

Business Interruption

A guide to identifying uninsured working expenses (UWEs)



As a partner, we're committed to being here for our brokers, delivering support that helps you do right by your clients. Making sure your clients have adequate business interruption protection is one way in which we're doing this, ensuring business owners have a length and level of cover that won't leave them underinsured should a claim occur.

Uninsured working expenses (UWEs) are costs that would stop being incurred following a loss, and should therefore not be included when calculating business interruption cover needs. However, identifying these expenses isn't always as straightforward as you'd think. To ensure your client isn't underinsured, it's important that only those uninsured working expenses that vary directly with turnover should be excluded from the insurance.

In this guide we'll look at some of the common examples of working expenses that clients choose not to insure. What we often find is that these working expenses **do not** always directly vary with turnover and should therefore be considered in the client's insurance level calculations. Remember the majority of losses are partial, not total, losses.



Bad debts

Bad debts are money owed to the insured which they cannot recover. They do not vary directly with turnover. In fact, they may increase following a loss as bad customers take advantage and good customers go elsewhere.

Verdict: should be fully insured.



Business rates

These will still be payable on the undamaged parts of the premises and will be payable as soon as the building is repaired, even if the insured has not yet moved back in. They will also need to pay business rates on temporary premises.

Verdict: should be fully insured.



Rent

It depends on the lease conditions, but rent may still be payable on undamaged parts of the premises, even if the premises are not suitable to continue business. Rent may also be payable as soon as the premises are repaired, including during the fit out period and before the insured has moved back in. Your client will also need to rent temporary premises to continue the business. There may also be an overlap between paying rent on the repaired premises and the temporary premises due to lease conditions or to allow for the staged move back to the repaired premises. This should not be confused with the situation where there is a separate material damage or business interruption item for rent.

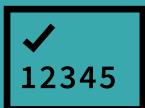
Verdict: should be fully insured.



Subcontracting

This will depend on individual circumstances. If, for instance, your client uses subcontractors for a particular process, such as painting each of the products they produce, then this may vary directly with turnover and can be excluded. However, they may still choose to insure these costs in order to pay subcontractor to retain their services especially if they would be difficult or costly to replace. Where back-office functions such as IT, payroll etc. are outsourced, these costs will not vary directly with turnover and so need to be insured.

Verdict: depends on agreements in place but generally should be fully insured.



Purchases

Purchases of materials for production or resale are already deducted in business interruption calculations. Anything else described as 'purchases' needs to be clarified as to exactly what it refers to.

Verdict: depends on what purchases relate to.



Utilities

While power and water costs do vary with turnover, the correlation isn't often in direct proportion – a lot of the costs are incurred regardless of how many products are manufactured in terms of light, heat and machine running costs. For example, there's often little difference in the machine-power costs between manufacturing 50 or 100 products.

Therefore, if production reduces following a claim, the power costs are unlikely to reduce in direct proportion and so should be insured. However, there may be exceptions; for example, it takes 20 gallons of water to make one pint of beer and so it may be appropriate for a brewer to exclude the production costs of water as these are directly variable. However, they would still need to insure their other water costs (drinking, toilets, washing, etc).

Verdict: should be fully insured except where a direct correlation can be shown.



Movement of goods and materials

If your client uses a third-party haulier then their transport costs may be directly variable depending on whether they pay per item/weight or per collection/delivery. If they pay per item, then this would vary directly with turnover as the cost of 50 items would be half that of 100 items.

However, if, say, they bake bread which needs to be collected daily, then the cost of half a lorryload might be the same as a full lorryload, making their costs not directly variable. If they have their own transport vehicles then these costs should be fully insured as they do not vary directly with turnover – half a lorryload would cost roughly the same as a full lorryload in terms of vehicle wear and tear, insurance, tax, vehicle finance, driver costs, fuel etc.

Verdict: depends on transport arrangements in place but generally should be fully insured.



Packing and packaging materials

Packing and packaging materials (boxes, wrapping etc.) are normally bought in the same proportion as goods bought/manufactured and so can generally be excluded from the insurance as they will vary directly with turnover.

Verdict: should not be insured.



Wages and salaries

These need to be fully insured as employees will still need to be paid. Companies can no longer ‘hire and fire’ without consultation periods for employees. Staff would also need to be fully paid during a short interruption, such as the premises being closed for two months due to flood damage. Even during a long interruption key staff need to be retained, other staff paid as per their contract and staff employed and trained prior to re-opening and any Turnover/Revenue being generated.

In cases where a business uses agency workers or zero-hour contracts, it’s possible for a percentage of wages to be deducted. However, it’s usually not appropriate to make such deductions as they are unlikely to always vary directly with turnover, particularly for short periods of interruption. Our experience of large losses shows that in industries that tend to use agency workers or zero-hour contracts workers these costs can actually increase as labour intensive processes replace automated ones or the Insured has to trade from several smaller sites rather than one large site.

Verdict: should generally be fully insured.

We hope this guide has proved helpful to you in understanding the pitfalls of uninsured working expenses. And remember that if you have any questions, your Aviva team are always on hand and happy to help.

This document contains general information and guidance. It is not intended to be specific advice and should not be relied on as such. It may not cover every risk, exposure or hazard that may arise and we recommend that you obtain specific advice relevant to your clients’ circumstances. We accept no responsibility or liability in respect of any person who may rely upon this document.

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