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BUSINESS INTERRUPTION WORDINGS - COMMONLY ASKED QUESTIONS

What does the term “Business Interruption” mean?

Business Interruption insurance is coverage that protects a business in the event of natural disaster, fire or other circumstances insured under the Material Damage section of a policy which result in a break in their commercial activities and their consequently being unable to maintain their turnover or income.

A “break in commercial activities” means an insured being either unable to trade or being forced to continue trading under reduced or differing circumstances which would have a direct effect on the turnover of the business.

How can any Insured know how long they will be affected by this break in activities?

The Insured chooses what is known as an Indemnity Period:

The Indemnity Period is defined as: *“The period beginning with the commencement of the damage (loss) and ending not later than the number of months thereafter stated in the schedule during which the results of the business shall be affected in consequence of the damage”*. The selection of the indemnity period is a matter for decision by the Insured, based upon certain criteria which would have a direct effect upon the time that it might take to restore the business to the level of turnover which it reached prior to the occurrence of damage.

How does an insured assess the necessary Indemnity Period?

The period decided upon should represent the full estimated time during which the business might be affected in consequence of the damage and which it would take to restore the business to its level of turnover before that damage occurred.

The Insured must estimate the time required to reinstate or rebuild the premises, replace the plant, machinery and stock and regain custom lost during the period during which trading is affected. This would include practical aspects such as the time taken to demolish and clear the site and to organise rebuilding including competitive tendering and possibly complete redesign where necessary. The time which it would take to obtain replacement plant, given that particularly specialised equipment might have a very long lead time, is also an important consideration. Additionally, the Insured might have to completely re-staff their business.

Might an Insured also be affected by other factors over which they have no control during the reinstatement or rebuilding process?

Any Insured would be well advised to allow a further margin of time for the unpredictable events which have a tendency to turn up when least expected and which will delay the resumption of full turnover still further. Examples of this might be strikes within the building industry, within the transport industry, at ports or shortages of materials such as bricks, steel, cement or whatever. Restrictions on the Insured's ability to rebuild might arise from municipal planning. Additionally very long delays can occur in obtaining new plant and machinery, especially if this is of a complex or sophisticated nature or manufactured in another country. Lastly, in businesses where there is a definite seasonal element to the trade, consideration must be given to its potential effect on turnover.

Given the above, what would happen if the Insured does not own the premises?

This is very often the case and, in that event, there is no certainty that the landlord will rebuild after the premises are destroyed. This can prolong the period of interruption, especially when the landlord takes weeks or even months to decide whether or not to rebuild.

This type of insurance is often referred to as “Loss of Profits” insurance. Is it the most commonly bought type of Business Interruption insurance available today?

It is only one type of Business Interruption insurance. The cover is for a maximum sum insured representing the Insured's Gross Profit and the increase in the Insured's cost of working for the anticipated period that production is interrupted following damage. Gross Profit is defined as the sum of the Insured's Net Profit plus Insured Standing Charges. The latter are simply expenses which do not change in direct proportion to changes in sales (i.e., fixed and semi-fixed costs such as taxes, rent and insurance). The definition of Standing Charges specifically excludes ordinary payroll and therefore, ordinary payroll is not insured unless a specific extension of cover is selected to include it.

How is the term “increase in cost of working” defined?

These are basically costs incurred to avoid or reduce the Insured's reduction in turnover. These are not specifically defined or mentioned within policy wordings. However, examples of these could be the rental of temporary premises, the rental of temporary equipment or the cost of outsourcing, the uninsured cost of equipment purchased, the expense of moving equipment and the like, the cost of cleaning temporary premises, the cost of light, power and heat at a temporary location, extra telephone costs, special bonuses and overtime pay to employees or rental of cars and other vehicles.

Might an insured wish to insure loss of their earnings rather than merely Gross or Net profit?

Gross Earnings insurance is another commonly purchased type of Business Interruption coverage. There are two types of coverage here, one for manufacturing entities and the other for mercantile or non-manufacturing entities. The manufacturing form defines Gross Earnings as “the sales value of production foregone less certain specified costs and expenses”. The mercantile form defines it as “sales foregone less the direct cost of goods sold and other direct material costs”. The definition of earnings under either of the two forms does not include a deduction for payroll expenses. Therefore, “ordinary payroll”, which generally means the expense related to non-essential employees, is insured.

One very important point should be noted. Gross Earnings insurance, unlike Loss of Profits insurance, assumes that the loss ends when the Insured are in a position to resume their operations. So in this case, the Indemnity Period is quite simply the amount of time required “with due diligence and despatch” (to quote the policy form) to rebuild, replace or repair the insured property.

What are the other types of Business Interruption coverage?

Most commonly these are Revenue (being the money paid or payable to the insured for goods sold and for services rendered in the course of the business at the premises), Gross Rentals (the money paid or payable to the Insured by tenants in respect of the rental of the premises and for services rendered) and Wages.

Construction policies often include a type of Business Interruption insurance called Advance Loss of Profits (ALOP) or Delay in Start-Up (DSU) coverage. This cover provides indemnity to the Insured in respect of loss of profits due to the contract works being delayed as a result of a loss insured under the terms of the works section of a Contractors All Risks or Erection All Risks policy. Usually, it is only the principal and financiers who can be insured under this type of coverage. It also differs inasmuch as the period of indemnity starts with the provisional hand over date at the end of the construction or period (known as the date of practical completion) and not the date of any loss under the material damage policy. Additionally, the risk of the entrepreneur and any contractual penalties cannot be insured under an ALOP or DSU policy.

Does Business Interruption coverage always follow a material damage loss? Might there be circumstances where it follows another type of coverage?

Any material damage policy will invariably include a pollution exclusion and the Insured may well take out an environmental insurance policy to address interruption not covered by this eventuality. Such policies typically cover the Insured’s first party costs in the event that an on-site mandatory clean-up is required by a Statutory Authority. Such an event may well require the Insured to cease or restrict trading until such time as the clean-up has been completed to the Authority’s satisfaction and will therefore result in loss of turnover. Business Interruption coverage under an environmental insurance is invariably subject to a highly bespoke construction according to the nature of the pollution coverage required and cover can be provided for both the first party and any third party impacted.

The Insured may well be reliant upon other parties for the supply of parts or goods which are essential to their continuing to trade and maintain turnover. Can they insure against the eventuality of these parties being unable to continue production?

Contingent Business Interruption (CBI) will protect a business should this situation arise and many Business interruption policies will include basic extensions to cover loss of turnover or income due to loss or damage at the premises of customers and suppliers.

More specialised CBI insurance can be purchased to insure against loss of turnover from more remote and often shorter-term events. Coverage here is bespoke case by case and can include situations where no physical damage is involved. Businesses which rely upon public attendance or a steady flow of visiting customers to maintain turnover are particularly vulnerable to occurrences which have the effect of reducing access or stopping attendance completely.

These might include railway companies, whose turnover is derived from thousands of daily travellers and who would be badly affected if stations spent periods of time out of operation as a result of a rail disaster. A major international airline which has the monopoly of flights to a specific holiday destination has taken out coverage against the resort suffering hurricane damage to the extent that the demand for flights is adversely affected or even ceases.

CBI insurance can also be purchased for a fear of the occurrence of certain events. An outbreak of legionnaires' or similar disease, emanating from a holiday centre or theme park would result in a loss of takings at that location and at similar associated venues, resulting in an indemnifiable loss.

In these instances, however, the Insured must be able to prove that the loss of turnover or revenue occurred as a direct result of, or was linked to, the CBI event insured against and was not due to another coincidental event which also affected the business to a substantial extent. A claim in respect of loss of income due to an outbreak of food poisoning affecting sales at an ice cream parlour would need to be adjusted to reflect the fact that it might have occurred during an usually cold and wet summer which itself had a significant impact on revenue.

Are there are other extensions which might be more commonly included within a Business Interruption policy?

There are several which are often included as standard coverage.

Denial of Access coverage indemnifies the Insured against their being prevented or hindered from entering their premises to conduct business due to damage to their own property or that of another party. A distance limit from the Insured's premises is usually imposed in respect of third party premises.

Public Utilities coverage indemnifies the Insured against loss or damage at the premises of electricity generating stations, transmission networks, gas suppliers, water purification plants, pumping stations and pipelines of an authority employed by law to supply water, gas or electricity for public consumption, all of which results in an interruption of such at the premises of the Insured.

Public Utilities coverage may often exclude damage directly or indirectly caused by drought, pollution of water, shortage of fuel or water, faults at the premises of the Insured or the exercise of an authority empowered by law to withhold or restrict supply of such utilities unless such withholding is directly attributable to damage at their property and not that of the Insured.

Public Telecommunications coverage indemnifies the Insured against interruption or interference with their business as a result of the failure of public telecommunications facilities at the premises of the suppliers.

Bomb (hoax or actual), Terrorist Activity, Murder, Suicide or Rape at the Premises coverage indemnify the Insured against interruption or interference with the business as the result of the premises being evacuated or closed as a result of these eventualities.

Can the Insured claim anything under this type of insurance in respect of contracts which they are unable to fulfil as a result of interruption or interference?

Fines and penalties in respect of breach of contract only can be written into the coverage but this will be limited to sums that the Insured is legally liable to pay in respect of late completion and non-completion of orders.

The Insured might be able to maintain a limited turnover either by trading from another site or by using existing accumulated stocks. Does the coverage provide for this?

It is a standard condition of a BI policy that the revenue from sales at an alternate premises shall be brought into account in arriving at the turnover during the Indemnity Period and also that an equitable allowance shall be made if the

shortage in turnover is postponed by the Insured continuing to trade from accumulated stocks.

Can the Insured claim for fees which they will have incurred as a result of the loss?

The Insurer will usually pay the cost of reasonable accountant's fees payable to an accountant for preparing and submitting claims under a business interruption section. Such clauses should also include allowance for an Insured's own internal costs in preparing claims, which can be very substantial.

For further information on Business Interruption or any other wordings issues please contact us via the details below.