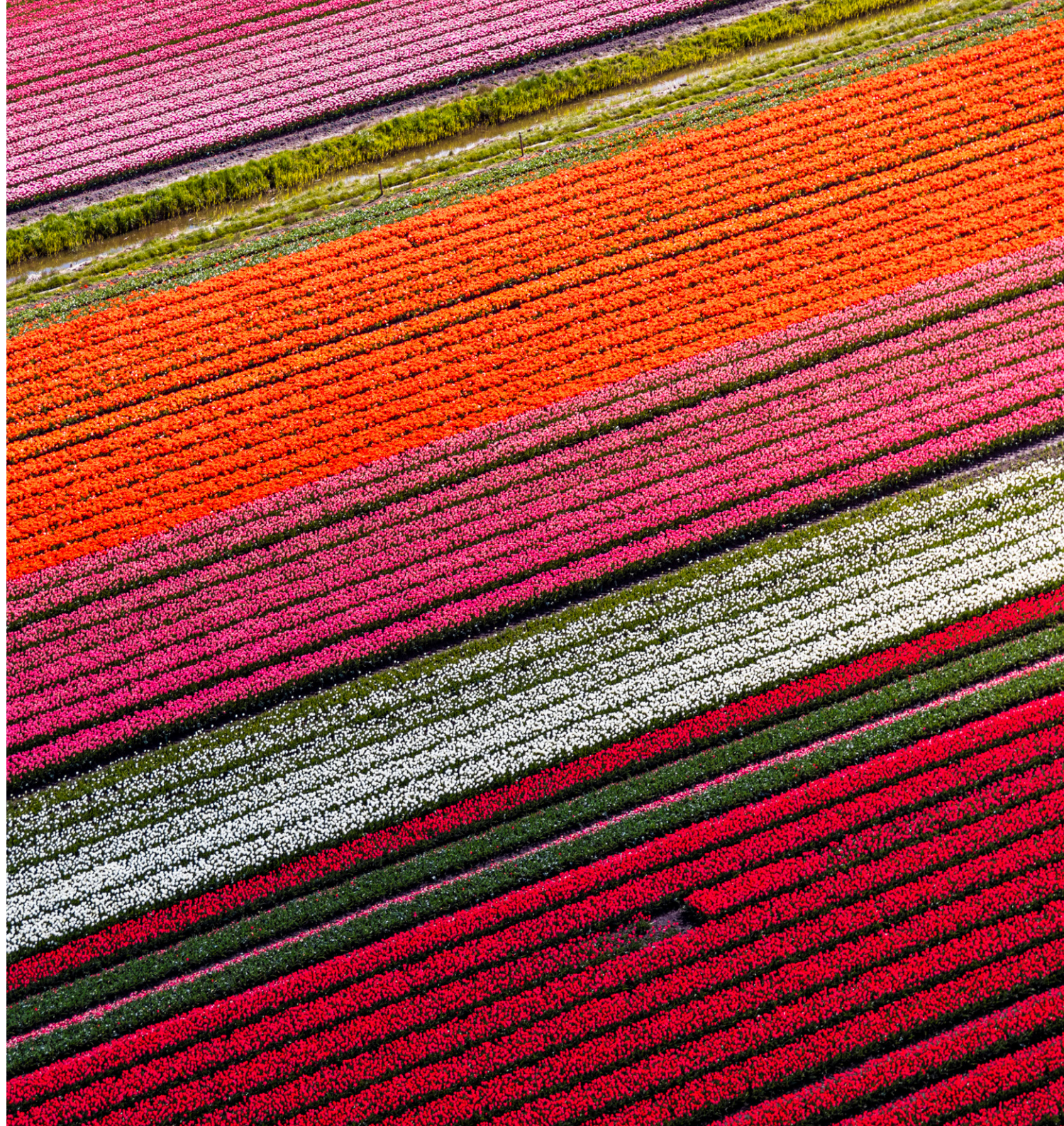


# Covernotes

Explaining issues that affect your insurance

## In this issue

- Business Interruption
- Construction Delays
- Martyn's Law
- Flooding
- Is it covered?





## Avoid Gross Mistakes with your Business Interruption Cover

Business success typically relies on a business carrying out its planned activities uninterrupted. It can, therefore, be beneficial to have insurance to cover lost income, should an unexpected event prevent business as usual - but only if the insurance policy has been taken out correctly.

Business Interruption insurance is the cover that can step in to put the business in the same position after its loss, as if the loss had not occurred. When taking this out, a business has to calculate its anticipated income and costs and insure for the difference between the two – the estimated

gross profit. That is where the business benefit from brokers guidance.

Many businesses think about their gross profit estimate in accounting terms, using figures their accountant produces for their end-of-year figures. That is not, however, the figure an insurer uses. When it comes to insuring gross profit for Business Interruption purposes, it is an Insured Gross Profit (IGP) figure that is required not Accounting Gross Profit (AGP).

The difference between the two is a fundamental one. IGP is the business's sales, less any costs varying directly with sales – the uninsured (specified) working expenses. AGP, on the other hand, is calculated on the basis of sales less the total cost of sales. Here, the costs deducted from income include wages, whereas, for insurance purposes, the

cost of wages should not be deducted. That is because it is rare for all wages to be variable and influenced by the sales generated.

Another mistake relates to rent. Some businesses assume this too is a variable and that, if they could not trade, rent would not be charged, and rates and utility costs not incurred. This might not be true. Partial building damage would still see rent paid and other costs charged.

Not including such costs would leave the sum for IGP at too low a figure, effectively leaving the business underinsured. If they claimed, the insurer could take one of two actions. They could either completely refuse to pay, if they believed IGP under-estimation had been deliberate to keep the premium down or could apply the law of average to the amount paid out. Here, they would base the payment on the ratio of the declared gross profit to the actual sum required, only paying out a fraction of the figure the business anticipated receiving.



This could be a very costly mistake and it is one the law adjudges the individual business's responsibility, even if they use a broker! The law believes it is not for a broker to question figures provided by the client. What the law does expect is for the broker to explain the difference between IGP and AGP, so the client can produce their figures accurately. A broker should also ask relevant questions, both when the policy is first taken out and at renewal.

However, it is for the business itself to calculate IGP and provide the figures, as well as deciding the maximum indemnity period for the policy – the length of time for which they will be covered. A broker will usually explain that a year is not enough. Following a major loss, such as a flood or fire, few businesses can get back to where they were pre-loss within a year. Premises may need to be completely rebuilt, with a lengthy planning permission process required.

[https://beale-law.com/wp-content/uploads/2019/10/Eurokey\\_Recycling\\_Ltd\\_v\\_Giles\\_Insurance\\_Brokers\\_Ltd\\_2014\\_EWHC\\_2989\\_Comm\\_Sept\\_2014.pdf?](https://beale-law.com/wp-content/uploads/2019/10/Eurokey_Recycling_Ltd_v_Giles_Insurance_Brokers_Ltd_2014_EWHC_2989_Comm_Sept_2014.pdf?)

There may also be long lead-times for acquiring specialist new equipment. Major contracts are often signed well in advance. It may take time to win clients back. A business may have seasonal demand, so may require two years to accrue the benefits from such seasonality. Again, however, it is for the business to decide on the indemnity period it requires, not the broker.

The broker needs to annotate all discussions and receive confirmations in writing from the client that the figure they have provided is the one they wish to provide to the insurer.

So, if you wish to insure your business against the losses that business interruption could bring, make sure you calculate your gross profit correctly, before supplying your figures. If not, the peace of mind you thought you had secured may not materialise.



## Beware What Lies Beneath!

Construction companies and piling contractors must do their homework with regard to a site's ground conditions. Understanding the lie and the geology of the land, by conducting or referencing an accurate site survey, is essential not just for the project but also because an insurer requires all material facts about work undertaken.

Getting valid insurance in place, and accurate pricing for that insurance, requires the underwriter to thoroughly understand the risk – and any changes to it - through information supplied.

Unfortunately, contractors and sub-contractors frequently encounter unanticipated obstacles that affect the risk, intended completion date and project cost. The obstacle could be a hitherto undetected water main, well or burial site. It could be a stratum of rock along a pile line. The HS2 project has even unveiled a previously hidden Roman trading settlement.

Whilst some obstacles could lead to considerable delay, others could make the proposed work more challenging, requiring a change of working method, different equipment and potentially more labour. Insurance alarm bells should ring.

Who bears the cost, may not be stated within the contractual terms agreed at the project's outset, but the general legal position is that, if a contractor promises to build a structure for an employer, they must do so, irrespective of whether the employer produced the design.<sup>2</sup> If not, they can be found in breach of contract and even arguments about lack of prior site access will probably not suffice.

Any switch in methodologies could influence insurance covers and the payment of any future claims, so the insurer needs to be instantly informed. New equipment may have to be used. Piling may have to be to a greater depth than policy terms allow. Contractors could

find themselves working on a site with groundwater issues and contaminated risings, or one with collapsed excavations, variable ground conditions or steep gradients. The risk can change.

Trying to combat adverse conditions with the wrong equipment, could also increase the health and safety risk. No matter what the contractual pressure to proceed, a contractor should always remember their duty of care to both employees and hired-in workers.

Essential covers are the legally required Employers Liability insurance and Public Liability protection. It could also be worth considering Excess Liability insurance, which will step in, should a claim exceed the core liability policy's limit.

A Contractor's All Risks policy will cover property damage, including improper structure construction and third-party injury and damage claims. If a contractor is a

<sup>2</sup><https://www.fenwickelliott.com/research-insight/annual-review/2017/site-conditions>

specialist, such as a piling company, a more tailored policy may be required.

But what of the contractual obligations? Purchasing a Performance Bond allows a contractor to guarantee their obligations to their client, offering reassurance that the project will be completed or in the event of breach of contract, direct losses or damages paid to affected third parties.

The message is to work with your broker, advise them and your insurer of everything and listen to advice relating to covers. If not, what lies beneath could catch you out.

## Leisure Businesses need Plan of Attack for 'Martyn's Law'

A new responsibility – the Protect Duty<sup>3</sup> – will fall on the shoulders of UK leisure and hospitality businesses later this year, as they join other 'public space' operators expected to "protect the public" from terrorism and "prepare staff to respond appropriately", should an attack occur.<sup>4</sup>

Home Secretary, Priti Patel on behalf of the Government said it is "committed to bringing forward legislation this year"<sup>5</sup>, to

introduce 'Martyn's Law', in memory of Manchester Arena bomb attack victim, Martyn Hett. His mother, and other campaigners have lobbied for enhanced venue terrorism security measures, to help prevent such tragic losses of life again.

A public consultation on suggestions in 2021 has led to proposals that will place the onus on places, spaces and venues to actively take a lead on terrorism prevention. Currently, there is no legislative requirement for such security measures in the majority of public places.

The legislation is likely to apply to any business, or community or faith venue, which can accommodate more than 100 people.<sup>6</sup> Some experts warn of GDPR-sized impacts.<sup>7</sup> There will need to be widespread counter-terrorism training for staff and probable investment in additional security measures.

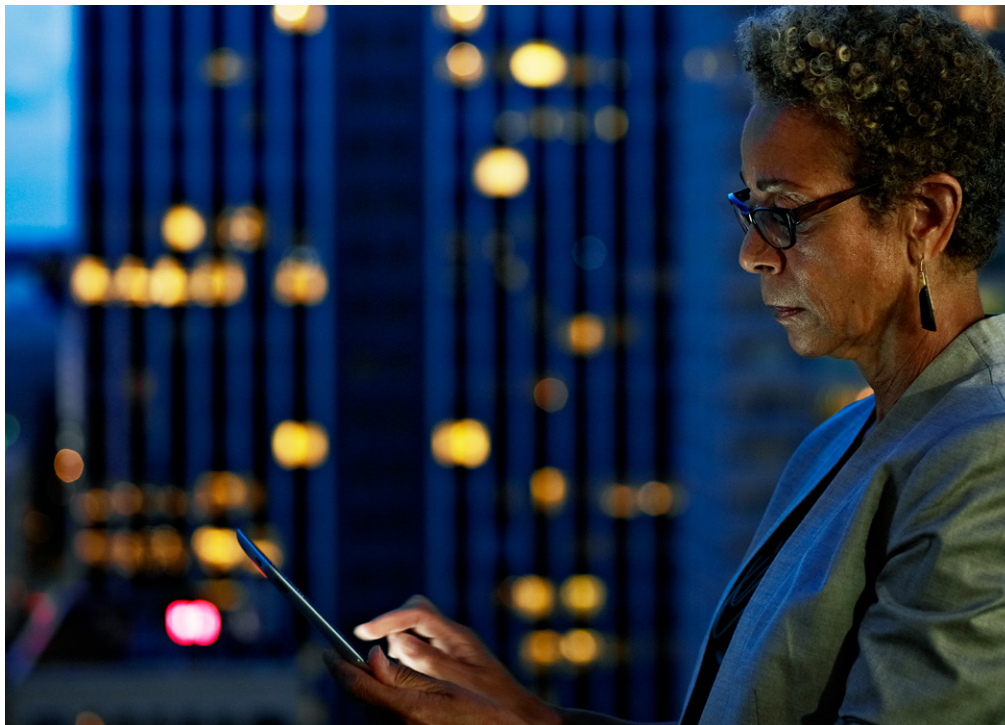
Commentators anticipate the starting point will be a terrorism risk assessment, conducted similarly to a health and safety risk assessment. The former, however, is likely to need to be more fluid, looking at variables such as the type of event staged and the artist, or other triggers that could spark an attack.

Insurers are already preparing to assist brokers with training and advice, so their clients can gain best guidance. Allowing a trained broker to steer you through



a terrorism risk assessment, could be invaluable assistance, ahead of the Protect Duty's arrival. Considering terrorism insurance is another step to take.

The Protect Duty consultation process found only 50% of respondents currently carry out terrorism risk assessments.<sup>8</sup> Only 55% currently access Government counter-terrorism advice. This is despite fears about increased radicalisation of extremists via the Web during lockdowns.



<sup>3</sup> <https://www.gov.uk/government/news/government-publishes-protect-duty-consultation-findings>

<sup>4</sup> <https://www.gov.uk/government/consultations/protect-duty/outcome/government-response-document> (Ministerial Forward)

<sup>5</sup> <https://accessaa.co.uk/venue-industry-reacts-to-governments-protect-duty-anti-terrorism-proposal/>

<sup>6</sup> <https://iosh.com/membership/member-benefits/our-membership-network/our-groups/sports-grounds-and-events-group/news/protect-duty-consultation-part-two-the-devil-is-in-the-detail/> (Section 1)

<sup>7</sup> <https://www.nmu.co.uk/protect-duty-legislation/>

<sup>8</sup> <https://www.gov.uk/government/consultations/protect-duty/outcome/government-response-document> (Q19)

The current terrorist threat level is 'substantial (18 March 2022)',<sup>9</sup> so attacks could recommence during post-pandemic 'normality'. Regardless of the Protect Duty's detail, businesses should consider an attack's likely impacts on their premises and footfall. An attack need not directly affect them, as a whole area can quickly lose its attraction to customers, if terrorism occurs anywhere within it. Cordons and restrictions of movement could also prevent physical access and an attack's aftermath could lead to financial loss through looting and pillaging.

Standard property and business interruption policies do not typically cover terrorism as standard, so it could be in a business's interest to consider terrorism insurance. Many such policies include terrorism advice provided by counter-terrorism officers, ex-military personnel and terrorism consultants. That could be of tangible benefit as businesses draw up their plans to suit the Protect Duty's final requirements, so talk to your broker today and be sure to be well-prepared for Martyn's Law, however you proceed.



<sup>9</sup> <https://www.gov.uk/terrorism-national-emergency>

<sup>10</sup> <https://lordslibrary.parliament.uk/housing-developments-on-functional-flood-plains/>

<sup>11</sup> <https://www.floodre.co.uk/about-us/>

## Ease the Pain of Flooding

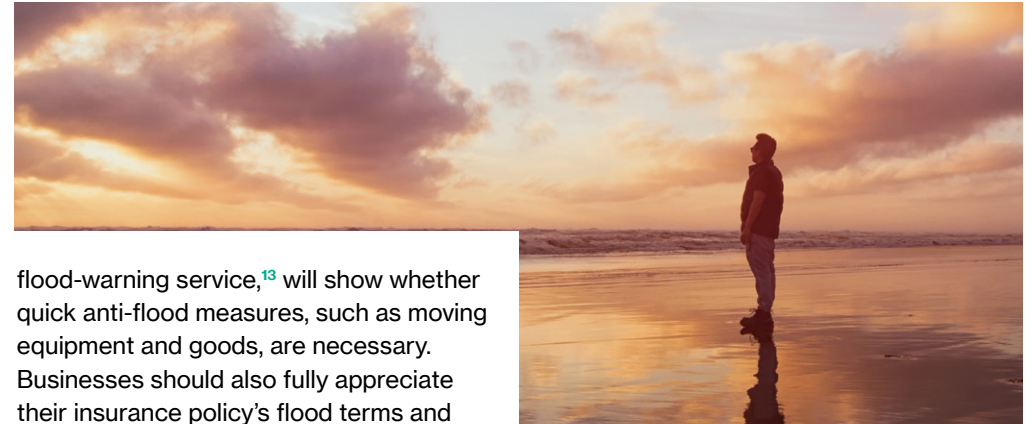
According to the Environment Agency's last published flooding risk and impact analysis (December 2019), 5.2 million homes, in England alone, are at risk of flooding.<sup>10</sup> Thankfully, many built before 2009, can access subsidised flood insurance under the 2016 Flood Re scheme, running to 2039.<sup>11</sup>

For the one-in-six commercial properties similarly classed as at-risk from flooding<sup>12</sup>, there is no such support. Many have to accept high flood insurance excesses or take out insurance with no flood cover. The Federation of Small Businesses suggests many small businesses, with premises on floodplains, lack flood insurance protection and are exposed.

Whether businesses face a financial hit through a high excess, or through having to completely finance refurbishments and pay for all equipment and other losses themselves, flood can bring true misery.

Things are unlikely to improve. The Environment Agency says the number of properties on floodplains is likely to double to 4.6m within 50 years and predicts a 59% increase in UK rainfall by 2050.

Businesses should assess their flood risk - whether from sea, river, surface water or groundwater - and be cautious in bad weather. Checking with a Government



flood-warning service,<sup>13</sup> will show whether quick anti-flood measures, such as moving equipment and goods, are necessary. Businesses should also fully appreciate their insurance policy's flood terms and excesses.

Those struggling to buy flood insurance, or who have tough excesses and exclusions because of their at-risk location or history of flooding, could consider a new insurance lifeline - parametric insurance. Unlike traditional insurance, this works via pre-set triggers, which automatically lead to a pay-out, if met. For flood policies, the trigger is the depth of water entering the property.

Technology underpins this insurance. An internet-connected sensor, fitted to the insured property, assesses when the water has reached trigger level and wirelessly communicates that, to generate a swift, excess-free pay-out. Loss adjuster visits and lengthy claim negotiations are not required.

The business selects its own trigger depth and pay-out value, according to its own circumstances. Its pay-out sum should be based on the cost of getting things back to their pre-loss condition and the additional expenses and income losses incurred.

Any business struggling with its flood insurance cover because of its location, should find this attractive. It is vital, however, to set realistic triggers and a sensible pay-out level, which is then regularly reviewed. When doing this, the business should consider aspects such as building repairs, drying-out costs, surveyors' fees and site clearance. However, other costs must similarly be considered, including damaged stock, possibly continuing to pay wages whilst closed, lost revenue, rehousing costs, long-term interruption and reputational damage. Working with their broker, a business should get this right.

Two-in-five SMEs never reopen after a catastrophic flooding, but a swift pay-out and embarkation on a recovery plan, could significantly enhance the chances of business continuity.

If face a flooding risk, speak to a broker and assess your options. Having the right strategy in place, including insurance, could just keep your business afloat.

<sup>10</sup> <https://lordslibrary.parliament.uk/housing-developments-on-functional-flood-plains/>

<sup>11</sup> <https://www.floodre.co.uk/about-us/>

<sup>12</sup> <https://floodflash.co.uk/flooding-statistics-get-clued-up-with-five-facts/>

<sup>13</sup> <https://check-for-flooding.service.gov.uk/find-location>

## Is it Covered?

In article 1, we considered the issues arising when calculating gross profit for Business Interruption cover. 'Is it Covered' feature explores one specific case.



### The Business Interruption claim in question

- In 2020, the broker placed cover for a manufacturing client, with a gross profit sum insured of £1m
- That year, the client suffered a major loss in a fire
- The insurer paid out for property damage but, for the Business Interruption part of the claim, the appointed loss adjuster said the gross profit insured should have been £3m.
- The discrepancy was down to the wage roll and salaries running through the business, mistakenly not included in Insured Gross Profit (IGP)
- Consequently, the insurer reduced the claim by the percentage of the difference in the two gross profit estimates.
- After applying the rule of 'average', the pay-out to the client was £300,000, not £1m
- The client changed broker and, in 2021, issued a solicitor's letter to the original broker, claiming the £700,000 they believed it had cost them, through lack of adequate advice.

### Obligations affecting this case

- The client is obliged to provide all material facts to the insurer, including the gross profit sums needing to be insured and the policy indemnity period. If the error in the gross profit figure is made recklessly or deliberately, the insurer can void the policy. If it is accidental, they can reduce the claim proportionately, as above.
- The broker has a duty of care to explain the client's obligations in providing insurer information and how gross profit should be calculated. However, it is not their duty to calculate the estimate or decide on an indemnity period.

### Outcome

The matter is still with solicitors and the outcome is yet to be determined. Below are two possible outcomes:

1. The broker may show they fully explained the client's obligations to provide the correct estimates of gross profit and the client made a genuine mistake. Here, the broker will reject the client's claim for £700,000 damages.
2. It is felt the client did not receive a proper explanation of how to calculate gross profit and the broker did not, therefore, exercise appropriate duty of care. Here, the broker may have to pay the £700,000, plus any other fees and costs.

The case highlights how brokers must exercise skill and maintain excellent records of procedures followed. They, and all other professionals providing advice or consultancy, require adequate Professional Indemnity insurance, to protect against financial loss, if sued.



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