

P&C RISK REVIEW

A PUBLICATION OF THE PROFESSIONAL LIABILITY INSURANCE NETWORK



FINANCE INSURANCE, LTD.
Quality Service For Your Insurance Needs

VOLUME 003, 2012

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The Basics of Business Interruption and Extra Expense Insurance

This material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, confer with a qualified professional who can provide guidance that considers your unique circumstances.

Most design firms recognize the risk of suffering property losses due to perils such as fire, wind, flood, earthquake, theft and vandalism. They typically purchase a package of property and casualty insurance policies that will cover the majority of the cost of repairing or replacing their valuable business property.

What many companies may overlook, however, is that even if insurance replaces 100% of their business property losses, including facilities, equipment, furnishings and supplies, they can still face substantial damages. Take the example of an architectural firm that suffers a significant fire. It may take months to repair the facilities and replace the damaged furnishing and equipment. The company's business operations can be suspended for a significant length of time resulting in a substantial loss of income and profits. To get operations running again, the business may have to take on added expenses – for example, renting a temporary facility and equipment to use while the business is being repaired. Even though the firm may have adequate property insurance to cover the physical losses, standard property insurance will not replace the loss of

income or the extra expenses that are incurred to get the company back on its feet.

Fortunately, there are coverages available that can help offset these additional losses and expenses.

Business Interruption Insurance

Business interruption insurance, sometimes referred to as business income protection insurance, provides companies with funds to offset the loss of income during the period a business is forced to suspend operations. For coverage to be triggered:

- There must be a direct physical loss of or damage to your property.
- The direct physical loss must take place at the premises described in the policy.
- The loss must be the result of a covered peril. Note: if the covered peril occurs offsite, such as a fire at an adjacent business, but your business is forced to suspend operations due to damage to your premises, such as resulting smoke or water damage, coverage typically applies.
- There must be a necessary suspension of company business due to the damage to or destruction of company property.

Depending on policy terms, coverage can apply not only to physical damage caused by covered perils such as fire, natural disaster, theft and vandalism, but to the loss of a key employee or business owner due to accident or injury. (These coverages are best coordinated with individual disability policies to ensure gaps are properly covered.) Companies that conduct a

substantial amount of business over the Internet can also be protected against loss of business caused by an interruption of service due to property damage, equipment failure or hackers.

Proceeds from business interruption policies can be used to cover ongoing expenses such as rent, mortgage payments, utilities, maintenance and taxes. What's more, policies can help compensate owners for lost revenues and may even cover employee salaries.

Prior year's earnings and projected income are typically the basis for determining appropriate policy limits and estimating lost revenues during a suspension of business. If a company has operated at a net loss, then the business interruption policy may only cover ongoing expenses. Policies are available that will pay for loss of earnings up to the company's profit level prior to the loss. Most business interruption policies can be customized to reflect issues such as fluctuations in seasonal income.

Business interruption coverage typically is in effect for the "period of restoration." This period runs from the time of the occurrence of loss until the time business operations resume or should have resumed in the permanent facilities.

However coverage limitations apply. For example, policies may have a waiting period, typically 24 to 72-hours of suspended business, before coverage takes effect. Deductibles and coinsurance factors may apply. The total coverage paid out is often established by a combination of the insurance limits of the policy, a maximum period of indemnity (for example coverage ceases after 120 days of suspended business) and/or a monthly limit of indemnity (a cap on how much the policy pays during any given month).

Extra Expense Insurance

Business interruption insurance is designed to cover the normal ongoing costs of a business during the time operations are suspended. But what about the extra added costs that would be incurred to keep operations going while a business is being restored? For example, a design firm may need to rent temporary facilities and equipment while its primary facility is being rebuilt following a fire or other disaster. That's where extra expense insurance comes in.

Extra expense insurance provides coverage for the excess costs incurred necessary to temporarily maintain operations during a suspension of normal business. These excess expenses must be incurred to avoid or minimize the suspension of business due to a covered cause of loss, and can include repairs and replacement of property as well as the restoration of lost information. Essentially, extra expense insurance pays for expenses that are necessary to minimize the suspension of business and the related losses that would typically be paid under a business interruption policy. Extra expense insurance can be purchased in addition to or in place of business interruption insurance.

You'll need to work with your accountant and insurance agent to determine the limits and terms of business interruption and extra expense insurance appropriate for your business. Typically, you'll be asked to complete a business income or business interruption worksheet that shows past, current and projected income, expenses, profits and losses. Premiums will be based upon these amounts and other factors such as the maximum indemnity period of coverage. Companies with multiple locations must often purchase coverage on a per-location basis. Terms, conditions and coverages can vary by individually policies and by the company's locale.

Insurance Not Enough

Companies should have business disaster and recovery plans in place to identify potential causes of business interruptions and methods to avoid or minimize the duration of a business shutdown. Recordkeeping policies that include adequate offsite backup of critical information are key for design firms to restore business operations in a timely manner.

Disaster avoidance and recovery planning combined with prudent insurance coverage can go a long way to ensuring your company can recover from a suspension of business operations and get back on its feet before it is overwhelmed by losses. We'll be happy to help you explore your options.

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.