COMMERCIAL UNDERWRITING MANUAL

SECTION 20.2.5
BUSINESS INTERRUPTION

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BUSINESS INTERRUPTION INSURANCE

SECTION 1 - BASICS

1 Introduction

A Business Interruption cover is an essential complement to a Property Damage Insurance. There are few if any business operations which having suffered damage by fire or other contingencies to productive assets, would not suffer financially either through loss of trade or additional expenditure during the immediate period following such damage.

Such financial losses might arise from - the non

fulfillment of orders
the unavoidable breaking of contracts
the loss of customers to competitors the
inability to attract new customers
the necessity to meet continuing expenses from reduced earnings
additional expenditure related to the hire of temporary premises, plant and other facilities
additional expenditure to meet the costs of overtime, express freight and similar expediting expenses additional expenditure to purchase goods from competitors in order to meet existing orders

to name but a few.

A Business Interruption policy is designed to provide the necessary funding to enable a business to achieve the financial results which would otherwise have been achieved had the damage not occurred.

The policy wordings quoted in the manual are from Multimark III, Tradeguard and Lloyds blue book on policy wordings. The wordings say the same but the easiest to understand has been chosen**.**

2 Measurement of the Loss - Basis

Experience has shown that a comparison of turnover figures before and after the damage is generally a satisfactory basis for measuring the effect of the reduction in earning capacity of a business as a result of damage, subject to appropriate adjustments for special circumstances and business trends.

Seasonal comparisons of turnover before and after damage will also form a reliable basis of measurement in cases where there are seasonal fluctuations in business activity.

3 Turnover as the 'yardstick'

Reduction in turnover is not synonymous with loss of net profit; on the basis that each R100 of turnover contributes an equal share of:

(a) prime costs such as purchases, wages, power, process and manufacturing costs - generally described as variable expenses in that they will vary proportionately with a rise or fall in turnover; and

(b) overheads such as administrative costs, selling and distribution expenses - these, by reason of the fact that they are not controllable as are the prime costs mentioned above, are referred to as standing charges; and

(c) the residual, being the net profit.

In the event then of a reduction in turnover by reason of damage, the prime costs will reduce proportionately resulting in no loss under (a) above. In respect of standing charges however and because they do not reduce in proportion to turnover, their ratio will in fact increase having an inverse effect by reducing the residue under (c). At the same time and by reason of the reduced turnover, there will also be a concurrent loss of net profit.

If however under the business interruption policy funding is provided for the amounts on standing charges and net profit on every R100 of lost turnover, the financial position will be restored to the extent of the results which would have been achieved had the damage not occurred.

4 Gross Profit

As the ratio of variable expenses to turnover is generally constant so also the balance of combined expenses (standing charges) and net profit must also be constant even though the relative proportions of those standing charges and net profit may vary. Recognition of this fact for insurance purposes is obtained by dealing with the standing charges and net profit on a combined basis under the heading of Gross Profit.

5 Rate of Gross Profit

In determining the amount payable and utilising the reduction in turnover as the 'yardstick' it will be apparent that by applying the percentage which the gross profit bore to the turnover, then that percentage which is termed 'Rate of Gross Profit', applied to the actual reduction in turnover will result in an amount sufficient to fund the standing charges and net profit resulting in the financial position being obtained which would, but for the damage have been achieved.

6 Difference Basis

The traditional method in arriving at the Gross Profit figure was that of adding to the amount of the standing charges the amount of the net profit. (The sum total of (b) and (c) mentioned in 3 above).

However if one were to take the difference between the Turnover figure and the prime costs (mentioned in 3(a) above) one should arrive at the same figure.

Currently then, the method of approach is to utilise the 'difference' basis being turnover less variables, which latter expenses are generally referred to as the 'uninsured working expenses'.

7 Accounting Gross Profit

The definition of Gross Profit within the policy, differs from that shown in the accounts of a business and should not be confused.

8 Simple Application of the Basic Concepts

A simple illustration shows how the basic principles are applied in measuring a loss resulting from damage by fire; the application of the rate of gross profit to the reduction in turnover; the resultant payment restoring the financial result to that which would have been achieved, but for the damage:-

Accounts for the financial year preceding the damage

	R			R
Purchases	360 000		Sales	1 000 000
Productive Wages etc	400 000			
Overheads	160 000	) Rate of gross		
Net Profit	80 000	) profit - 24%		
	1 000 000			1 000 000

Accounts for the 12 months during which a 50% reduction in Sales has resulted from the damage

	R			R
Purchases	180 000		Sales	500 000
Productive Wages etc	200 000			
Overheads	160 000		Claim-Rate of GP	
Net Profit	80 000		applied to reduction	
			in turnover -	
		(24% x R500 000)		120 000
	620 000			620 000

It will be seen that despite the reduction in sales the claim payment has enabled the business to maintain their overheads and net profit at their previous levels.

9 Increased Ratio of Standing Charges

In paragraph 3 above, it will have been noted that reduced turnover will affect net profit in two ways - a smaller volume of business (turnover) will result in a corresponding reduction in net profit and an increased ratio of standing charges caused by reduced turnover will automatically reduce any net profit earned on the turnover maintained to the extent that it may not only cancel it out, but be sufficient to result in a net trading loss.
Such circumstances even in a short period, could offset the whole of the year's net profit or even result in a trading deficit.

As an example, assume an annual turnover of R2 000 000; variable charges R1 400 000 (70%); standing charges R500 000 (25%) and net profit R100 000 (5%). Damage results in an interruption during six months resulting in a loss in turnover of R720 000. The actual loss would amount to 30% of R720 000 = R216 000, which equates to more than twice the annual net profit.

Such a potential loss as a result of an increased ratio of standing charges, underlines the necessity for business interruption insurance even during times of adverse trading. The fact that a business is actually running at a loss does not detract from the necessity for business interruption cover which, if not effected could result in a business going into liquidation should there be a reduction in turnover by reason of damage to productive assets.

10 Additional Expenditure

The occurrence of damage and a consequent interruption to the business will inevitably involve additional expenditure with the object of minimising the reduction in turnover and returning the business to normal operations as quickly as possible.

Thus an indemnity for financial loss resultant upon such damage must also provide compensation for such additional expenditure which is undertaken to reduce prospective loss of turnover.

This is provided in the standard policy to the extent that such additional expenditure does not exceed the reduction in gross profit thereby avoided (the economic limit - the policy will not pay more than R100 to save R100).

SECTION 2 - POLICY FORMAT

11 Policy Form

Whilst reference to the Company's printed policy forms is recommended, it will generally be found that policies follow a standard pattern without the proliferation of different wordings so often found in other areas - that for the reason that the major part of the policy wording deals with the formula for the settlement of claims.

12 Perils Covered - 'Damage'

The perils insured against are the same as those applicable to the Insured's assets under the corresponding material damage policy, without such perils having specific definition, which is unnecessary by reason of the 'material damage proviso' which forms an integral part of the policy preamble - (refer to paragraph 14). Collectively the perils are referred to as 'Damage'.

The standard exclusions relating to War/Political and Nuclear risks are applicable and call for no particular comment.

13 The conditions of the Operative Clauses (Preamble)

(a) The consequential loss must result from destruction or damage by an insured peril, which is then referred to as Damage.

(b) Such damage must occur at premises used by the Insured for the purpose of the Business which is that otherwise defined in the schedule to the policy.

(c) The damage must cause an interruption of or interference with the Business carried on by the Insured at the Premises as stated in the specification to the policy.

(d) The interruption or interference with the Business must be in consequence of destruction of or damage to any building or property or part thereof, used by the Insured at the Premises for the purpose of the Business.

(e) There must be in existence a material damage policy covering the interest of the Insured in the property damage sustained, and the Insurer under such policy must have admitted liability for such property damage - 'the material damage proviso'.

14 Material Damage Proviso

The prime object of this provision is to ensure that the Insured will be in a financial position to repair or reinstate the property damage, otherwise rehabilitation of the Business might be delayed or even financially impossible.

At the same time the proviso ensures that the Insured has complied with the conditions of the material damage policy thus obviating the need for such conditions to be embodied in the business interruption policy and also relieves the underwriters of the business interruption policy of the necessity of enquiring into the circumstances of the property damage.

Whilst generally the Underwriters under both the material damage and business interruption policies are the same, it is not essential that they should be, although Santam always prefers to play the dual role.

It may be the case that the material damage policy is made subject to an excess or deductible which could well preclude the admission of liability for the property damage, in which circumstances it is usual to amend the proviso appropriately with regard to losses under the material damage policy below a specified amount - the excess figure.

15 Policy Conditions - General

The conditions are similar to those found in a standard fire policy and relate to misdescription, alteration, fraud, contribution, subrogation and arbitration etc.

The introduction of multi-sectional policies such as Multimark and Tradeguard etc has resulted in such conditions being applied to all sections of the entire policy thus obviating repetition.

There are however specific conditions relative particularly to Business Interruption cover which warrant comment - (refer to paragraphs 16 and 17).

16 Alteration of Interest

This condition states that the insurance shall cease if the Business is wound up or carried on by a liquidator or judicial manager unless the Insurers agree to the change of interest.

It should be realised that this condition applies to the state of affairs prior to damage taking place. Once liability has been established the position is governed by the conditions relating to claims.

The appointment of a liquidator generally signifies the winding up of a business and when that point is reached there would be no call for the continuation of a business interruption policy designed to protect future earnings.

The appointment of a judicial manager on the other hand might infer the possible continuation of the business which however would require a complete reconsideration of the changed position by the Insurers.

The business interruption policy is silent with regard to any increase in actual risk of damage as it relies upon the corresponding material damage policy through the 'material damage proviso'.

17 Claims condition - Due Diligence

This condition amplifies the implied conditions with regard to good faith, and the action which an insured must take or permit to be done in minimising any resultant loss, and in addition embodies a time limit for the furnishing of details relative to any claim.

18 The Schedule

This will generally contain reference to

(a) the Insured;
(b) the Business;
(c) the Premises

as well as the period of insurance and first/annual premiums.

(a) The Insured - it is essential that the full and correct title of the Insured be stated. In the case of a group it is acceptable to name the parent company and its subsidiaries provided that all are named or declared. The use of the term 'associated companies' is however not acceptable as the term has no legal meaning.
(b) The Business - this should be adequately and accurately stated as the term 'Business' is that otherwise referred to in the policy with regard to interruption or interference with the business.
(c) The Premises - here again a full and accurate list of the premises is essential as the policy refers to Damage at the Premises; and interruption or interference of the Business at the Premises. (refer paragraphs 13 (c) and (d)).

SECTION 3 - POLICY COVER

19 Formula for claims

The policy specification contains the formula for ascertaining the amount payable in the event of a claim.

Whilst a material damage type policy generally deals with the loss or damage of tangible and identifiable property at a fixed point in time, the Business Interruption policy relates to the intangible and hypothetical trading results which would have materialised in the future had the damage not occurred. It is therefore in the interest of the parties that the contract should set out the method to be adopted in the event of a claim.

20 Turnover Basis

Generally a specification based upon reduction in Turnover is to be preferred, it having been found that turnover is the most satisfactory basis upon which the anticipated earnings of a business can be measured.

Other bases such as gross revenue, gross income or gross fees may be appropriate in respect of certain businesses to which reference is made later (refer paragraphs 52 and 53).

21 Turnover - definition

The normal definition refers to - 'the money paid or payable to the Insured for goods sold and delivered and for services rendered in course of the Business at the Premises'.

Such a definition caters for most types of businesses and accords with the normal accounting practice for the figure credited to the trading account. It is thus preferable that the wording of this definition be left unchanged despite alternatives which may be put forward by Brokers, unless checked out against the Insured's books of account.

22 Rate of Gross Profit - definition

Rate of gross profit is defined as being - 'the rate of gross profit earned on the turnover during the financial year immediately before the date of the damage'.

This makes the results of the nearest pre-damage accounting year the basis for the calculation of the gross profit ratio, it being likely to give the most up to date information and best indication of what the rate of gross profit would have been.

Changes in trading conditions need to be taken into consideration and these are adequately catered for within the 'Special Circumstances clause".

23 Indemnity Period - definition

The definition of the indemnity period is - 'the period beginning with the occurrence of the Damage and ending not later than the maximum indemnity period thereafter during which the results of the Business shall be affected in consequence of the Damage' and is completed by the maximum indemnity period being the number of months selected (generally reflected in the schedule) for the time limit for the payment of compensation.

Subject to the maximum period selected the indemnity period continues until the results of the Business are restored to normal, which may be well after the physical damage to buildings, machinery and stock has been made good. It should be noted that in the event of damage causing an interruption of business the indemnity period is not necessarily the same as the maximum period selected; it is the period starting from the date of the damage and ending when the results of the business are no longer affected by the damage, subject to such period not exceeding the maximum number of months selected.

24 Standard Turnover - definition

The standard turnover is that against which a comparison is made in order to ascertain the shortage in turnover as a result of the damage; being the turnover during the period in the twelve months immediately before the date of the damage which corresponds with the period of interruption within the selected maximum indemnity period. Such a comparison against the same calendar period in the preceding twelve months provides for seasonal fluctuations which affect a large proportion of businesses.

The definition is also qualified by the 'Special circumstances clause' allowing for adjustments in the trend of the business and other circumstances affecting the business either before or after the damage.

25 'In consequence of the Damage'

It must be borne in mind that the indemnity related to reduction in turnover is qualified by - "in consequence of the Damage", it being the underlying intention to adjust the claim against projected results which but for the Damage would have been obtained in the relative period following the Damage.

26 Increase in cost of working

It is in the interest of the Insured to restore normal trading conditions as quickly as possible after the occurrence of Damage and there is a duty imposed on the Insured to do so by the "Due Diligence Clause" (refer paragraph 17). This may involve considerable expense in undertaking special measures to reduce the loss of turnover during the indemnity period and to hasten the resumption of normal trading. Action on these lines is also of benefit to the Insurers as its affect is to reduce the amount which would otherwise be payable against loss of gross profit.

Payments under this heading may be varied embracing for example additional overtime wages either to an Insured's own employees to make good loss of production, or to builders and other tradesmen's workers to hasten the restoration of the damaged property and plant. Additional expenditure may also take the form of the hire of temporary premises or purchase of temporary plant and advertising expenditure in order to regain lost custom.

The cost of demolition and removal of debris in connection with damaged buildings and their contents does not constitute increase in cost of working as such costs are recoverable under the material damage policy, but additional expenditure involved to speed up such work and hasten rebuilding operations would be admissible.

27 Increase in Cost of Working - Abnormal Expenditure only is covered

If following Damage certain charges of the business do not reduce proportionately with the reduction in turnover their increased incidence will result in a financial loss. That however should be adequately catered for under the heading of standing charges within the gross profit item. Thus increase in cost of working does not provide for an increase in ratio of cost of working.

The expenditure must be of an additional nature or what might more appropriately be termed abnormal expenditure.

28 Increase in Cost of Working - The Economic Limit

Additional expenditure in the form of increased cost of working for the sole purpose of avoiding or diminishing the reduction in turnover is limited by - 'not exceeding the sum produced by applying the rate of gross profit to the amount of the reduction (in turnover) thereby avoided'. This, the economic limit says the Insurers will not pay more than Rx to save Rx.

29 Increase in Cost of Working - During the Indemnity Period

Payment in relation to increase in cost of working is limited to the additional expenditure incurred to minimise the reduction in turnover during the indemnity period. In the event that the period of interruption following the damage exceeds the maximum indemnity period then Insurers will not be liable for that proportion of any additional expenditure incurred which benefits the business following the expiration of that maximum period.

On the other hand the results of the business might well be restored to normal by means of the payment of additional expenditure under the heading of increase in cost of working within the maximum period of indemnity, in which event it will be realised that but for such on-going additional expenditure the result of the business would still be affected and therefore the period during which such expenditure is incurred (subject to the maximum indemnity period) will be admissible, it being the case that the indemnity continues, subject only to the maximum period, as long as the results of the business continue to be affected as a result of the damage.

30 Increase in Cost of Working - Apportionment for uninsured standing charges

In utilising the form of specification in which the gross profit is defined as being the net profit plus insured standing charges, (Additions basis) increase in cost of working is limited to that proportion of such expenditure which the sum of the net profit and insured standing charges bears to the sum of the net profit and all the standing charges.

This is equitable, as additional expenditure incurred to minimise potential loss of turnover will assist in paying not only for those standing charges included within the gross profit, but also for those standing charges which have been omitted.

In the specification on the Difference basis in which gross profit is defined as turnover less variables, although all standing charges will automatically be included it may be the case that within the uninsured working expenses have been included some not wholly variable charges thus creating an inadequate insurance against gross profit.

In a similar manner this specification provides that the amount recoverable on increase in cost of working shall be that proportion of the additional expenditure which the gross profit bears to the sum of the gross profit and the uninsured standing charges.

31 Increase in Cost of Working - Necessity for adequate insurance

The foregoing paragraphs in relation to Increase in Cost of Working which generally forms a major part of any claim settlement, emphasise the necessity for insurance on an adequate basis both with regard to the sum insured on gross profit and in relation to the maximum indemnity period.

32 Savings Clause

The specification provides for a deduction from the claim of any sum saved during the indemnity period in respect of such charges included within the gross profit figure as may cease or be reduced in consequence of the damage.

This maintains a true indemnity as the Insured will not have to disburse such charges.

However it may be the case that certain charges are less during the period of interruption than they were in the relative period of the preceding year, due to causes unrelated to the damage. For example, interest on overdraft may have reduced in which event the Insured should not be deprived of that benefit which would have taken place irrespective of the damage. In that regard the Savings Clause is qualified by the words - 'in consequence of the Damage'.

33 Average Clause

This operates on the universally accepted principle that in the event of there being less than full insurance, the Insured is his own insurer for the difference between that proportion of the claim which the actual sum insured bears to the full insurable figure and the total figure.

34 Sum Insured - Adequacy

In setting the sum insured against the Gross Profit figure it is essential that projected figures reflecting the anticipated financial results of the future be utilised as those of the last financial year will not take cognisance of increasing trends, planned changes and extensions of the future, or other factors such as economic inflation on future turnover and gross profit.

On the basis of a maximum indemnity period of twelve months therefore and on the basis that the damage might occur during the last week of the insurance period the forward projection will need to be made two years into the future.

In those cases where the maximum indemnity period is longer than twelve months the projection must be correspondingly that much further into the future to cater for such extended maximum period of indemnity.

35 Sum Insured in relation to Indemnity Period

When the maximum indemnity period is twelve months or less the sum insured should not be less than the amount of the annual gross profit which is estimated will be earned in the future.

With maximum indemnity periods of less than twelve months the estimated annual gross profit figure is still that to be insured, with the premium rating table making allowance for a reduced premium by reason of the shorter indemnity period.

In the case of maximum indemnity periods in excess of twelve months the sum insured should represent the estimated gross profit which will be earned in the future, during a corresponding period of time. Thus in the case of an eighteen month period the sum insured should be one-and-a-half times the annual projected figure.

With regard to businesses of a seasonal nature however where for example two years gross profit might be earned in eighteen consecutive months, the sum insured for a maximum indemnity period of eighteen months should equate to that for a two year period.

Further, it should be appreciated that the maximum period of indemnity selected should be adequate not only to reinstate the damage, but also to regain markets and customers it being the case that the policy continues to provide an indemnity until such time that the financial results of the business cease to be affected by the damage subject to the entire period not exceeding the maximum indemnity period.

36 Value Added Tax

Policy terminology and definitions relating to items such as net profit, standing charges, turnover, gross profit and the like do not embrace VAT, however it is recommended that the VAT inclusive route be followed in all Business Interruption covers with the sum insured being expressed as including VAT. On that basis and to the extent that the Insured may be liable for VAT on any indemnity payment, such will be added to the final claim payment. VAT on the premium is also included at the time of premium computation and only reflected separately on the policy schedule for legislative reasons.

SECTION 4 - POLICY ENDORSEMENTS AND EXTENSIONS

37 Deposit Premium Clause

By reason of it being impossible to estimate the future amount of gross profit with absolute accuracy it is prudent to add a realistic margin to the estimated figure thus ensuring a full indemnity in the event of a claim.

A deposit premium calculated at 75% of the gross premium based upon the increased gross profit estimate is then paid and adjusted at the end of the insurance period against the actual gross profit earned (proportionately increased in cases where the maximum indemnity period exceeds twelve months) with an additional or return premium not exceeding 33% of the provisional premium being paid or allowed. The clause is not permissible on non-annual policies. Such policies are to be coded adjustable on the computer - enter "yes" on screen.

When the deposit premium clause has been initialised a declaration of the actual gross profit must be requested at renewal date. If this is not received within three months of renewal the policy is to be adjusted at 100% i.e. a 33.1/3% additional premium is to be charged.

38 Additional Increase in Cost of Working

Although the standard cover relating to the insurance of gross profit allows for additional expenditure necessarily and reasonably incurred in order to minimise or avoid a loss of turnover, such expenditure is limited to the sum which would otherwise have been payable for loss of gross profit had such additional expenditure not been incurred - the economic limit.

There may well be circumstances and types of business under which the economic limitation may be seen to be inadequate in which event an item on additional expenditure beyond that recoverable under clause (b) of the item on gross profit can be effected under the heading of 'Additional Increase in Cost of Working".

Such item being an arbitrary amount is not subject to average, and by reason of its first loss nature should carry a higher rating than that applicable to gross profit.

39 Accumulated Stocks Clause

Following the occurrence of damage the turnover of the business may not be immediately affected by a shortage in production by reason of there being an accumulation of finished and saleable stock on hand. The indemnity period however commences from the date of the damage and not from the date that any reduction in turnover may be experienced.

Where then a manufacturer holds substantial stocks of finished goods which

(i) are depleted in maintaining turnover during the indemnity period
(ii) cannot be replaced by the end of the maximum term of the indemnity period, and
(iii) not having been replaced prior to the expiry of the indemnity period result in a loss being experienced to which the policy would not respond - (the maximum indemnity period having expired)

then Insurers will make an allowance for the loss under (iii) to the extent of the benefit obtained under (i).

This is accomplished by means of the Accumulated Stocks Clause.

40 Departmental Clause

Many businesses will comprise more than one revenue earning department and produce and sell a number of differing commodities thus resulting in differing rates of gross profit to turnover in different departments.

In terms of the standard specification the defined rate of gross profit will be the average rate for the whole of the business. If then, damage were to interfere solely or mainly with a department having a low rate of gross profit the Insured would receive more than an indemnity and conversely should a high earning department be affected the Insured would be under indemnified.

In order then to ensure a true indemnity and where a business is conducted in departments, sections, divisions or branches the independent trading results of which are ascertainable the 'Departmental Clause' should be employed.

41 Output (alternative basis) Clause

Many local policies will be found to contain the Output alternative to the standard turnover basis. There is however little doubt that the standard turnover basis has proved the test of time in providing the best formula for the settlement of claims although short interruptions might well result in a position in which the work involved outweighs the actual loss sustained.

Insurers, and Santam in particular have always indicated that they are prepared to measure the loss by whatever yardstick is most appropriate in the particular circumstances and in those terms it would be wrong to be limited solely to the alternative of Output which may not necessarily be the most appropriate, particularly when it will be noticed that such wording puts the alternative basis solely at the option of the Insured.

42 Salvage Sale Clause

In respect of retail and other similar type businesses a salvage sale may be arranged following the occurrence of damage, attracting business not otherwise available and enabling the disposal of lightly damaged stock on favourable terms. Generally the level of mark-up will be lower than normal and if the Insured were recompensed under the policy by payment based upon the shortage in turnover, they would lose the difference between the average rate of profit on the sale goods at reduced mark-up and their normal rate of mark-up.

The clause states that the Insurers agree to disregard turnover derived from a salvage sale, provided that the Insurers are credited with such gross profit as might be realised from the salvage sale.

This maintains the underlying intention of the policy in providing an indemnity as the turnover from the salvage sale is disregarded and does not contribute to reducing the shortage in turnover during the indemnity period.

43 Extensions to other premises (see note below 45)

Within modern industry major manufacturers rely upon the supply of many components from other specialist manufacturers who if Damage were experienced at their Premises, might be unable to supply such components resulting in a loss of turnover on the part of the major manufacturer.

In a similar way, in the event of a customer experiencing serious Damage they may be unable to accept the product of a manufacturer thus resulting in a loss of turnover on the part of that manufacturer.

Interdependency situations as may arise in circumstances as outlined above, may be insured in terms of the policy extensions relating to Suppliers and Customers (refer paragraphs 44, 45, 46).

In all such cases the perils within the definition of Damage may not be wider than those applying to the Insured's own Premises.

44 Suppliers Extension - Specified (see note below 45)

Having determined the degree of dependency upon any particular supplier or suppliers, which should be expressed as a percentage of gross profit insured, the appropriate extension may be employed against additional premium with the name(s) and premises of the supplier(s) being stated in the policy schedule against the selected percentage of the gross profit figure.

45 Suppliers Extension - Unspecified (see note below 45)

In cases where there are perhaps a considerable number of Suppliers each responsible for a very small proportion of the total supplies, it is permissible to extend the policy in much the same way as described above provided that in respect of any one supplier the limit does not exceed 5% of the insured gross profit figure.

NOTE:

Assets policies generally exclude from the definition of Property Insured, growing crops and growing timber; such property is not therefore within the scope of damage to property when dealing with the corresponding consequential loss insurance. In the same way, we have generally viewed damage to property at the premises of suppliers in the same light, and consequently would not have picked up a consequential loss type claim arising, for example, from a fire in a timber plantation whether the property of the Insured or a supplier of timber to the Insured.

We have heard of such a scenario where Lloyds were of the same view. They were subsequently persuaded that the term property when applied to the Insured, does not necessarily have the same meaning when applicable to the property of Suppliers. The claim arising from the loss of growing timber by fire at a Suppliers plantation was ultimately settled by Lloyds under their suppliers extension, notwithstanding the fact that the Insured's own assets policy did not extend to include growing timber.

Whilst the situation under such circumstances is certainly arguable it is preferable that our intention be made clear at the outset, particularly when bearing in mind that Insurers have never experienced much success with claims which have resulted in a court hearing.

Thus when dealing with Industries whose base suppliers are in the agricultural sector, such as Saw millers/timber merchants, Sugar millers, Canners, Cotton ginneries, Vegetable oil mills, Maize and Flour mills and the like, we believe it necessary to qualify the Suppliers extension to the Profits Section where it is not intended to pick up claims as the result of damage (<u>which would include not</u> <u>only fire but weather related perils such as storm, wind, hail etc)</u> to growing crops at the Suppliers premises - this would of course be of greater importance should there be particular growers under commitment to an Insured.

It is Company Policy not to write Crop insurance; it follows that we also do not wish to provide Consequential Loss cover following material damage to crops.

These comments will bring to attention the need, for underwriting purposes, to make enquiry regarding Suppliers and the extent of an Insured's dependency on such Suppliers. Where Suppliers are unspecified and the Insured's Business is such that they are dependent on growing crops or growing or felled timber an exclusion under the Consequential Loss section of the policy is mandatory.

46 Customers Extension

In cases where manufacturers are reliant upon specific customers who take a large proportion of products so also may the policy be extended at additional premium to address a reduction in turnover on the part of such manufacturer due to the inability of the customer to accept supplies by reason of Damage at the customer's premises.

In much the same way as the extension applicable to Suppliers is limited to a proportion of the gross profit figure so also is the Customers extension, with the name and premises being identified.

47 Storage, Transit and Vehicle Extension

In as much as the basic policy wording refers specifically to Damage at the Insured's own premises, it will be appreciated that there may be circumstances where Damage to goods in storage elsewhere than at the Premises or whilst in transit, would result in an interruption of the business and consequent reduction in turnover. There may also be the possibility of damage to the Insured's own motor fleet away from the Insured's premises, which might result in a hindrance of the business by reason of the inability to make deliveries, and the need to hire substitute vehicles.

Circumstances such as these are addressed under the extension relating to Storage, Transit and Vehicles.

48 Contract Sites Extension (Not in the Insured's Occupation)

Clients within the building industry, such as constructional engineers, electrical engineers, heating and air-conditioning engineers, glaziers, tilers, joinery contractors, sanitary engineers, painting contractors, refrigeration engineers and others may well experience a reduction in turnover should the project on which they are engaged be Damaged thus resulting in a delay before work can re- commence. Artisans will still have to be paid despite the interruption and other standing charges will continue unabated resulting in financial loss.

This type of exposure can be dealt with under the Contract Sites Extension.

49 Prevention of Access

In the event that there should be Damage to an adjacent property it may well be necessary for the authorities to close off the immediate area in the interests of public safety, until such time as demolition and clearance of debris has been undertaken. Such action may well deny access by customers to an Insured's premises thus resulting in an interruption of the business. Such circumstances might be particularly applicable to premises within a shopping centre complex.

Similarly, damage to roads and bridges in a flood situation, might prevent access to premises resulting in a cessation of work at those premises.

Circumstances of this type are catered for within the Prevention of Access Extension under which it will be realised that despite an interruption of the business the Damage is not at the Premises, but in the vicinity.

50 Public Utilities Extension (Electricity, Gas and Water)

Most manufacturing and industrial operations are dependent upon the public supply of electricity, gas and water, and failure of any one of those utilities would result in an interruption of business with a resultant reduction in turnover.

This extension to the Business Interruption policy may be provided on the basis of Damage as insured at the Insured's own Premises or alternatively on an 'All Risks' basis, the latter being at a higher additional premium and generally subject to a proviso that the interruption shall be for a longer period than 24 hours, in so far as the interruption may arise from mechanical or electrical breakdown.

51 Intergroup Dependency

Between members of a group of businesses in which there exists a parent/subsidiary relationship, but which are insured by separate policies it is recommended that the individual insurances be extended to the premises of any or all of the other group members. This is equivalent to a combined customers and suppliers extension and gives the effect of all the group companies being insured by a single policy.

It is not however necessary to incorporate an inter dependency clause where a single policy for the group is arranged, although the application of the departmental clause should not be overlooked. (refer paragraph 40)

SECTION 5 - ALTERNATIVE BASES AND ADDITIONAL ITEMS

52 Revenue Basis*

Although the Turnover basis as indicated in Section 1 is to be preferred there are business operations which do not purchase raw materials in the normal sense, and there are therefore no purchases to deduct from turnover to arrive at Gross Profit. Generally such businesses provide an amenity or service, and in such cases the whole of the income generally termed Gross Revenue is insured. Businesses in this category include Warehousemen, Cold Storage operations, Schools, Churches, Sports and Social Clubs.

53 Gross Income/Gross Fees Basis*

In relation to individuals or firms whose earnings are derived from businesses providing generally a service and operating from offices, consulting rooms and similar premises - e.g. Attorneys, Architects, Accountants, Estate Agents, Surveyors, Doctors, Dentists and other Professions; a Gross Earnings, Gross Fees or Gross Income basis is appropriate.

* *In respect of these Specifications reference should be made to the standard wordings and definitions published in the standard text books dealing with Business Interruption insurance*.

54 Rent - Generally

Cover in relation to Rent may be provided under either a Material Damage type policy, or under a Business Interruption policy.

Santam recommends that such cover is arranged under a Business Interruption policy, by reason of the fact that under the material damage policy the insurance will only pay proportionately to the time during which the premises are rendered unfit for occupation, whilst under the Business Interruption cover the policy will provide an indemnity for the period until the premises are again tenanted, subject of course to the maximum Indemnity Period. The Business Interruption policy also includes cover in respect of Increase in Cost of Working.

55 Rent Payable

This will generally be the rent payable by the Insured as a normal business expense and should therefore be included (as a standing charge) in the insurance on Gross Profit.

Rent payable for temporary accommodation following Damage to the Premises would be recoverable as Increase in Cost of Working under the Gross Profit item.

56 Rent Receivable

It is recommended that the Rent Receivable be covered under a Business Interruption policy under a separate item. If however Rent Receivable is included within the Gross Profit figure the sum insured should be checked for adequacy as such Rent usually appears in the Accounts below Turnover and should therefore be added to the Turnover figure. Additionally the definition of Business must include 'property owner', or some similar expression.

57 Wages

A serious interruption to a Business following Damage will also have a considerable impact on the workforce and pose problems for management in deciding what action should be taken bearing in mind labour legislation and union action.

Only by the insurance of the entire wage bill can an Insured be certain of being fully covered whatever the nature and duration of the interruption. The premium expense on such a full cover may however prove to be an unnecessary expense or appear to be impracticable if it results in employees remaining idle over an extended period.

In most businesses a distinction is drawn between wage earners and salaried staff. Wage earners are mostly to be found on the factory floor paid on an hourly or weekly basis. Salaried staff would generally be considered as more permanent with payment on a monthly basis and would generally be considered as essential to the recovery of any Business following Damage. Salaries will therefore generally be insured in full (as a standing charge) within the Gross Profit item.

In the event of a long anticipated period of interruption and subject to wage agreements, legislation and labour union agreements it may be possible to dismiss the workforce after a period of notice and the payment of severance pay, with an agreement of re-engagement for training prior to the recommencement of the business.

58 Dual Wages Basis

Under the dual basis method the total wage roll is insured as a separate item and the insurance operates in a similar manner to the Gross Profit item with a maximum indemnity period of the same length of time.

The cover provides an indemnity during two specific periods. It allows for 100% of the wage roll to be insured for an Initial Period and for a lesser percentage for the remainder of the maximum Indemnity Period.

The Initial Period of full cover should be adequate to provide for notice and redundancy payments in accordance with legislation and wage agreements.

The percentage of wages to be insured for the Remainder Period can only be decided after taking into consideration those essential employees whose services would be retained throughout the entire period of interruption, with allowance also being made for re-engagement of employees towards the end of the Indemnity Period when the Insured will be re-assembling the workforce and retraining employees.

The wording allows great flexibility in that if during the Initial Period savings are made, that amount may be carried over to the Remainder Period. There is also the option in cases where the interruption is comparatively short and it is decided to retain the services of all employees, of converting the cover to 100% of wages for a number of weeks (the ‘option to consolidate’) which is shown in the policy as the Alternative Period, and is a factor of the rating.

59 Pro-rata Wages/Notice Wages

On this basis and with the wage-roll being omitted from the Gross Profit figure, the insurance provides an indemnity against the payment of wages for a period beginning with the occurrence of the damage and ending not later than a selected number of weeks thereafter. Such an arrangement may be suitable for seasonal casual workers and where recruitment at a later date will not be problematic. The sum insured represents the wage roll of those employees for the stated number of weeks and the indemnity payable is the actual amount of wages paid to those employees whose services are not required or who cannot be fully employed during the selected number of weeks.

No increase in cost of working is included within this method of insuring wages.

60 Fines and Damages for breach of contract

Losses in the nature of fines or damages for breach of contract consequent upon Damage and an interruption of the Business are not covered within a standard Business Interruption policy on gross profit, by reason that they cannot be measured by a reduction in turnover and are not within Increase in Cost of Working.

Fines and Damages for breach of contract may accordingly be insured under a separate item against which a first loss figure must be selected by the Insured. The item is not subject to average and generally carries a higher rating than that applicable to Gross Profit by reason of the first loss nature of the item.

61 Increase in Cost of Working Only

Requests for cover in respect of Increase in Cost of Working in place of a full Gross Profit insurance often arise from the unwillingness to pay the premium rather than that a full cover is inappropriate.

It may well be argued that the effects of Damage would be negligible and that the only cover required would involve payments for emergency measures to maintain trading.

The disadvantages of this approach are:

(a) the sum insured can only be fixed by guesswork and may not always prove to be adequate;
(b) part of the loss under a Gross Profit item may be in respect of Increase in Cost of Working, but most incidents will inevitably also involve a loss in respect of Gross Profit.

Approaches for cover on this restricted basis should be declined.

SECTION 6 - RATING

62 Basic Rate

In respect of the perils of fire, explosion, malicious damage and earthquake the average material damage rating relative to those perils and applicable to the contents of the premises to which the business interruption cover is to apply is ascertained and termed the “BASIS RATE”.

Where two or more situations are involved such average rate is determined on the basis of the total contents premium for those perils being divided by the total sums insured on the contents of all situations. (This is not the same as the simple mathematical average of the differing rates).

With regard to premises which are protected with an approved sprinkler installation (duly certified by A.S.I.B.) a discount will have been applied to the material damage fire rate, and a further discount of 33.33% may also be applied in arriving at the basis fire rate for the Business Interruption cover.

The BASIS RATE in relation to Special Perils (storm, wind, water, hail, snow, flood, impact and aircraft) will be that as applicable in terms of the Special Perils Market Agreement.

63 Rating Tables

Differential rating in accordance with the length of the maximum indemnity period is obtained by applying the percentage multipliers in Rating Tables 1, 2 and 3 to the BASIS RATE as mentioned above.

Rating Tables 1 and 2 address the perils of fire, explosion, malicious damage and earthquake, with Rating Table 1 being applicable to general Commercial and Industrial Risks where the process plant is generally readily obtainable as a standard item of manufacture (e.g. plastic extruders, machine tool manufacturers, weavers (looms), printers etc). Rating Table 2 is to be applied to Industrial Risks where the process plant is specially designed and manufactured specifically (e.g. Chemical and Fertiliser Manufacturers, Petro-Chemical type risks, Aluminium and Steel Smelters, Oil Refiners, Paper Mills etc.).

It will be appreciated that in those industries in which the process machinery and plant is specially designed and specifically manufactured the lead time in replacement will be much longer, than in those cases where the machinery is of standard manufacture, thus resulting in a longer period of interruption and the need for a higher level of premium.

Rating Table 3 is applicable to all types of risks in respect of Special Perils (storm, wind, water, hail, snow, flood, impact and aircraft).

The final Business Interruption rating relative to Gross Profit is thus obtained by adding the rates obtained by the application of Tables 1 and 3 or Tables 2 and 3.

The rationale to this approach is that it is generally not considered that an interruption as the result of Special Risks is likely to last very long and thus in respect of maximum indemnity periods longer than twelve months the premium rate is reduced proportionately so as to make the actual premium payable for Special Perils, the same as it would be were the maximum indemnity period only twelve months.

64 Dual Wages Rating Tables

In respect of businesses under which the gross profit item is rateable under Table 1, the percentage multipliers for Dual Wages in respect of the perils of fire, explosion, malicious damage and earthquake are reflected in Rating Table 4 with the percentage multipliers relative to Special Perils (storm, wind, water, hail, snow, flood, impact and aircraft) being reflected in Rating Table 6.

Those businesses to which Rating Table 2 is applicable are similarly rated for the purposes of Dual Wages under Rating Table 5 in respect of fire, explosion, malicious damage and earthquake; and Rating Table 6 in respect of Special Perils.

The tables relating to the option to consolidate follow each of Rating Tables 4 and 5. In that regard the Fire tables determine the percentages to be utilised, without regard to the differing percentages brought out for Special Perils.

65 Rating of Policy Extensions

The indicated rates and basis of rating as shown for the various extensions assume that such extensions embrace the normal full range of perils (within the definition of Damage) namely - fire, explosion, malicious damage, earthquake and Special Perils (storm, wind, water, hail, snow, flood, impact and aircraft).

In respect of Suppliers and Customers Extensions under which a limit, expressed as a percentage of the gross profit applies, such percentage is applied to the key rates as indicated, to produce the policy rate for the extension, irrespective of the maximum Period of Indemnity.

The rating of other Extensions under which there is no specific limitation, is accomplished on the basis of the rates as indicated being applied to the full gross profit (and wages), sum(s) insured, irrespective of the maximum Period of Indemnity.

Whilst local market practice has been to allow a number of policy extensions free of charge or to consider the Basis Rating to embrace all extensions this is not the correct approach, it being the case that any extension must be worth an additional premium. Underwriters should be alert to adverse features exhibited within the policy extensions with cognisance being taken by way of increased premiums where appropriate.

The standard Territorial Limits as applicable to the Multimark/ Tradeguard policy wordings have been envisaged in contemplating the various rates for the policy extensions and such geographical limitations should not be extended without reference, there being different considerations overseas than generally apply locally - earthquake in Japan or California; flood risks in Holland; hurricanes/tornadoes in the Gulf States; and cyclones affecting the Indian Ocean Islands, to name but a few.

66 Suppliers Extensions

The rate for these extensions is that produced by applying the percentage limit to the key rate.

(a) Specified Suppliers - In respect of more than one specified supplier the rate is to be calculated as follows:

(i) each supplier is to be individually rated, by the application of the percentage limit to the key rate, and the resulting rates listed in descending order;
(ii) the resultant rate shall be the sum of: 100%
of the highest such rate
50% of the second highest such rate
25% of the third highest such rate
10% of each succeeding rate

(b) Unspecified Suppliers - the limit under this extension shall -
(i) be less than the lowest limit for any Specified Supplier,
(ii) not exceed 5% of the gross profit (and wages) sum insured

	KEY RATES
Specified Suppliers	0.125%

Where the assumed average material damage rate of the suppliers own premises exceeds 0.300%, the key rate is to be increased by 50% of the difference between such average rate and 0.300%

Unspecified Suppliers	0.250%

67 Customers (Specified) Extension

The rate for this extension is that produced by applying the percentage limit to the key rate.

	KEY RATE
Customers	0.100%

Where the assumed average material damage rate at the customers own premises exceeds 0.300% the key rate is to be increased by 50% of the difference between such average rate and 0.300%.

68 Other Policy Extensions - Rating

The recommended rates for the under-mentioned extensions which are applicable to the sum insured on gross profit/wages, irrespective of the maximum indemnity period, are -

1. Storage, Transit and Vehicle Extension 0.025%
2. Contract Sites Extension 0.028%
3. Prevention of Access Extension 0.005%
4. Public Utilities Extension
   (a) Perils basis 0.005%
   (b) 'All Risks' basis 0.008%

69 Rent Items - Rating

Separate items in respect of Rent, whether payable or receivable should be rated in accordance with the percentage multipliers applied to the material damage rating of the leased or rented premises - Tables 1 & 3.

70 Pro-rata Wages/Notice Wages - Rating

In respect of an item on wages for a selected period, such item should be rated on the same basis and multiplier as applicable to the gross profit item and the premium on that basis multiplied by the following factors to achieve the resultant premium -

Period of Liability	Factor
1 week	x6
2 weeks	x5½
3 weeks	x5
4 weeks	x4½
6 weeks	x4
8 weeks	x3½
10 weeks	x3
12 weeks	x2½

71 Fines & Damages Item - Rating

An item relating to Fines and Damages, being of a first loss nature should attract a rating based upon a multiplier of not less than 200% of that applicable to the gross profit. Items of this category which may be particularly exposed (e.g. Machinery Manufacturers, Vegetable Processors with contracts to growers/suppliers) should be more highly rated with multipliers of 350% to 500% where warranted, being applied.

72 Additional Increased Cost of Working - Rating

Items of this nature being first loss, should attract higher multipliers than those applicable to the gross profit item.

It is recommended that multipliers of between 150% and 300% be utilised, with the higher range being applicable in cases where a particular type of exposure is envisaged under such an item (e.g. air freight costs to import finished products from overseas).

73 Allocation of Rates

The allocation of rates is the same as that for material damage cover with which business interruption forms a same risk.

74. Cause Codes

The cause codes are the same as those for the material damage claim. It is important to use the code that corresponds with the material damage claim code when handling claims.

RATING TABLES

New rating tables to follow. In the interim use the rates currently on the Persetel system.

SECTION 7 - BUSINESS INTERRUPTION IN THE CORPORATE AREA

75 Corporate Risks - General

The basic theories discussed in the earlier Sections of this manual apply equally to the Corporate area, although by reason of the fact that within this area there will be conglomerates comprising extensive groups of companies (or divisions) it will generally not be practicable to refer to each specific premises, but rather to all collectively, within the definition of Premises. (The Brokers underwriting information schedules should provide a complete listing of the various premises and the gross profit figures relative thereto).

A suitable wording would be -"all premises owned or occupied by the Insured for the purposes of the Business (as declared to Underwriters)"

The Departmental Clause on a Company (or Division) basis should be employed in all cases.

76 Extended Perils

Generally, Assets type programmes are underwritten against the normal fire department perils (Fire, Explosion, Malicious Damage, Earthquake and Special Perils comprising storm, wind, water, hail, snow, flood, impact and aircraft) with Extensions embracing Subsidence and Landslip, and Accidental Damage. These Extensions may be embodied within the Business Interruption cover through the definition of Damage and the Material Damage Proviso, subject to sub-limits of liability on a combined basis over both the material damage cover and business interruption policy.

The rating of such Extensions should be approached on a similar basis to that adopted for the fire peril.

In a number of isolated and special cases the Business Interruption policy may also be extended to embrace Engineering (Machinery Breakdown) risks, but this, which requires different considerations, should be referred to Johannesburg SRS, Technical Risk Management Department for guidance.

Theft and Goods in Transit may also be acceptable perils against which a Business Interruption policy may be extended, although the underwriting approach is slightly different from that of the traditional perils and again assistance from Johannesburg SRS Technical Risk Management Department should be sought. Needless to say, Fidelity Guarantee (Commercial) is not a suitable extension against a Business Interruption policy.

77 Policy Extensions - Suppliers /Customers

Suppliers and Customers Extensions operate in the Corporate area on a similar basis to that indicated in paragraphs 44, 45 and 46 although there is usually a request for these Extensions to have a wider geographical area, sometimes worldwide. This approach requires greater knowledge of dependencies and the need in so far as earthquake (Japan and California) and flood risks (Holland), for the introduction of specific sub-limits for these perils.

In circumstances under which the definition of Damage embraces Accidental Damage the need for adequate underwriting information relative to the particular Suppliers and Customers will be readily apparent. A sub-limit might again be appropriate in the circumstances.

In the event that Machinery Breakdown is included within the definition of Damage then the Suppliers and Customers Extensions should be restricted solely to the Fire Department perils as such Extensions should not be given against the Engineering type risks, as there would be no knowledge with regard to maintenance programmes at those other premises.

78 Policy Extensions - Public Utilities

The standard wording of this extension refers to the supply of electricity, gas and water. Brokers generally prefer the inclusion of telephone and fax lines which in the Corporate area is generally allowed by reason of deductibles - to which reference is made in paragraph 85.

79 Policy Extensions - Prevention of Access

This extension generally refers to adjacent / surrounding property in the vicinity of the Premises, damage to which prevents access to the Premises. An extended version of this Extension relating to Damage to roads, railways, bridges, tunnels and harbour facilities which result in an interference with the Business (e.g. the impairment of transportation facilities by damage as defined) is fairly common in the Corporate area where deductibles are applicable. Such extended cover should not however be employed unless the deductible is of some magnitude and equivalent to an interruption of three days or more.

80 Policy Extensions - General (Definition of Property)

It will be noted that the introductory wording to the policy Extensions relating to Customers/ Suppliers, Transit, Storage and Contract Sites is slightly different from that utilised for Denial of Access and Public Utilities, in that the term 'Property' is qualified in the former as being no wider than that of the Insured. Such a restriction should not be altered or the term 'Property' left unqualified as that will have the effect of the Extension applying to circumstances which are not intended - (e.g. damage to animals or growing crops of a supplier - see note following paragraph 45).

81 Property in course of construction/erection

Where for simplicity of approach the reference to Premises is along the lines of 'All Premises' (refer paragraph 73) it is essential to ensure that the definition of Property under the corresponding assets section excludes property in the course of construction / erection as otherwise Advance Profits type cover will inadvertently be provided against those new premises, without the appropriate terms being applied. (See Advance Business Interruption - Section 8 - paragraphs 88 - 94).

82 Wages - Wage Roll Basis/ 'Payroll'

Methods of insuring wages have been dealt with under paragraphs 57 - 59, although in the Corporate area where the wages item on an annual basis is not less than R5 000 000 it may be appropriate to adopt the 'Wage roll" basis, also referred to as 'Payroll'.

This provides for 100% of all wages and salaries to be insured for the entire maximum period of indemnity, and on the understanding with the Insured that they will allow the normal wastage of labour by way of retirement, the dismissal of non-skilled workers and any temporary staff, thus ensuring that there will be a saving in wage costs a reduced premium rating is applicable on the basis of 70% of the percentage multiplier otherwise applicable to the gross profit item for the fire department perils (Rating Tables 1 and 2).

83 New Businesses

The accepted method of comparing past trading results with those following the occurrence of Damage will not be possible in the case of new ventures which have no past trading results. This situation is overcome by the use of the 'New Business' clause which amends the definitions relating to rate of gross profit, annual turnover and standard turnover, allowing the trading results from the time of the commencement of the business to the date of the damage to be expanded so as to provide proportionate figures for a twelve month period. Such an approach coupled with the Special Circumstances Clause should adequately cope with increasing trends and other aspects likely to be encountered during the first year's trading.

84 Standing Charges only

A request for cover in respect of Standing Charges cover only might indicate that the business is not earning any net profit, or alternatively such might arise from a desire to pay a limited premium for a limited cover. Whilst such limited protection is not to be recommended, it should be borne in mind that in respect of increase in cost of working (which generally figures quite prominently in any claim settlement) that proportion only of such increased costs as the sum of the standing charges bears to the full gross profit figure will be payable.

85 Deductible Programmes

In circumstances under which an Insured is prepared to bear part of the risk, either through direct funding or by way of a captive, the total premium over both the material damage and business interruption policies may be suitably modified against a deductible operating on a combined basis over both such policies. Such an arrangement generally goes hand-in-hand with a formal risk management programme and therefore the better risk, against which an Insured is prepared to "put his money where his mouth is".

In determining the value of such an arrangement the monetary amount of the deductible should for the purpose of the Business Interruption cover be related to the number of days' interruption likely to benefit the underwriter. Where such a calculation indicates a benefit of only one or two days it will be appreciated that in premiums terms the discount will be minimal, although in the larger cases where such relates to a period of ten days or more it will be significant, with the equivalent of periods of up to 30 days not being unusual on the very large Corporate cases.

It may also be appropriate to apply the deductible to the material damage cover on a monetary basis, coupled with a time excess on the business interruption policy, thus ensuring that on the latter cover the deductible is in fact meaningful.

86 Time Excesses

Generally, losses will be proportionately larger during the immediate period following Damage and it will be during that period that additional costs may be incurred in mitigating the loss and extent of that interruption.

Where then time excesses are applicable it will be seen to be inequitable for such expenditure to be borne entirely by the Insured during the period of the time excess when that expenditure may also be to the benefit of insurers following expiry of the time excess. In such circumstances the additional expenditure should ultimately be apportioned within the claim adjustment, as between the Insured and Insurers on the basis of the benefits derived from that expenditure.

In some instances a slightly different approach may be employed in apportioning the entire adjusted loss on the basis of the proportion which the period of the excess bears to the entire period of the interruption. If this approach is adopted a slightly longer time excess period should be employed to counteract the difference between the proportionately larger loss during the immediate period following Damage and the progressive improving position towards the end of the period of interruption. This approach will automatically cater for the increased or additional costs expended towards mitigating the reduction on turnover, without the need for a separate apportionment of such costs.

87 Policy Limits

On the larger cases the introduction of a policy limit may be adopted, in which event such limit should be taken as the MPL.

However, a combined limit covering both the material damage and business interruption policies is not acceptable and a business interruption limit may not be utilised in overriding the necessity for a maximum indemnity period.

SECTION 8 - ADVANCE BUSINESS INTERRUPTION

88 Rationale

Considerable capital will have been invested in a new manufacturing venture and any intervention which delays the anticipated commencement of production will result in financial loss by reason of the deferment of sales and the delay in earnings on the capital invested (loss of interest on that capital) or interest on loans and continuing expenses.

Delays may occur from a variety of causes which may not necessarily be covered by contract penalty clauses, thus indicating the advisability of insuring against all insurable contingencies which might delay the start-up of a new manufacturing facility or major extension to an existing factory. (Refer previous comments with regard to property under construction per paragraph 81).

89 Basis of Cover

The basic principles outlined in the earlier section of this manual are applicable with however certain changes to meet the peculiar circumstances of this type of policy.

It will be appreciated that arrangement of the cover should be made as soon as construction commences or orders in respect of plant and machinery are placed, with the period of insurance being from that point in time, to the final anticipated start-up date following the completion of testing and commissioning.

90 Maximum Indemnity Period

As opposed to the position under a standard business interruption policy the indemnity period commences not from the date of the damage, but from the projected date of the commencement of manufacturing operations - "the period commencing with the date on which but for the damage turnover would have commenced."

In the event of the contract falling behind schedule by reason of causes outside the scope of the insured contingencies (e.g. shortage of materials, delays in deliveries etc.) the policy should be extended to coincide with the revised completion date, with the commencement of the maximum indemnity period being similarly deferred.

91 Time Excesses

Technological developments and new plant frequently introduce unpredictable risks and inevitable teething problems resulting in operational delays which generally prompt insurers to insist upon a time excess to allow for stable operations to be achieved. Such an excess may be for a period of 3 days, to as long as 28 days depending upon the nature of the particular risk the machinery involved and processes presented.

92 Policy Wording

As in the standard type of policy, reduction in anticipated turnover during the indemnity period is utilised as the yardstick for the settlement of claims with modifications to the definitions of rate of gross profit, standard turnover and annual turnover by reason of there being no prior figures against which a comparison can be made. The basis adopted is that of the anticipated turnover on budget projections, the planned production programme, planned costs and budgeted prices relating thereto, to which adjustments may be made in terms of the special circumstances clause as may be appropriate in the particular circumstances.

93 Increase in Cost of Working

Increase in cost of working in terms of clause (b) to the gross profit item operates in the normal way being those costs necessarily and reasonably incurred to avoid or diminish a reduction in turnover, but by reason of the fact that damage must occur prior to the commencement of the indemnity period, such additional expenditure may be incurred prior to or during the indemnity period.

94 Damage - Perils

The operation of the material damage proviso is paramount for the reasons already explained (refer paragraphs 12 - 14) and an advance business interruption policy may well supplement the material damage cover based upon the standard fire department perils or a contractors all risks/erection all risks type cover. In the event of plant and machinery being procured from overseas manufacturers with attendant Marine Transit risks being involved, those perils might also be included although it is usual for Marine advanced Business Interruption to be written in the Marine department as Santam's fire treaties do not cover these risks.

With perhaps an involvement of overseas manufacturers any Suppliers Extension would embrace the overseas factory premises.

The full extent of such wide covers should be taken into consideration in establishing a realistic level of premium.