

Advance Loss of Profit / Delay in Start-up Insurance (ALOP / DSU)

Principals and contractors alike are being confronted with escalating financial risk exposure in the wake of the increasing industrialisation.

Principals now often collateralise loans with project assets and repay them purely on the basis of projected earnings (i.e. Non-recourse Financing - debt financing provided for projects with no or very limited recourse to the assets of the project sponsor. The financier relies on the technical, commercial and financial viability of the project and its earnings as the sole source for debt servicing).

The revenue generating capability of a project has thus become a critical financing factor.

Any delay in the start-up of a project would immediately cause a loss in anticipated revenue.

Therefore, stringent conditions regarding delays in scheduled project completion are now commonplace in contracts between financiers and principals, and particularly to those between principals and contractors.

Principals are, therefore, under pressure to ensure the economic viability of the projects by generating revenue immediately following the scheduled completion date.

The traditional Storage Cum Erection Insurance (SCE) does not cover loss of anticipated revenue / gross profit in the event of a delay in the scheduled start up date of any project, even though the same may have arisen due to a peril insured by the SCE Insurance.

Oriental's Delay in Start up Insurance (also known as Advance Loss of Profits Insurance) provides the broadest possible insurance cover available in the market to meet such contingencies. **In fact, we were the first insurance company in India to offer Delay in Start up Insurance to our valuable customers.**

The DSU insurance is recommended to be purchased as an extension to the Storage Cum Erection Insurance / Marine Cum Erection Insurance (SCE / MCE)

Delay in start-up

- Delay in start-up (DSU) cover is designed to secure the portion of revenue which the principal requires to service debt and realise anticipated profit.
- For the principal / investor group, a major incident / a large number of smaller incidents of damage to the works during the construction phase (or) is likely to result in a delay in the commencement of commercial operation of the project and consequently the ability to earn revenue
- The works contract between the principal and the EPC contractor stipulates that, as a rule, the contractor is accountable vis-à-vis the principal for any project startup delay arising through any fault on the part of himself or his subcontractors.
- Whilst some of these losses may be recoverable from the 'contractor's delay penalties' under the construction contract, others may not give rise to penalties because the contract provisions relieve the contractor of this obligation for any risk explicitly assumed by the principal.
- While these risks may vary from contract to contract, the usual exclusions are with regard to "Force Majeure" events (earthquake, flood or windstorm etc.) as well as other physical destruction or damage by any cause beyond the control of the contractor, subcontractor or supplier.
- Furthermore the recovery of the full amount of revenue loss from the Contractors is often limited by a 'cap' on liquidated damages, thus leaving the Principal / Investor Group exposed to losses in excess of this limit.
- The Advance Loss of Profits Insurance, ***covers the interest of the principal only***, provided that the delay in start up of the project from the ***scheduled business commencement date*** and the resultant loss of revenue is due to physical damage covered under the underlying:
 - Storage cum Erection Insurance and
 - by the same set of perils as covered under the parallel Advance Loss of Profit Insurance

Who can take the policy?

- The policy is taken by the **Principal** as he stands to lose in case of any delay in the commissioning of a new project under installation / construction
- Quite often the interests of the **project financiers** is also included as "additional insured"
- Contractors / sub-contractors ***cannot be*** included as the joint insured – as they have no insurable interest (unlike in an EAR / CAR Policy)

ALOP / DSU covers are to be purchased **in conjunction with:**

1. Marine Cargo Insurance for critical items of the project
2. Erection All Risks Insurance / Construction All Risk Insurance

Irrespective of whether the delay results from damage covered under the marine or the erection policy, the trigger date remains the same.

Hence, it is recommended that a single DSU policy in conjunction with the Marine Cum Erection Insurance be purchased which would cover:

- ❖ All (insured) physical damage
- ❖ Loss of Gross Profit arising out of a delay in project, due losses covered by the underlying storage cum erection insurance.

Indemnification

The indemnity provided by the Advance Loss of Profit Policy shall be in respect of:

Loss of **gross profit** (Hyperlink) sustained during the **indemnity period** (Hyperlink) resulting from a reduction in **turnover** (Hyperlink) including any **increased cost of working** (Hyperlink)

or

Specified standing charges (Hyperlink), the amount actually not earned during the indemnity period resulting from a reduction in turnover including any increased cost of working

The indemnity shall not exceed the **sum insured** (Hyperlink) for the maximum indemnity period.

Q1. What does **Gross Profit** mean?

Answer: **Gross profit** means the amount by which the value of the turnover and the value of the closing stock exceed the value of the opening stock and the amount of the specified working expenses. The value of the opening and closing stocks shall be calculated in accordance with the insured's normal accounting methods, due provision being made for depreciation.

Q2. What do **specified working expenses** mean?

Answer: **Specified working expenses** means any costs incurred for the acquisition of goods, raw materials or auxiliaries as well as for supplies unless required for the upkeep of operations and any costs of packaging, carriage, freight, intermediate storage, turnover tax, purchase, tax, licence fees and royalties, insofar as such costs are dependent on turnover.

Q2. What does **Indemnity period** mean?

Answer: **Indemnity period** is the period during which the interest insured is affected as a result of the delay in start-up, beginning on the scheduled date of commencement of the business insured and not exceeding the maximum indemnity period specified in the schedule.

Q3. What does **Turnover** mean?

Answer: **Turnover** means the amount of money (less discounts) paid or payable to the insured for goods, products or services sold, delivered or rendered in the course of the business insured.

Q4. What does **Increased cost of working** mean?

Answer: **Increased cost of working** means the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of gross profit which, without such expenditure, would have taken place.

Q4. What do **Specified standing charges** mean?

Answer: **Specified standing charges** mean any fixed costs specified in the schedule which continue to be payable in full during the indemnity period.

Q5. What does **Sum insured** mean?

Answer: The **sum insured** should be decided by the insured on the following basis:

- ❖ the annual anticipated **gross profit** (Hyperlink) or
- ❖ annual anticipated **specified standing charges**. (Hyperlink)
- ❖ Should the **maximum indemnity period** (Hyperlink) exceed twelve months, the gross profit or the specified standing charges shall be the pro rata amount for that period.

Q5. How should the insured decide the **maximum indemnity period**?

Answer: The length of the indemnity period should be decided carefully on a reasoned guess estimate basis as to how long will it take to actually start production in the event of a major loss during the erection or testing period. This should be planned on a 'worst case scenario basis'.

- ❖ The indemnity period should be selected by the insured based upon the **longest replacement time required for critical items**
- ❖ Includes : time required for re-ordering, re-manufacturing (if required – 'made to order'), transportation to the site, re-erection, testing and commissioning

The extent of the **maximum likely period of interruption** will need to be assessed from a number of possible scenarios and the resultant financial impact on the Project. Particular attention needs to be paid to any "Take-or-pay" provision in the Fuel Supply Agreements (if any) and possible delay linked penalties for failure to supply the finished product to specified buyers.

Thus the coverage is determined by the amount of insurance purchased and by the agreed indemnity period, which should be commensurate with the risk. For example, if repair or rebuilding requires 12 months, the indemnity period should be at least 12 months and include a buffer for contingencies.

CAUTION: *If the sum insured and maximum indemnity is not appropriately decided, it will result in application of the under insurance. Thereby, it may not be possible for the policy to provide you appropriate compensation for your loss.*

Q6. What does **Rate of gross profit** mean?

Answer: **Rate of gross profit** means the percentage of gross profit which, had the delay in start-up not occurred, would have been earned on the annual turnover.

Q7. What does **annual turnover** mean?

Answer: **Annual turnover** means the turnover which, had the delay in start-up not occurred, would have been achieved during the twelve months after the scheduled date of commencement of the business insured.

Q8. What does **date of commencement of the business** insured mean?

Answer: **Date of commencement** of the business insured means the actual date on which the business insured commenced.

Q9. What does **Scheduled date of commencement of the business** insured mean?

Answer: **Scheduled date of commencement of the business insured** means the date specified as such in the schedule or any revised date upon which the business insured would have commenced had the delay in start-up not occurred.

Q10. What does **Delay in start-up** mean?

Answer: **Delay in start-up** means a delay in the ***scheduled date of commencement of the business insured.***

IMPORTANT - 1

Progress reports

- The insured shall take all reasonable steps to complete the works as scheduled
- **The insured shall provide the insurer with updated progress reports at the intervals stated in the schedule.**
- The progress report shall show the progress of the work on the insured contract(s) in relation to any contractual programme of work prepared by any contractor.

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- The progress report shall **identify any delays or potential delays** in the progress of work and the **effect of such delays in terms of a potential claim** under this section and
- any measures taken or intended to be taken to minimize the effect of any such delays.
- In the event of difference between the **anticipated** and **actual progress**, necessitating a revision in the anticipated date of completion, the same may be got **amended by an endorsement on the DSU policy**.

IMPORTANT - 2

- The amount payable is invariably subject to the **actual loss sustained** which must be **substantiated by the insured**.
- Accordingly, if there are no tenants for a rental property or no buyers for manufactured products, there will be no recovery from the DSU insurance.
- One of the preliminary steps to calculate the loss is as under:

Actually Attainable Gross Profit (on best calculation and estimate basis)

- (minus)

Actual Gross Profit during the Indemnity Period

However, the '**Actually Attainable Gross Profit**' can be established only after the project has been in **operation for at least 12 months**.

- Thereby:

Actually Attained Gross Profit (12 months after the actual business commencement date)

- (minus)

Actual Gross Profit during the Indemnity Period

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Indemnity provided by the policy

- Therefore, at the initial stage, for an indemnifiable loss. The Advance Loss of Profits policy may only provide an '**on-account**' payment'. **The final amount payable shall be calculated on completion of 12 months after the actual commencement date of business**.

IMPORTANT – 3

No extension of the period of insurance under the Storage Cum Erection Policy shall automatically extend the period of insurance for Delay in Start-up Insurance.

Any anticipated change in the scheduled date of commencement of the business insured shall be reported to the insurer and be effective for this section **only if specifically agreed upon by the insurer in writing.**

If as a result of a delay in start-up the period of insurance under this section is to be extended, the time excess and the indemnity period shall be renegotiated and agreed upon in writing.

IMPORTANT – 4

Insured Vs Uninsured Delays

It is necessary to *separate*:

- ❖ **insured incident** (physical damage covered by the underlying Storage Cum Erection Insurance)
- ❖ from **uninsured incidents** others which may be contributing to the project delay say 'slow works progress'.
- ❖ **Hence, while compute the financial impact of the delay, it is necessary to exclude the impact of delay arising out of uninsured events.**

IMPORTANT – 5

- ❖ If a project falls behind schedule due to **delays caused due to insured events** covered in the underlying material damage policy
- ❖ the insurance period for DSU cover **must be extended to maintain full cover.**
- ❖ Any physical damage triggering a loss of profit which qualifies for DSU cover must **occur *within*** the DSU insurance period / extended period (if any)
- ❖ Damage occurring **after DSU cover** is triggered is **no longer insured** under the policy, unless it concerns accidents directly associated with the repair or replacement of the initially damaged items.

Significant Exclusions

The following shall be excluded from the cover provided by this section:

- ❖ **Unless also expressly covered** in the Delay in Start Up Insurance Loss or damage:
 - ❖ Covered under underlying Storage Cum Erection Insurance by way of endorsement (if any).

- ❖ Earthquake, volcanic eruption or tsunami
- ❖ Loss of or damage to fuel or feedstock or any materials necessary for the business insured, unless also covered in the underlying Storage Cum Erection Insurance
- ❖ loss of or damage to items of a prototype nature,

- ❖ Redesigning, altering, adding to or improving the property insured or rectifying defects or faults;
- ❖ Non-availability of funds;
- ❖ Any fines or damages for breach of contract, for late or non-completion of orders or for penalties of whatever nature
- ❖ Loss or damage to surrounding property, construction plant and machinery
- ❖ Loss resulting from suspension, lapse or cancellation of a lease, licence, order, contract or agreement

Conditions For Loss Settlement

In the event of a loss of interest insured the basis of loss settlement shall be as follows:

Loss of gross profit

1. In respect of loss of gross profit, the insurer shall pay the amount obtained:
 - by multiplying the rate of gross profit
 - by the amount by which the actual turnover during the indemnity period falls short of
 - the turnover which would have been achieved had the delay in start-up not occurred.
2. If the annual sum insured is less than the amount obtained by multiplying the rate of gross profit by the annual turnover or, if the maximum indemnity period exceeds twelve months, the turnover calculated for the equivalent period, ***the amount payable shall be reduced proportionately.***

Specified standing charges

1. In respect of specified standing charges, the insurer shall pay the amount obtained:
 - by multiplying the percentage by which the actual turnover during the indemnity period falls short of
 - the turnover which would have been achieved had the delay in start-up not occurred
 - by the amount of specified standing charges incurred during the indemnity period.

Fine-tuning / Adjustment Clause

In calculating the rate of gross profit and annual turnover, the following aspects shall be taken into consideration:

- ❖ the results of the business insured for the **12-month period after the date of commencement** of the business insured
- ❖ any circumstances which would have affected the business insured had the delay in start-up not occurred
- ❖ any circumstances affecting the business insured after the actual date of commencement of the business insured
- ❖ **The final figures shall represent as closely as may be deemed reasonable the results, which the business insured would have achieved after the scheduled date of commencement of the business insured, had the delay in start-up not occurred.**

Effect of Underinsurance

If the sum insured hereunder is less than the amount obtained by multiplying the rate of gross profit by the annual turnover or, if the maximum indemnity period exceeds twelve months, the pro rata turnover for that period, ***the amount payable shall be reduced proportionately.***

Increased cost of working

In respect of increased cost of working, the DSU policy shall pay:

- ❖ the additional expenditure ***necessarily and reasonably incurred*** for the sole purpose of ***avoiding or diminishing*** the reduction in turnover which, without such expenditure, would have occurred during the indemnity period after the time excess.
- ❖ The indemnity, however, shall ***not exceed*** the amount of loss of interest insured thereby avoided.

Add on covers

In addition to the perils/ expenses covered, the proposer can opt to seek cover in respect of the following perils on payment of additional premium:

- ❖ Premises of Customers
- ❖ Public Utilities
- ❖ Prevention of Access Damage at the Premises of Suppliers
- ❖ Damage at the
- ❖ Denial of Access

How to claim

In the unfortunate event of a claim please:

- Immediately intimate such loss / damage to the nearest office with a copy to the policy issuing office, so that a Competent Surveyor may be deputed for loss assessment.
- Take all steps to minimise the loss, as if no insurance has been taken.
- give an account of all properties damaged or destroyed with estimated amounts having regard to their values as on the time and date and place of loss, not including profit of any kind
- cooperate with surveyors by providing all the necessary documents for assessment of loss and establishing liability.
- cooperate with the insurer.
- inform particulars of all other insurances existing on the property at the time of loss.

Documents required by insurer for processing the claim:

Claim due to Fire and/or Explosion

- ❖ Copy of Claim intimation given to Company together with xerox of policy & premium receipt
- ❖ Duly filled Claim Form
- ❖ Police Panchnama / First Information Report / Final Police Report (Forensic Deptt.)
- ❖ Fire Brigade Report
- ❖ Photographs of Damaged Property showing extent of damage &/or video film of loss

To substantiate quantum of loss, value of damaged insured property just prior to loss, & value of salvage. Please make available to surveyors/investigators fixed Asset Register, original Bills/ Invoice, Repairs/Replacement Bills/Invoices and stock Register

Claim due to Flood, Storm, Cyclone, Earthquake, Subsidence/ Landslide

- ❖ Copy of Claim intimation given to Company together with xerox of policy & premium receipt
- ❖ Duly filled Claim Form
- ❖ To substantiate quantum of loss, value of damaged insured property just prior to loss, & value of salvage. please make available to surveyors/investigators fixed Asset Register, original Bills/ Invoice, Repairs / Replacement Bills/Invoices and stock Register

- ❖ Newspaper cutting wherein the incidence of occurrence of flood / storm cyclone / earthquake / landslide has been reported
- ❖ Meteorological Report

Claim due to Riot, Strike, Malicious Damage and Terrorism (RSMdT)

- ❖ Copy of Claim intimation given to Company together with xerox of policy & premium receipt
- ❖ Duly filled Claim Form
- ❖ Police Panchnama/First Information Report/Final Investigation Report
- ❖ 04104
- ❖ Newspaper cutting wherein the incidence of riots has been reported
- ❖ Photographs of Damaged Property showing extent of damage &/or video film of loss

Marine Inland Transit Loss of cargo/machinery

- ❖ Copy of Claim intimation given to Company together with xerox of policy cover note/certificate/declaration & premium receipt
- ❖ GR/RR
- ❖ Delivery Receipt with remarks
- ❖ Invoice & Packing list
- ❖ Survey Report & Duly paid Survey fee bill
- ❖ Loss minimisation expenses receipt
- ❖ Police Panchanama/First Information Report
- ❖ Photographs of Damaged Property showing extent of damage &/or video film of loss
- ❖ Duly filled Claim Form
- ❖ Original policy duly discharged by assured/consignee
- ❖ Original open delivery/non delivery/short delivery certificate of carrier duly signed & sealed
- ❖ Copy of Regd. A.D. letter lodging claim with carrier along with monetary claim bill
- ❖ A.D. card of claim lodging letter on carrier
- ❖ Original reply of carrier in reply to claim lodging letter
- ❖ Letter of subrogation cum undertaking
- ❖ Claim bill

Marine Loss of cargo/machinery during Import

- ❖ Copy of Claim intimation given to Company together with xerox of policy & premium receipt
- ❖ Invoice & Packing list
- ❖ Bill of lading/Airways Bill
- ❖ Landing Certificate with remarks for short delivery/damage
- ❖ Custom clearance certificate
- ❖ Joint Survey with shipping company/Port Trust Authority
- ❖ GR/RR
- ❖ Delivery Receipt with remarks for short delivery/damage
- ❖ Survey Report & Duly paid Survey fee bill
- ❖ Sale Contract
- ❖ Photographs of Damaged Property showing extent of damage &/or video film of loss
- ❖ Duly filled Claim Form
- ❖ Original Policy/Certificate/Cover note duly discharged by Assured/Consignor
- ❖ Copy of Regd. A.D. letter lodging claim on Shipping Co./Air Carrier with monetary claim & reply of shipping co.
- ❖ Letter of subrogation cum undertaking
- ❖ Bill of entry
- ❖ Certificate of Origin

Claim due to Breakdown during Testing / Commissioning

- ❖ Copy of Claim intimation given to Company together with xerox of policy & premium receipt
- ❖ Duly filled Claim Form
- ❖ Statement of eye witness to loss about cause of loss & circumstances of loss
- ❖ Asset Register, log-book, original bills/Invoices/bill of entry of damaged property & repair/replacement bills/invoices to substantiate the quantum of loss.(To be made available to surveyor).
- ❖ Proforma invoices of new machine
- ❖ Photographs of Damaged Property showing extent of damage &/or video film of loss

Claim due to Burglary

- ❖ Copy of Claim intimation given to Company together with xerox of policy & premium receipt
- ❖ Duly filled Claim Form
- ❖ Police Panchanama/First Information Report
- ❖ Police investigation report
- ❖ Photographs of Damaged Property showing extent of damage &/or video film of loss
- ❖ To substantiate quantum of loss, please make available to surveyor/investigator, your stock register, original Bills/ Invoice, cash memos, fixed asset register, bank statement, cash-book/ledger
- ❖ Inventory of articles kept in bank-locker