

Making sense of Business Interruption insurance



Guest editorial
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Manufacturing or distribution industry property losses would typically make people think of fire damage to the facility itself, plus inventory and equipment inside the building.

- How will my insurance policy respond to a loss like this?
- What will it pay to rebuild my facility and replenish my inventory?

Although these are good questions to ask and the answers are important to understand, Business Interruption (also called Business Income or Loss of Income) coverage is sometimes overlooked, and therefore not well understood.

What if your facility had a fire and you were unable to conduct business there? Your property policy would likely pay to rebuild the facility and for the contents of that facility, but what would happen to your livelihood while the building was being rebuilt? Would your employees go work for a competitor? How would you retain the customer base you've worked so hard to develop? This is the scenario when the Business Interruption coverage steps to the foreground.

Business Interruption coverage can include several things depending on how the coverage is structured for your operation:

- Loss of revenues due to the 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 you incur in order to conduct operations at an alternative facility while yours is being repaired or rebuilt. This is referred to as Business Interruption Including Extra Expense. Some expenses you may incur would include rental space for a temporary location, installation of phones, computers, etc., as well as advertising to your client base that you are still in operation at the temporary location. The Extra Expense coverage is provided to help you retain as many clients and as much revenue as possible during the difficult time after a property loss.

Note, Extra Expense coverage can be purchased by itself; not in *addition* to the Business Interruption coverage. Purchasing Extra Expense by itself, without Business Interruption, may be a good option for businesses that don't require a specialized facility or have an operation that could be conducted essentially anywhere. This is typically not the case with manufacturing operations.

Business Interruption can also be extended for a period of time after the facility is rebuilt and you are actually back to work. The need for this option arises because it often takes time for revenues to bounce back to where they were before your loss — perhaps you need to reach out to customers who went to a different facility while you were rebuilding, or you need to re-staff

at some level to get back to 100% capacity. One of the basic tenets of the insurance policy is to restore you to pre-loss condition. It often takes more than just repairing or rebuilding your facility and resuming operations to get revenues to pre-loss condition.

Once you've reviewed options with your agent and have chosen the Business Interruption coverages most appropriate for your operation, there will be some discussion about how the coverage will pay once a covered loss occurs. The coverage can pay based on the length of time you are unable to conduct business or based on a dollar amount for a specific time period. Examples of both are as follows:

- You can estimate your dollar exposure is about \$1,000,000 per year and that it will take about six months to restore your business to pre-loss condition. In this scenario, you would choose a limit of \$500,000 at 50% coinsurance, which tells the insurance company the \$500,000 limit chosen represents half a year. In this situation, there is no limit to how

much you could receive per month, understanding that the policy will simply not pay more than the \$500,000 limit. (You can also choose up to a year or even longer than a year if estimated restoration time is longer.)

- Using the same \$1,000,000 of exposure, you can choose to receive a certain dollar amount per month. If you think it will take the same six months to restore your business, you could opt to receive the \$500,000 at 1/6 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 1/6 of \$500,000. (You can choose other monthly limits such as 1/3 or 1/4 depending on estimated restoration time.)

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

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