when referring to those different parts of a business, and a Departmental Clause is often included in wordings to the effect that:

- If a specific department has been affected, *and*
- The ROGP (as defined in the policy wording) for that department can be established (it is not usually a requirement for P to have historically accounted for the department as a distinct profit stream), *then*
- The more specific Rate should be used; it is usually not optional.

Difficulty can arise if P previously made a claim using the average rate for a less profitable department but subsequently wishes to use a higher rate for a high performing part of the business. Insurers would need to be consulted were that to be the case.

It used to be a market agreement in the UK that the trends clause (discussed above in respect of turnover) was deemed to be wide enough to allow a departmental Rate of Gross Profit to be used even in the absence of a Departmental Clause.

However, historical market agreements may not still be adopted by insurers. While they may agree to allow a departmental rate to be used in the absence of a Departmental Clause, that is a concession that should not be assumed without prior agreement.

Good examples of businesses with departments that have a significantly different Rate of Gross Profit (assuming Gross Profit is defined as turnover less material purchases) include hotels and golf clubs, with the material cost of renting out a room or earning green fees being substantially less than the material cost of selling an evening meal or a golf club.

Similarly, a motor trader will usually earn substantially different rates of Gross Profit in each of the principal sections of the business. This is illustrated below:

ABC Motor Traders

	Car Sales	Parts/Service	MOT
	£'000	£'000	£'000
Turnover	4,400	1,200	200
Opening Stock	1,200	160	1
Purchases	3,550	288	1
Wages	250	270	30
Other Costs	50	92	50
Closing Stock	(1,100)	(170)	(1)
Cost of Sales	3,950	640	81
Gross Profit	**450**	**560**	**119**

The Gross Profit per the policy wording for each department would be as follows:

ABC Motor Traders

	Car Sales	Parts/Service	MOT
	£'000	£'000	£'000
Turnover	4,400	1,200	200
Closing Stock	1,100	170	1
	5,500	1,370	201
Opening Stock	1,200	160	1
Purchases	3,550	288	1
Cost of Sales	4,750	448	2
Gross Profit	**750**	**922**	**199**

Each department's Rate of Gross Profit would be:

ABC Motor Traders

	Car Sales	Parts/Service	MOT
	£'000	£'000	£'000
Turnover	4,400	1,200	200
Gross Profit	750	922	199
ROGP	17.05%	76.83%	99.5%

The average Rate of Gross Profit (to be applied in the absence of a Departmental Clause) amounts to 32.26%:

ABC Motor Traders

	Turnover	Gross Profit
	£'000	£'000
Car Sales	4,400	750
Parts/Service	1,200	922
MOT	200	199
Total	5,800	1,871

ROGP $\frac{£1,871 \times 100}{£5,800} = 32.26\%$

The average rate would produce an over or under indemnity if only one department was affected, but not if the whole business was equally impacted.

The key point to appreciate is that P, in taking out Gross Profit insurance and deducting costs from turnover (uninsuring them) to calculate Gross Profit, is requiring insurers to pay a rate in the pound that assumes that those costs will reduce in line with turnover whether they actually do or not.

The adjustment steps above have discussed calculation of the reduction in turnover and the application of the rate of Gross Profit to that.

It was noted above that trends need to be reflected in the calculation of Adjusted Standard Turnover. For completeness, the same also applies to the ROGP. Significant variations in the expected ROGP are rare but may be present in certain market sectors (such as commodities).

Two further elements of BI cover remain to be addressed – inclusion of any Increase in Cost of Working and then deduction of any costs that have reduced (savings).

3.3.3 Increase in Cost of Working

If there is a reduction in turnover, that means that P's customers have been let down, leading to the potential long-term loss of their business.

Long-term losses are expensive both for P and insurers. To address this, policies routinely cover additional expenditure incurred to avoid such a turnover reduction.

Key features typically include:

- A requirement for costs to be incurred:
  - Reasonably
  - Necessarily
  - Solely to avoid a reduction in turnover
- There must be an actual cash increase in the cost claimed
- A limit on expenditure, to not exceed the loss of Gross Profit that would otherwise accrue (throughout the duration of the MIP) if the expenditure was not incurred. This is often referred to as the 'economic limit', albeit that term does not usually appear in policy wordings. In other words, P can spend £1 to save £1, but no more
- A requirement for the reduction in turnover avoided to be within the MIP (the additional expenditure could be incurred after the MIP has ended to avoid a reduction in turnover within it)
- Usually no explicit requirement for insurers' consent before costs are incurred (in practice, it is wise to discuss it in advance to avoid misunderstanding)
- A restriction on increased cost claims where fixed costs have been uninsured (i.e. deducted from turnover to calculate Gross Profit). This is commonly set out as an Uninsured Standing Charges Clause.

Addressing the above issues in order:

Reasonably and Necessarily

Policies do not usually specify who decides what is reasonable and necessary. In the first instance, it is reasonable to assume that this is P – they know their business best and can identify appropriate mitigation in the circumstances.

This is subject to excluding clearly inappropriate expenditure, for example rent on alternative premises that are disproportionately more expensive than for other suitable venues in the vicinity.

It should be noted that the requirement is usually for expenditure to be *both* reasonable and necessary. What might be reasonable may not also be necessary and the inclusion of both terms strengthens insurers' ability to question increased cost expenditure incurred, usually where it is questionable and has perhaps not been discussed in advance (albeit few policies require advance approval from insurers for ICWs to be incurred).

Solely

Sometimes, expenditure serves a dual purpose. As well as avoiding a future reduction in turnover, it may avoid contractual penalties that would otherwise present themselves or underpin P's brand generally in the medium term (beyond the MIP).

Inevitably, successful increased costs are never incurred to solely avoid a loss of Gross Profit within the MIP. If they are successful, and any customers retained by the expenditure remain at the end of the MIP, it could be considered that the cost incurred has protected an element of Gross Profit *after* the MIP.

It would be inequitable to argue that such expenditure has not been incurred solely to protect Gross Profit within the MIP, as few increased costs would ever then be payable.

The 'solely' test for increased expenditure for services therefore needs to be considered in terms of its validity within the MIP and should not be discounted simply because customers are successfully retained at the end of the MIP.

The position is slightly more complex with regard to assets. If an additional piece of plant is purchased to avoid a loss of Gross Profit within the MIP, and that is retained by P in the long term (as a useful addition to manufacturing capacity), it has a value at the end of the MIP. The allowable cost in the claim is not the price of buying it, but the difference between that price and its sale value at the end of the MIP (regardless of whether or not the purchase price is economic).

In practice, P will often seek to retain additional assets purchased, and a notional value can be agreed with the parties in this respect. Where possible, P may realise at the outset that they will wish to retain the asset, and its residual value can be agreed before it is even purchased to provide clarity.

Actual Increase in Cash Paid

It is not enough that a cost increases in proportion to turnover – it must actually increase to constitute a loss.

P's turnover may fall from £100k to £80k, but the electricity cost may stay the same at £20k. As a proportion of turnover, it has increased from 20% to 25%. However, the cash cost is the same – it has not increased in absolute terms and there is no loss to claim.

The Gross Profit lost on the reduction in turnover would be payable, but there is no increased cost to deal with. Only costs that actually increase or decrease need to be reflected in a claim. Costs that are unproductive, but which do not increase, do not represent a loss.

They are in fact covered by any claim for loss of Gross Profit, assuming that the list of costs deducted from turnover has been kept to a minimum.

This is not always clear to P, and wage costs in particular can cause confusion. If the workforce is unable to do anything for a week, their wages will be unproductive and therefore 'wasted' expenditure/costs.

The policy will not pay for the wage cost if the expenditure does not represent an increase (if they would have been paid the same wages regardless of an incident, for example). However, that does not mean that P will not be indemnified. If the cessation of production produces a loss of Gross Profit or Revenue, that will be paid and that will cover the normal operating costs of the business.

Economic Test/Limit

Historically, businesses would suffer loss and subsequently seek to recoup that from insurers; many policies still contain clauses requiring claims to be submitted within 30 days of the end of the IP in anticipation of that.

P may not have the cash resource to be able to suffer a significant loss over a year or more and then seek to recover from insurers.

Most commonly, P is looking to insurers and loss adjusters for collaborative agreement to a mitigation plan and necessary expenditure before it is incurred, particularly if the sum is significant, and definitely if they do not have the cash to fund it without confirmation of the policy position.

It is reasonable to expect P to support any proposed expenditure with a business case, identifying the amount of expenditure proposed and the anticipated benefit to be gained. All of the costs related to any particular mitigation strategy should be accumulated before applying any particular economic test and they should be treated consistently.

By way of example, the cost of moving back into the risk address from a temporarily occupied alternative site after the MIP is an inevitable commitment flowing from the initial decision to occupy those temporary premises. It is the total of the costs associated with establishing the temporary facility, and relocating thereafter, that need to be assessed with regard to the economic limit.

Technically, many policies reserve the right for insurers to apply a retrospective economic test, but there is a general willingness to proactively

agree a programme of expenditure to retain as many customers as possible (for the benefit of all).

It will be apparent that actually applying an economic test is not always possible, and the availability of future turnover data may not assist at all. If £10,000 is spent on advertising, and actual turnover of £1m is generated thereafter, it may not be possible to measure the precise benefit that the advertisements have provided.

In such cases, it is better to pro-actively agree a mitigation strategy (supported by a business case) at the outset. Otherwise, delay, uncertainty and additional loss potentially arise. Further, there may be no greater clarity about the precise benefit additional expenditure has provided a year or two down the line.

Whether or not a cost is economic should be assessed with reference to the exposure to the business throughout the MIP of not spending the money.

For example, the additional cost of airfreighting a delivery may not be economic if measured against that sale alone. Nevertheless, it may be economic if, by so doing, the customer is retained for a longer period.

P remains under a duty to mitigate loss and is not at liberty to do nothing pending clarification of the policy position, especially where modest expenditure can avoid a significant turnover loss or where there is only one practical mode of mitigation and P has (or can readily obtain) the funds to effect that.

Within the MIP: Reduction in Turnover Avoided

Gross Profit (and Gross Revenue) policies do not usually require increased costs to be incurred within the MIP.

What has to accrue within the MIP is the reduction in turnover/Gross Profit avoided.

So, to the extent that costs incurred within a time excess period to avoid a reduction in turnover after the excess period has ended, they are payable.

The opposite is also true. Costs incurred after a time excess period to exclusively avoid Gross Profit losses within it are not going to be covered.

The timing of the reduction in turnover avoided, not the timing of incurring additional expenditure, is key.

Examples of increased costs and the probable policy response include:

Increased Cost	Covered?
P had booked a holiday before a fire occurred. This has to be cancelled so that they can assist with mitigation.	No – costs incurred pre-loss (but the rebooked holiday cost might be covered).
A commercial (goodwill) payment is made to a customer who threatens to take all of their business elsewhere due to disruption caused by the Damage.	Yes – if economic and the threat is real (and the payment is not a contractual penalty).
The insured are tenants and they pay for building repairs rather than waiting for the landlord to do so.	Yes – if the landlord cannot be contacted, repairs are modest and the landlord is pursued for non-premium costs incurred.
Security guards are retained at temporary alternative Premises.	Yes.
Security guards are retained at the Damaged Premises.	Yes – if some production is ongoing; otherwise, this may be a cost to include in the PD claim if security is to protect assets to be salvaged.
The extra cost of a machine better than that damaged (the equivalent reinstatement cost of the damaged machine is paid for by the PD section of the policy).	Yes – if faster than replacing like for like, less any residual value.

Increased Cost	Covered?
Payments to a key supplier to stop them becoming bankrupt (the insured are the only customer and they give no orders to the supplier for 6 months).	Yes – subject to the merit of each case, the demonstrated inability of a supplier to obtain finance, etc.
Extended cost of subcontracting due to delay installing post-loss risk improvements required by insurers.	No – BI cover relates to historic Damage not future Damage avoidance.
Wasted cost of advertising in the week before a large fire.	No – evidenced increased turnover due to advertising would be included in the Gross Profit loss calculation (the extra cost of repeat advertising would be covered).
Contribution to building costs if there is no tendering process to avoid delay.	Yes.
Cost of a project manager to drive the mitigation plan.	Yes.
Cost of temporary furniture in alternative premises.	Possibly – if permanent replacements are not available, but may be a PD not BI loss if assets equivalent to those damaged can be easily obtained.
Cost of collecting contaminated debris from the vicinity after a fire.	No – this is a PD issue (if cover is extended to include debris in the vicinity).

Increased Cost	Covered?
Cost of training courses for employees to use new equipment purchased after an incident.	Yes – if like for like equipment is no longer available.
Cost of redesigning the insured's website after an incident to improve sales.	Yes – subject to contribution for benefit beyond the MIP.
Cost of planting trees in the city at the request of the local planning department (made while applying to rebuild after a large fire).	Yes – if unavoidable and the delay avoided is economic.
Fines paid to a government agency for negligently allowing an incident to happen.	No – costs arising are not to avoid a reduction in turnover.
Cost of recruiting a new CEO after the current CEO collapses with stress after a large fire.	Technically no – only loss flowing from PD is covered.
Overtime payments to employees to recreate destroyed stock after an incident.	Yes.
5% retrospective discount for all customers based on six months' turnover post loss.	Yes – if tied to a resumption of turnover expected but for the Damage for each customer.

Increased Cost	Covered?
Increased depreciation charges on equipment bought post incident.	No – depreciation relates to asset purchase not avoidance of turnover loss. Also, this is not an actual increased cash cost.
Cost of making staff redundant post incident.	No – not an ICW, but would reduce the wage saving deduction.
Proposed cost of an advertising campaign (where P is unsure of the impact it will have).	Yes – but best to agree costs with insurers to avoid a retrospective economic limit test.
Cost of unproductive staff wages after an incident.	No – staff costs would have been paid anyway (not an ICW), but any loss of GP that covers wages would be covered.
Cost of removing uninsured debris.	No – this is a PD issue.
Cost of an open evening for customers post reinstatement.	Yes.
Bonus payments to staff after repairs are complete to thank them for their assistance.	No – but staff bonuses to support mitigation offered in advance might be.
Condolence payment to a family member of an employee killed by faulty electric wiring.	No.

Some increased costs may be inadvertently also included in an associated PD claim, such as charges for training on new plant and equipment. All elements of a claim (PD and BI) should be reviewed holistically to avoid costs being paid twice.

Increased cost cover is there to empower P to be proactive and agreement to mitigation should not be unreasonably withheld. If there is doubt, P should be invited to justify the proposed expenditure (both the cost to be spent and a quantification of the expected benefit they will bring) and that proposal can be submitted to insurers for consideration.

Uninsured Standing Charges Clause

This clause should not be confused with Uninsured Working Expenses. The latter is a term used to refer to costs deducted from turnover in calculating Gross Profit.

The Uninsured Standing Charges Clause concerns increased costs.

Sometimes, usually against the advice of their broker, P will deduct many costs in calculating Gross Profit. Usually, these will be variable (such as the bulk of the electricity bill), but sometimes they will be fixed (such as the local authority rates bill).

If P uninsures (deducts from turnover to calculate Gross Profit) fixed costs, they are effectively taking part of the Gross Profit risk to their own account.

It follows that any increased costs that are incurred to mitigate loss are partly to reduce the insured loss and partly to reduce the loss that P has elected to bear.

So, if P's Gross Profit should be £100, but they have uninsured fixed costs of say £20, giving an insured Gross Profit of £80, they will only recover 80% of the increased cost expenditure.

Relevant observations are as follows:

- The clause applies to fixed costs only. It has no relevance to variable costs that have been (however imprudently) deducted from turnover
- The fixed cost has been uninsured since inception not post loss, and the test of whether or not it is fixed should be applied to cost behaviour before an incident, not after
- In practice, it can be difficult to assess whether a cost is fixed or variable – many costs have elements that are fixed and variable. Further, some variable costs appear fixed simply because P's turnover itself may not vary.

3.3.4 Additional Increase in Cost of Working

Sometimes, it can be difficult to show that a cost will prove to be economic, albeit P is in no doubt that the

proposed expenditure is essential. In extreme cases, it may be obvious that such expenditure will definitely not be economic, but is still essential (in P's opinion) to protect the business.

The proposed expenditure can be difficult to support in the context of the economic limit. Additional Increase in Cost of Working ('AICW') cover addresses that issue, by removing the economic limit test.

That is the main difference between AICW and ICW. There is no economic limit on the former.

Whereas ICW cover is provided as part of the GP limit and does not appear separately on the schedule, AICW is subject to a separate limit of indemnity and usually appears as a specified item in the policy schedule.

In all other respects, the requirements for an AICW claim are the same as for ICW. There is still a need to show a benefit to P's business within the MIP. Advertising costs incurred near the end of the MIP and claimed as AICW will be just as difficult for a policy to respond to as if claimed as ICW, as the interruption avoided will probably be after the expiry of the MIP.

Likewise, any residual values still need to be taken into account. If a machine with a 20-year life is purchased 6 months after a fire, it will have 18.5 years' economic use at the end of say a 24-month MIP. The admissible claim is not the full cost of the new temporary machine. It is that cost less the value at the end of the MIP. That could be established by selling the machine at that point.

Alternatively, a mutually acceptable contribution by P in order to retain it can be agreed (it is good practice to agree this at the point of purchase where there is a clear intention from the outset for P to retain it).

All of the comments about ICW also apply to AICW, with the exception of the removal of the economic limit.

3.3.5 Savings

In the case of a Gross Profit policy, costs that P assumed would reduce directly in proportion to any reduction in turnover have already been deducted in calculating the Rate of Gross Profit. These are the uninsured (or specified) working expenses.

There may be additional costs that do actually reduce, but have not been deducted to calculate Gross Profit as it may have been imprudent to assume that they would always reduce in line with turnover in every circumstance. Wage costs and utilities often fall into this category.

To achieve an indemnity, any actual reduction in costs (not already deducted to calculate Gross Profit) must be deducted from Gross Profit

losses so that the financial result is most nearly what it would have been but for the Damage.

A reduction in a cost that has been deducted to calculate Gross Profit cannot be taken as a saving. Savings are reductions in costs insured as part of the Gross Profit. Costs already deducted to calculate Gross Profit fall outside of that.

Many businesses have a cost base that is primarily fixed and savings may be modest except in cases of complete destruction.

Wages will usually be paid, even in cases of complete closure, to retain key staff. Most other operational costs will continue.

Two main approaches may be taken in respect of calculation of savings. Either costs before and after an incident can be reviewed and any reduction can be measured (much the same as the calculation of a reduction in turnover), or the profit and loss account can be reviewed and costs that will logically have reduced can be identified. The total of those as a percentage of preincident turnover can be established, and that percentage (a ‘rate of savings’) can then be applied to the agreed turnover loss due to Damage.

The ‘rate of savings’ approach may be the most practical for smaller losses, as cost reductions may be too modest to be identifiable in trend calculations.

In some cases, there are specific savings that need to be dealt with separately – rent cessation and rates rebates are the most obvious examples.

Three further observations should be noted in respect of savings. Firstly, the reasonable decision about which costs to continue to pay belongs to P. They are in the best position to decide what is reasonable. While cost reductions cannot be demanded by insurers, P is not at liberty to decline achieved savings that ought to be realised.

Making staff redundant before a mitigation plan is in place, for example, would be foolish, but laying off unskilled staff where a single site business is going to be closed for over a year is unlikely to be.

Withholding payment of bonuses/commission to sales staff could be unwise (if they all leave, turnover could reduce dramatically). If such payments are not made, the benefit of that decision accrues to insurers, not P, as the cost avoided is deducted from the claim.

Hasty and ill-considered cost savings benefit nobody.

On the other hand, there is a duty to mitigate the overall loss, but not to mitigate the insured loss within the MIP at the expense of suffering an uninsured loss beyond it.

Secondly, growth trends do not just affect turnover. If it is the case that turnover would have increased but for the Damage, it is reasonable to assume that variable costs would have done likewise.

So, a saving calculation should compare actual costs incurred to costs amended by the amount necessary to support any applicable trend (rather than the actual costs subsisting pre-damage) to avoid under or overstating the calculation of saving. That depends on whether the trend is upward or downward.

Thirdly, savings are a discrete part of the policy cover and technically should not be netted of increased costs incurred. However, in some instances, this can result in attractive mitigation measures being rejected as uneconomic. Proposed ICW (gross of savings) might be greater than any GP loss avoided, but ICW net of savings might be less.

Insurers may wish to set aside the technical approach (of dealing with each part of the cover separately) on a commercial basis in these cases.

3.3.6 Proportionate Reduction

PD covers are usually subject to average, so that, if the value at risk at the time of Damage is greater than the corresponding Sum Insured, any loss calculated will be reduced by the proportion of underinsurance.

Sometimes, a margin of error of 15% is provided (85% average).

Traditional BI policies do not refer to average, but use the term proportionate reduction. It means the same thing. If the Gross Profit produced using the assumptions in the settlement (Rate of Gross Profit applied to the Adjusted Standard Turnover) is greater than the Gross Profit Sum Insured, the net settlement is reduced.

In other words, average is applied to the net amount of GP, plus ICW, less savings. It does not apply to the GP item only.

3.4 Declaration Linked Policies

Traditional policies (written on the 'difference basis') are subject to proportionate reduction (average).

It is possible to purchase BI cover without any proportionate reduction clause. These are referred to as Declaration Linked policies and they may be written on a Gross Revenue or a Gross Profit basis.

Typically, the word 'Estimated' will appear before Gross Profit or Gross Revenue (or an 'e' inserted after the amount) if this is the case.

These policies were introduced in the 1980s when inflation was high and P may have found it difficult to assess the right level of cover. P was invited to estimate Gross Profit at the start of the policy year and to then confirm the actual amount at the end of it, with additional (or a rebate of) premium.

Additionally, average was waived and P could claim 133.33% (some policies offer other uplifts) of the declared amount in respect of unforeseen growth.

It should be stressed that the 33.33% is not a margin of error available to P. The declared amount should not be less than the amount at risk (P can declare a higher amount if growth is expected). The 33% uplift is only relevant at the time of a claim for unanticipated growth subsequent to the start of a policy period. It is not relevant to assessment of the adequacy of the declaration.

There is a practical problem in that declarations are not made in the majority of cases and potentially significant underdeclarations might only be identified when a claim is made.

There may be no average clause and no policy sanction available to insurers. However, in extreme cases, significant underdeclarations may be deemed to constitute a breach of the Duty of Fair Presentation, described in the Insurance Act 2015.

At the time of writing, no cases have come before the courts to test this issue. It is unique to Declaration Linked covers – a Sum Insured subject to average already has a contractual remedy written into the policy contract to deal with it. Declaration Linked policies do not.

The scope of underdeclaration is evidenced by a number of surveys conducted by CILA over the last 12 years:

	Declarations understated	When understated, degree of adequacy
2008	37%	50%
2009	52%	63%
2012	40%	45%
2017	44%	44%

In other words, the problem of underdeclaration is a significant one and the adequacy of the declaration is best established at an early stage (preferably before liability is confirmed).

Discrepancies should be referred to insurers, to avoid surprises later in a claim.

For small claims, it may be impractical to assess the overall adequacy of a declaration for a large group of companies. That just needs to be communicated to insurers to avoid any misunderstanding.

Three final observations need to be made.

Firstly, an underdeclaration may require scrutiny even if it is accidental rather than deliberate, particularly if a misunderstanding arises due to P not having read their policy properly (or at all).

Secondly, when considering the adequacy of a declaration, care should be taken in respect of indemnity periods longer than 12 months. For a 24-month period, the amount should be doubled, tripled for 36 months etc. MIPs shorter than 12 months retain the need for a 12-month declaration, i.e. it is not halved for a 6-month MIP, for example.

Thirdly, declarations may be made for premium adjustment purposes for policies that are not declaration linked. Just because a declaration is made, that does not necessarily mean that there is no proportionate reduction clause.

Calculation of the Overall BI Loss: A Recap

The policy specifies the arithmetical steps to be taken in words (rather than numbers):

- Standard Turnover
- Trend
- Adjusted Standard Turnover
- Actual Turnover
- Reduction in Turnover
- Calculation of the Rate of Gross Profit
- Loss of Gross Profit (applying the Rate of Gross Profit to the Reduction in Turnover)
- Add: Increased Costs of Working
- Deduct: savings
- BI settlement
- Less any applicable proportionate reduction.

3.5 Interim Payments

Following a loss. P may not only be suffering a reduction in turnover but also incurring increased costs resulting in pressure on their cash flow. Cash flow per se is not covered under the policy but, as solvency post loss is desirable for all, interim payments/ payments on account are usually made.

While many policies have a payment on account clause, they generally offer no specific guidance as to how interim payments should be calculated. It is sensible to try to forecast any payments in advance, considering major plant reinstatement and also allowing for operational overheads in order to keep P in a cash neutral position, regardless of whether there is a clause addressing payments on account. The Enterprise Act 2016 gives P an opportunity to claim damages in the event of late payments after sums are due.

Some payment on account clauses are very specific, but many are vague and do no more than signal a willingness to consider interim payments.

As noted in the Introduction, it is good practice to recommend interim payments where settlement cannot be achieved quickly. This empowers P to mitigate loss, for the benefit of all.

3.6 BI/PD Overlap

BI and PD are distinct areas, but they can overlap.

To calculate Gross Profit, variable costs that reduce in direct proportion with any reduction in turnover are deducted from that turnover. So, the Gross Profit amount is insuring all of the costs that have not been deducted, along with the net profit:

£000	**£000**		
Turnover		100,397	This part of the profit and loss account is insured as PD (Stock), or assumed to reduce directly in line with turnover.
Opening Stock	4,299		
Purchases	52,499		
Closing Stock	(5,317)		
Cost of Sales		(51,481)	
Gross Profit		48,916	
Administrative		33,772	This part of the profit and loss account is insured as BI.
Expenses			
Distribution Costs		8,643	
Interest Payable		1,232	
Profit before Tax		5,269	

The BI claim and the Stock claim together can never add up to more than the selling price ('SP'). That would amount to an over-indemnity. Policies are simply apportioning the SP between the stock and business interruption covers.

Some (typically marine or stock throughput) policies value finished stock at SP. When that is the case, the turnover paid in the stock claim should be deducted from Adjusted Standard Turnover in the BI claim.

In the example above, if the stock valuation includes only purchases, there is no overlap with the business interruption cover. However, if P had included administrative or distribution costs in their stock claim, then there would be double counting, as those same overheads are also covered under the BI cover. Insurers will not pay for the same overheads twice.

Assume that (a different) P values their stock as follows:

	£
Raw material purchases	50
Wages	10
Power	5
General overheads	15
Total cost of stock	80

P sells stock for £120.

A fire occurs, destroying the stock and also causing a loss of turnover.

The stock claim is resolved first, as is usually the case, at £80 per unit. A BI claim is then submitted at £70 per unit (SP £120 less raw material purchases of £50). The PD and BI claims total £150, whereas P would only have received £120 (the initially anticipated SP) had the Damage not occurred.

The reason that the policy at first sight appears to offer overpayment of £30 is that the wages, power and general overheads in the table above total that amount. They have been included in the stock claim. Because they are not deducted from turnover to calculate Gross Profit, they are also included in the BI claim.

Most policies do not define how stock should be valued for settlement in the PD section. If P claims for stock loss at material cost only, there will be no overlap (assuming that purchases have been uninsured in the BI cover).

As a matter of indemnity, costs can only be claimed once, and as a matter of pragmatism, they will usually be deducted from the business interruption claim. If the stock sum insured is subject to average, P may prefer to claim only on a raw material basis to reduce the impact of any stock underinsurance.

It should be observed that P may have a stock loss without any BI claim (they may have sufficient buffer stock to meet orders) and it may be sensible to insure overheads under both policy captions for this reason.

The overlap issue is not confined to stock. Use of P's staff to carry out restoration work will produce the same result.

Assuming that wages have not been uninsured (i.e. have not been deducted from turnover to calculate Gross Profit), payment for P's employees to carry out cleaning/repairs of plant and machinery as part of a PD claim represents an over-indemnity as the wages are also being paid as part of any Gross Profit loss. The wage cost is not additional – it is a redeployment.

Subject to agreement in advance, insurers sometimes allow the admission of these costs as a matter of pragmatism, where the costs are lower than third party external costs and where the involvement of the employees keeps them engaged and retained.

Against this, there remains the duty to mitigate loss, and payment of wage costs that would have been incurred irrespective of the Damage results in over-indemnity.

The presumed position in the absence of any explicit agreement is that the policy is not there to reimburse costs that would have been incurred had the Damage not taken place.

3.6.1 Overlap in Salvage Sales

Following Damage to stock, there may be value in the remaining salvage. A salvage sale may therefore be held to sell off stock at a reduced price in order to realise an element of revenue.

Salvage may be sold to a salvage dealer, in which case proceeds are deducted from the stock loss.

Alternatively, P may sell the salvage in a salvage sale. Where that takes place, the loss crystallising is the difference between the sales value that would have been generated on the stock sold as salvage and the actual lower salvage price achieved. Key observations in relation to that are as follows:

- Salvage sale profit may be lower than normal Gross Profit due to Damage. However, the normal calculation (in the absence of a salvage sale clause) assumes all actual turnover after an incident achieves the normal Rate of Gross Profit
- The above situation can give less than an indemnity, so actual turnover after an incident excludes the salvage sale turnover. This increases the reduction in turnover to which the normal ROGP is applied to calculate the loss of Gross Profit. The actual Gross Profit earned on the salvage sale is then deducted from that
- For small salvage sales, there is a need to split the loss between PD and BI covers.

Suppose P's normal profit is as follows:

	£
Selling Price (SP)	12
Cost	7
Gross Profit (GP)	5
Normal ROGP	42%

If the SP for a unit is depressed due to Damage, the reduced selling price has arisen because of physical impairment (thereby satisfying the material damage proviso).

The loss cannot all be BI because the selling price is only reduced due to the physical impairment. Likewise, the loss cannot all be PD as the unit would not be able to be sold at all if it was totally damaged. Some means to apportion loss therefore needs to be established.

A suggested approach is to first estimate the BI element of the loss, with the PD accounting for the balance. To do this, the normal Rate of Gross Profit needs to be applied to the actual salvage sale turnover achieved.

Effectively, this approach seeks to pro rate loss between BI and PD on the basis of the normal ratio between Gross Profit and cost of stock.

Assume (scenario A) a severely depressed selling price:

	£
Normal SP	12
SP achieved in salvage sale	5
Loss on salvage sale	7

The £7 loss needs to be apportioned between the PD and BI claims:

	£
SP achieved in salvage sale	5.00
GP thereon at normal rate (42%)	2.08
GP anticipated but for the Damage	5.00
Less GP achieved on salvage sale	(2.08)
BI loss	2.92
Total loss	7.00
BI loss (calculated above)	(2.92)
Therefore, PD loss (balancing amount)	4.08

The above example used a reduction in the SP of £7.

Alternatively, assume (scenario B) a marginally depressed selling price producing a loss to be apportioned of £3:

	£
Normal SP	12
SP achieved in salvage sale	9
Loss on salvage sale	3

	£
SP achieved in salvage sale	9.00
GP thereon at normal rate (42%)	3.75
GP anticipated but for the Damage	5.00
Less GP achieved on salvage sale	(3.75)
BI loss	1.25
Total loss	3.00
BI loss (calculated above)	(1.25)
Therefore, PD loss (balancing amount)	1.75

4

CONCLUDING REMARKS

While there is a formulaic basis for the calculation of the BI indemnity in many policy wordings, and there may be a temptation to immediately begin calculations of loss, two observations are offered:

- Consider whether cover applies in the first instance
- Sense check any calculations, regardless of the arithmetic correctness of the detail. If the historic trend suggests no loss has arisen, but P's premises were smoke logged for several weeks, there is something wrong with the assumptions in the calculation (this may also be true of improbably aggressive trends).

The overriding advice is to establish an overall strategy for loss resolution from the outset. Drive that through ICW expenditure and produce the best outcome for all parties.

The key to a successful BI outcome is proactive mitigation rather than retrospective measurement, the latter usually involving unpleasant surprises (as opposed to best outcomes) for all.

APPENDICES

A

TERMINOLOGY

Accumulated Stocks Clause	The Accumulated Stocks Clause anticipates a situation where P depletes their buffer stockholding to avoid a reduction in turnover and has not been able to replace such buffer stock by the end of the Maximum Indemnity Period.
Adjusted Standard Turnover	Standard Turnover is adjusted to reflect any necessary trend such that it then represents the turnover that would have occurred had it not been for the Damage.
Alternative Trading Clause	This allows the claim to be adjusted for turnover generated at other Premises after Damage.
Annual Turnover	Income/revenue P received from the sale of goods/services during the 12 months immediately prior to the date of claim as per the annual accounts.
Automatic Reinstatement of Loss	Following payment of a claim, the policy is restored to the full original amount of coverage. An additional premium may be required by the insurer.
Average	If the sum insured is less than the sum produced by applying the Rate of Gross Profit to the Annual Turnover (or to a proportion of the increased multiple thereof where the Maximum Indemnity Period exceeds 12 months), the amount payable should proportionately be reduced.
Budgeted Turnover	Based on projected sales.
Co-insurance Clause/Condition	This is where P shares a percentage of the loss with the insurer rather than a fixed amount as in the case of an excess, e.g. a 20% co-insurance would mean P is responsible for 20% of the loss and the insurer 80%.
Co-insurance Policy	A policy of multiple insurers each taking a percentage or line of the risk and premium, normally with wording and claims managed by the lead office. All co-insurers should be notified of loss.

Contract Price Clause	For goods sold but not delivered, the liability is the contract price.
Customers' Extension	This covers loss resulting from the interruption of or interference with P's business in consequence of loss, destruction or damage at a Specified Customer or Unspecified Customer as detailed in the Schedule up to the limit purchased for the extension.
Declaration Linked	A BI policy usually not subject to proportionate reduction.
Deductible	Same thing as an excess.
Denial of Access	Loss of or restricted access to Premises as a result of damage by an insured peril in the vicinity, which may be specified as a set distance.
Departmental Clause	If P's business has separate departments, whose financial performance can be discretely measured, then the Rate of Gross Profit for the department affected replaces the overall average.
Difference basis wordings	GP cover that is subject to proportionate reduction/ average ('Difference' referring to the difference between the total of turnover and closing stock and the total of purchases and opening stock).
Economic Limit	This refers to increased costs. Insurers will not pay more for costs incurred than the Gross Profit loss the expenditure has avoided (this does not apply to AICW).
Excess	The first amount of any claim that P must bear themselves. The claim payment is made in excess of this amount. It may be a monetary amount or a period of time.

Franchise	If a loss is less than the franchise amount, nothing is paid, but the loss is paid in full if it exceeds the franchise amount. It may be a monetary amount or a period of time.
Fraud indicators	Fraud indicators are signs that a claim has the potential to be fraudulent, e.g. a loss immediately post inception of the policy.
Gross Profit	The amount by which: i) the sum of the amount of the Turnover and the amounts of the closing stock and work in progress shall exceed ii) the sum of the amounts of the opening stock and work in progress and the amount of the Uninsured Working Expenses.
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 P's business shall be affected in consequence thereof.
Insurable Interest	The principle requiring P to demonstrate a benefit or a loss arising from the destruction of the subject matter of insurance.
Inventory	Means the same thing as Stock.
Loss of Attraction	Reduction in turnover due to a fall in custom, usually as a result of damage to property in the vicinity (which may be specified as a set distance) that otherwise draws customers to P.
Material Damage Proviso	There must be in force an insurance covering the interest of P in the property that has been damaged, and for a payment to have been made except for the excess/deductible.
Maximum Indemnity Period	The period after which BI cover ceases to operate, whether the results of the business continue to be affected or not.

Mitigation of Loss	There is a written Condition in the policy that P must mitigate (reduce) their loss.
Net Profit	This equals the 'bottom line' or gross profit less overheads.
Other Circumstances Clause	This clause allows for any circumstances that would have affected P's business but for an incident to be taken into account in calculating the loss. Sometimes, it is called the 'trends' or 'variations' clause.
Professional Accountants Clause	This covers the costs of accountants routinely used by P for providing information from books of accounts (some policies require the advance written agreement of insurers to be admissible).
Proportionate Reduction	A BI term that means the same thing as Average.
Purchases	This is generally assumed to refer to raw materials (but wordings might not be specific).
Rate of Gross Profit	Gross Profit for the previous 12 months divided by the turnover for the previous 12 months multiplied by 100 = x% (the Rate of Gross Profit). This percentage is then applied to the calculated Reduction in Turnover to produce the total Loss of Gross Profit.
Reduction in Turnover	Adjusted Standard Turnover less actual turnover generated.
Salvage Realisation	The intention of the salvage sale is to generate turnover, although the Gross Profit earned on the sale may differ from the normal Rate.
Savings	Saved variable costs that would have been incurred had there not been a loss, e.g. a reduction in electricity costs if a machine is not running. This does not include costs that have been uninsured.

Standard Turnover	The turnover generated in those months in the previous year corresponding with the period affected by the Damage.
Suppliers' Extension	Loss resulting from destruction or damage at either a Specified Supplier or Unspecified Supplier as detailed in the Schedule up to the limit purchased for the extension.
Trends	The Standard Turnover is adjusted for any necessary trend such that it then represents the turnover that would have been anticipated but for the Damage.
Turnover	The amount that the business has earned (Sales and Revenue mean the same thing).
Uninsured/ Specified Working Expenses	These are costs/overheads that (P has assumed will) reduce in direct proportion to the reduction in turnover, e.g. purchases, carriage and freight.
Uninsured Standing Charges Clause	This applies to Increased Costs. If P has uninsured or specified fixed costs, not all ICW will be payable (in the proportion that the fixed costs bear to Gross Profit had they not been deducted in calculating it).
Utmost Good Faith	Principle set in the Marine Insurance Act 1906: '*insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party*'.

B

LOSS CALCULATIONS – WORKED EXAMPLE

A more detailed example of a BI adjustment is provided in the following pages. This adjustment is based on an SME furniture retailing business and assumes a loss scenario as follows:

On 1st January 2019, the premises were subject to a serious fire which destroyed the building, all contents and stock. Despite a conscious effort to find alternative temporary premises, nothing suitable could be located before expiry of the MIP.

The annual turnover of the business is summarised below. Turnover excludes VAT. The insured are tenants in the building and only insure Contents, Stock and BI under their policy.

There is a cessation of rent clause within the lease with the landlord. The policy is subject to average.

BI insurance is provided as follows:

- Gross Profit sum insured (not declaration linked) £200,000
- Maximum Indemnity Period 12 months
- Uninsured Working Expenses as stated in the policy are:
  - Purchases, net of stock movement
  - Delivery charges
  - Bad debts.

Increase in Cost of Working is claimed as follows:

Loss assessor's fees £19,000
Accountant's fees £ 3,000

For the purposes of this example, P continued to pay staff during the interruption period and all other costs remained. In the event of a total loss, there are normally savings in rates and utilities for example, but for this illustration only rent has been used.

Turnover for the years before the fire was as follows:

- 2016 £959,591
- 2017 £1,165,775
- 2018 £1,096,355

Accounts for the year ending 31st December 2018:

	£	£
Sales	1,088,819	
Finance commission	3,476	
Income from concession	4,060	
Turnover		1,096,355
Opening stock	21,367	
Production wages	71,494	
Purchases	608,323	
Closing stock	(22,646)	
Cost of sales		678,538
Gross profit		417,817
Wages and salaries	126,368	
Rent	44,068	
Rates	73,678	
Delivery charges	36,422	
Utilities	8,507	
Cleaning	372	
Waste disposal	779	
Repairs and maintenance	2,912	
Postage/telephone	2,481	
Advertising	37,198	
Bad debts	2,500	
Credit card charges	548	
Depreciation	1,015	
Total overheads		336,848
Net profit		80,969

Calculating the Rate of Gross Profit

	£	£	Notes
Turnover		1,096,355	
Less Uninsured Working Expenses			1
Opening stock	21,367		
Purchases	608,323		
Delivery charges	36,422		
Bad debts	2,500		
Closing stock	(22,646)		
		(645,966)	
Gross Profit per the policy		450,389	2
Rate of Gross Profit		41.08%	

Calculating the Loss

	£	Notes
Standard turnover, 01/01/18 to 31/12/18	1,096,355	
Trend (say –5%)	(54,818)	3
Adjusted standard turnover	1,041,537	
Less actual Turnover	0	4
Loss of Turnover	1,041,537	
Loss of Gross Profit (£1,041,537 × 41.08%)	427,863	
Add increased costs	0	5
Deduct savings	(244,068)	6
Loss before average	183,795	
Net Loss after average (£183,795 × 46.74%)	85,906	7

Notes

1 Reference should always be made to the actual policy wording to check the definition of Uninsured Working Expenses. In this example, the policy listed purchases, delivery charges and bad debts.

If a cost has been uninsured (deducted from turnover to calculate Gross Profit), it must be deducted to calculate the Rate of Gross Profit, whether or not that cost actually reduces in line with turnover.

2 Production wages were deducted to calculate gross profit in the 2018 accounts, but are not an uninsured cost when calculating policy Gross Profit (per the definition in the policy in this example). It is common for policy Gross Profit to be higher than gross profit in a set of accounts (because the latter is likely to deduct more costs).

However, as the calculation of Gross Profit (as defined in the policy) also deducts costs that have not been deducted to calculate gross profit in the accounts (delivery charges and bad debts in this example), that is not always the case.

3 In this example, the trend calculation has been based on the movement in turnover from 2017 to 2018:

	Year	Turnover
		£
	2017	1,165,775
	2018	1,096,355
Downward trend		–5.95%

In this example, a rounded trend of 5% has been used. Trends can be nil, positive or negative, depending on the circumstances. Neither a positive nor a negative trend need carry on indefinitely. Indeed, trends over time will tend to level out, unless other factors change them.

4 This example assumes that no alternative premises could be found (despite searching for these for four months) and that no turnover could therefore be generated in 2019. In practice, all parties would want to be satisfied with regard to the scope of the search for alternative premises.

5 Loss assessor’s fees are not a valid increased cost as they are not incurred to avoid a loss of Gross Profit. They are simply a cost incurred at P’s option and are inadmissible. Generally, policies state that P must submit a claim at their own expense. (Some policies include cover for claims preparation costs, which might cover assessor’s fees.)

Accountants' fees are not a valid ICW as they are not in mitigation of a loss, although they could be considered under the Professional Accountants' Clause. As no turnover was achieved post loss, the economic limit would be nil in any event, so no valid amount is available for ICW incurred.

In practice, P should be encouraged to incur increased costs to avoid a reduction in turnover. The ideal business interruption loss is one comprising increased costs only.

6 Savings

	£
Rent – Cessation of rent clause known to apply so full saving	44,068
Total other overhead savings, say	200,000
Total savings	244,068

The reason why savings are less than the total overhead is that wage costs (in particular) do not suddenly stop, but continue until redundancy periods/costs come to an end.

Note that this example assumes a complete loss, although P's costs continued while the search for alternative premises went on, and staff were retained during that period.

Most claims result from partial losses and, if a business carries on trading, costs may be largely unaffected even though the revenue may reduce significantly (which is why it is imprudent to uninsure a long list of costs). In practice, one would consider each cost to determine whether and to what extent a saving exists.

7 This example assumes that the policy is subject to underinsurance, and that the underinsurance clause is based on the adequacy of the sum insured in the 12 months after damage (in other words, in this case, the Gross Profit loss shown in the final section of the calculations above):

$$\frac{\text{Sum insured}}{\text{Value at risk}} \quad \frac{£200{,}000 \times 100}{£427{,}863} = 46.74\% \text{ adequacy}$$

The VAR is the product of applying the ROGP to the Adjusted Standard Turnover (shown under Calculating the Loss above).

Basis periods for the calculation of underinsurance (and for Declarations of Estimated Gross Profit) vary. Policies variously may specify the last set of accounts, the 12 months before Damage, the 12 months before policy inception, or the financial performance in the financial year most nearly concurrent with the policy period (this is not an exhaustive list).

Remember that declaration linked policies are not normally subject to average.

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