Tricky Matters 3

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Contents

Introduction

This is the third general compilation of Tricky Matters – we have also previously issued a liability exclusive and a collection of issues arising from one-off opportunities (the context was the Olympics in 2012). Inevitably, there continue to be new issues and new twists on old issues, so we have gathered a selection of these which we hope you will find useful.

Should you want to discuss any issues with us, or would like copies of any of the other editions of Tricky Matters, please feel free to call me or any of my colleagues and we will do our best to help.

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Increase in Cost of Working only cover

Purchasing ICW only cover (as opposed to Gross Profit/ Gross Revenue) may reduce premium costs, but the presumption that all problems can be sorted by spending money has been shown to be incorrect in the past, regardless of the calibre of the management team.

Where this cover is selected, choose a policy that does not restrict proportions of the insured amount to periods of time where possible.

It should be remembered that in most cases it is necessary to demonstrate, regardless of the absence of an economic limit test, that the increased expenditure is still reasonable and necessary, and provides a benefit within the Maximum Indemnity Period.

Subrogation Waiver

Some businesses have very close relationships with suppliers or customers, to the extent that it would be commercially undesirable to ever bring legal actions against them, regardless of legal justification.

Following an insured event, this might mean that it is better not to make an insurance claim at all than to have insurers pursue recovery against those commercial partners. In extreme cases, this can negate the benefit of having insurance at all.

In these uncommon circumstances, consider having subrogation waivers, in respect of named third parties, written into the policy pre incident.

Fidelity Guarantee – references

Fidelity covers generally include details of systems for checks that need to be observed as a matter precedent to liability. These will usually include a requirement for written references to be taken, at least for new employees.

It is not unusual to find that the reference requirements, often based on proposal information supplied by the policyholder, are not met and that a claim may not succeed as a consequence.

Reference requirements should be reviewed pre-claim to ensure that they reflect existing policyholder practice (as should all controls, albeit any failure with regard to reference requirements is more easily established).

» Product recall – rehabilitation vs redesign

Product recall covers frequently provide for the cost of rehabilitating a product post recall.

There can be debate as to whether that includes the cost of redesigning recipes to exclude suspect elements (to prevent recurrence, particularly where the cause remains unclear). If the cover relates to the rehabilitation of the existing product (made to the existing recipe) rather than the creation of a new one (made to a redesigned recipe), the costs would not be met.

On the other hand, if it is correct to view the product as the branded item, then a minor variation in recipe may not be relevant and the costs might then be payable.

As always, discussion and certainty pre-loss avoids difficulty.

Electronic Damage

There has been debate as to whether damage to computer records as a result of viruses or hacking constitutes property damage. In some cases, policies seek to exclude it but leave the definition of All Other Contents unaltered.

That definition allows for the costs of clerical time (but not consequential loss, which is insured under the business interruption cover) in recreating books and records, commonly including computer fields and records.

If it is the intention to exclude this kind of damage, the definition of All Other Contents would benefit from revision.

Premises

Business Interruption cover is triggered by Damage or Loss at the Premises (with extensions expanding on that).

Some businesses sub-contract all their manufacturing, or supply all their services, at one or a limited number of third party locations. Suppliers'/customers' extensions may not adequately cover businesses where the majority or all of their business is undertaken this way. It might be more appropriate for those sites to be brought within the definition of Premises, thereby benefiting from the core cover.

Utilities extensions

Policies sometimes include cover for utility failure without increasing the premium. This can be a useful benefit, usually being triggered by named perils occurring at the land-based premises of generating companies.

However, it remains the case that most power failures result from accidental damage to pipes/cabling between the generating site and the insured premises. This requires the wider cover that responds to accidental failure at the terminal ends.

An appreciation of the different ways in which utility failures can be covered is important.

Market agreements

The market worked on the basis of a number of accepted protocols for many years. More recently, a view has arisen that not all of these continue to be appropriate – 2012 saw the end of the ABI agreement on contribution (different rights and interests), for example.

Consequently, it might be better for policies to explicitly deal with issues previously dealt with on the basis of such market understandings. A BI example would be the Blundell Spence agreement, which allowed for increased costs to be accepted even where the economic viability of those could not be directly evidenced (such as additional costs at a head office that burnt down).

BI – proving a loss

Sometimes, the nature of a business, or the sector in which it operates, means that elements of any BI loss would be difficult to evidence. This can be the case with, for example, non-recurring but significant short term contracts.

In some cases it is possible to agree claims' protocols at inception so that an agreed formula is adopted when a claim is submitted.

In other cases, this may not be practicable, and it might be appropriate to restrict the scope of the BI cover. That would avoid paying a premium for parts of the business where it could be difficult to ever demonstrate a loss, while retaining gross profit/gross revenue cover for the other activities.

This also avoids any misunderstanding about the scope of gross profit estimates and their fundamental adequacy.

Imprudent insurance

Many global policies include cover for DIC/DIL and for inadvertent under-insurance.

It can be that gross profit declarations made under local policies include deductions of significant costs beyond those contemplated in the global master.

Subject to the facts and specific circumstances, it could be considered that high levels of deductions are either imprudent or inappropriate but that, in either case, they represent deliberate choice rather than any error or inadvertency. Consequently, the claim recovery could be lower than would have been achieved using the approach envisaged in the master policy, without the latter meeting the shortfall.

Electronic Damage – limits of liability

It is increasingly common for policies to accept electronic damage, caused by viruses, hacking, etc as property damage, but to limit policy exposure by way of an upper amount claimable. Those limits are often incorporated in the property section of the policy rather than applying to the policy overall.

It is our experience that small property losses are increasingly generating large BI claims, and if premiums have been priced on the basis that the limit will serve to cap claims' spend, it would be better to have any limits applying to the policy overall rather than solely to the property damage section.

Suppliers – brand damage

There have been instances of damage at supplier locations arising as a consequence of health and safety issues not being observed and/or which highlight poor governance issues such as the employment of child labour.

Losses claimed by the policyholder may arise partly as a consequence of Damage and partly due to customers boycotting them because of reputational damage. Whilst it may be difficult to separate the impact of these, losses flowing from reputational blemishing are not normally covered by supplier extensions.

Increased costs – solely to mitigate loss

After an incident, additional processes or assets may be put into place, primarily to avoid a recurrence but which also reduce gross profit losses flowing from the historic incident.

Such costs may not be solely incurred to avoid any future turnover reduction, albeit that might be a side effect.

Alternatively, there can be cases where increased expenditure avoids loss within a Maximum Indemnity Period, even though it may be primarily incurred on a strategic basis to protect the business beyond it.

Early discussion with regard to proposed costs and the likely policy response to them is essential to avoid dispute.

There are wordings that do not include the term 'solely' and these expand the scope of the cover significantly, not always deliberately.

Buildings valuations

Sometimes, buildings are valued on a market value or indemnity basis rather than re-instatement cost.

Where the re-instatement basis is correctly used, surveyors without any direct experience of insurance claims can overlook the potential additional expense of clearing the site of a destroyed building and removing the debris. Valuations should be reviewed to address this.

Output policies

Some businesses manufacture goods that will not be sold for many years, such as whisky distillers. Others provide services or develop new products that will develop income streams (royalties) in the future.

In such cases it would be impractical to have Maximum Indemnity Periods running into decades.

The solution is to have an output policy (or option to use an output model) responding to the sales value of lost production within a Maximum Indemnity Period of normal length, rather than requiring an actual reduction of turnover itself. For service industries, the loss of development output can also lend itself to this model.

Time deductibles

Engineering policies typically carry a 24 or 48 hour excess or franchise period. These can be interpreted in different ways.

Consider a business operating 9am to 5pm, Monday to Friday. A breakdown may occur at 4.59pm on Friday. Does a 48 hour excess period expire over the weekend when no production is taking place (and no loss arises over those days to exclude) or does it apply to the first two days of loss in the following week?

A clear definition in the policy would assist.

(Sub) Contractors

Some policies cover hired-in plant on a market value (indemnity) basis, protecting a business from third party claims in tort. However, contracts may insist on re-instatement cover for newer assets and a shortfall between insurance settlement and third party debt may arise.

To avoid this, it may be better to insure on a legal liability, rather than market value, basis. Further, to match contractual exposures with policy cover, include an 'indemnity to principals' clause on liability policies.

Finally, obtain 'new for old' coverage for assets less than one year old.

Public Authorities

The material damage cover is often extended to include the additional cost of re-instating in a different manner, as required by a local authority.

However, there can be delay/additional expense arising from the involvement of government agencies where they are not making specific requirements on the basis of legal powers.

Conceptual or general points could be made by government agencies that do not amount to specific requirements, but might be so fundamental as to stop even commencement of re-instatement works. Additional costs and, in extreme cases, consequential increases in business interruption losses, are not covered by many existing policy wordings.

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