

Making sense of Business Interruption insurance



Guest editorial
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When considering property losses in manufacturing or distribution, most people think of fire damage to the building as well as inventory and equipment inside. They wonder how their insurance policy will respond to such a loss and what will it pay to rebuild the facility and replenish inventory. While these are essential questions, it's important to understand Business Interruption (also called Business Income or Loss of Income) coverage and how it can help.

What if your facility had a fire and you could no longer conduct business there? Your property policy will likely pay to rebuild and for the contents inside. But what would happen to your livelihood in the meantime? Would your employees leave to work for a competitor? How would you retain your customer base? This is when Business Interruption coverage steps to the foreground.

This coverage can include several things, depending on how it's structured for your operation:

- Loss of revenues due to total inability to use the facility
 - Reduction of revenues due to the ability to only use the facility at a fraction of its capacity
 - Payroll for key employees so they don't go to a competitor during the rebuilding phase
 - Payroll for all employees so they don't go to a competitor during the rebuilding phase
- In addition, Business Interruption can be structured to include extra expenses incurred from conducting operations at an alternative facility while yours is being repaired or rebuilt. This is referred to as Business Interruption Including Extra Expense (such as rental space for a temporary location, installation of phones, computers, etc., as well as advertising your interim site to customers).

"It often takes more than just repairing or rebuilding and resuming operations to reach pre-loss revenues."

Extra Expense coverage is provided to help you retain as many clients and as much revenue as possible after a property loss. Note, it can be purchased by itself. Buying it without Business Interruption may be a good option for companies that don't require a specialized facility or have operations that could be conducted anywhere. This is typically not the case with manufacturing.

Business Interruption can be extended after the facility is rebuilt. The need for this option arises because it often takes time for revenues to return to normal levels. For example, you may need to contact customers who went to a different facility or re-staff for your operation to reach 100 percent capacity again. A basic tenet of this insurance policy is to restore you to "pre-loss condition." It often takes more than just repairing or rebuilding and resuming operations to reach pre-loss revenues.

After reviewing options with your agent and selecting appropriate Business Interruption coverages for your company, there will be discussion about how the coverage pays when a covered loss occurs. It can pay based on length of time you are unable to conduct business or based on a dollar amount for a specific time period. Following are examples of both situations.

- You estimate dollar exposure is about \$1 million per year and that it will take six months to restore the business to pre-loss condition. In this scenario, you would choose a limit of \$500,000 at 50 percent coinsurance, which tells the insurance company the

\$500,000 limit represents half a year. There is no limitation on how much you can receive per month, with the understanding that the policy will not pay more than \$500,000. (You can also choose up to a year or more if projected restoration time is longer.)

- Using the same \$1 million of exposure, you can opt to receive a certain dollar amount per month. If you think it will take six months to restore your business, you could choose to receive the \$500,000 at a one-sixth monthly limit of indemnity. In this scenario, the policy would pay no more than \$83,333 per month for a maximum of six months, or one-sixth of \$500,000. (You can choose other monthly limits such as one-third or one-fourth, depending on estimated restoration time.)

When selecting coverages for your business and policy method of payment in the event of a covered loss, the discussion should be between you and your agent to determine how to best protect your company.

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