

Business Interruption



A guide to identifying uninsured working expenses (UWEs)



We're committed to being here for businesses delivering support that helps determine the right level of insurance cover. Making sure adequate business interruption protection is in place, is one way in which we're doing this, ensuring businesses have a length and level of cover that won't leave them underinsured should a claim occur.

As well as the standard uninsured working expenses (UWEs) stated in the policy, businesses also have the option, at their own discretion, to specify and exclude other costs from the insurance cover as other uninsured working expenses. However, identifying these expenses isn't always as straightforward as you'd think. To avoid being 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 businesses choose not to insure. What we often find is that these working expenses don't always directly vary with turnover and should therefore be considered in the business's insurance level calculations. Remember the majority of losses are partial, not total, losses, and many of these costs will continue to be payable or reduce, but not in line with the reduction in turnover.

Bad debts

Bad debts are money owed to the business which can't be recovered. They don't vary directly with turnover. In fact, they may increase following a loss as bad customers take advantage of the situation 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 business has not yet moved back in. Business rates will also need to be paid 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 aren't 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 business has moved back in. It's likely that temporary premises will need to be rented 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 shouldn't be confused with the situation where there's 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, the business 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, sub-contractors are unlikely to wait for the business to recover and will seek alternative contracts. This means that they may be difficult to recover or replace when the business is operational, with alternatives possibly more expensive. By choosing to insure these costs, the option remains to continue to pay the subcontractors or to pay them a retainer fee to avoid losing their services. 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.

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

However, if the business bakes bread which needs to be collected daily, then the cost of half a lorryload might be the same as a full lorryload, meaning the costs aren't directly variable. If the business has their own transport vehicles then these costs should be fully insured as they don't 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'll vary directly with turnover.

Verdict: shouldn't be insured.

Wages and salaries

These need to be fully insured as employees will still need to be paid. Companies can't '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.

Even 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 business has to trade from several smaller sites rather than one large site.

Verdict: should generally be fully insured.

This document contains general information and guidance. It's not intended to be specific advice and shouldn't 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 you or your clients circumstances. We accept no responsibility or liability in respect of any person who may rely upon this document.

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