

# Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 04/2007 – “Business Interruption Insurance”

April, 2007

Commercial Insurance Update © 2007 Cavnac & Associates — All Rights Reserved

## Business Interruption Insurance

By Jeffrey W. Cavnac, CPCU, RPLU, CRIS  
© 2007 Cavnac & Associates — All Rights Reserved

**D**irect property insurance is pretty easy to understand. It covers the cost to repair or replace property which is damaged or destroyed by a covered peril such as fire, windstorm, vandalism or theft. Indirect property coverages, however, are a little more confusing but equally important. Indirect exposures include business income, extra expense, and rental income coverages. One way to look at direct property coverage is that it

protects a company’s balance sheet; whereas indirect property coverage protects a company’s income statement.

For the sake of brevity, I’ll refer to indirect property exposures as business interruption coverage (BI). BI coverage can be confusing, is commonly misunderstood, and is probably the toughest coverage to set a limit for. It also creates the biggest opportunity for inadequate values and coinsurance

**Business Interruption** (continued on page 2)

### In this issue...

<b>Business Interruption Insurance</b> .....	1-5
<b>2007 FOCUS Seminars</b> .....	3
<b>Loss of Income Worksheet</b> .....	6
<b>Extra Expense Worksheet</b> .....	7
<b>Eat Well, Live Well</b> .....	8



Published by

**Cavnac & Associates**  
INSURANCE BROKERS

License No. OA99520

450 B Street, Suite 1800  
San Diego, CA 92101-8005

✦ Phone 619-234-6848 ✦ Fax 619-234-8601  
✦ Web Site [www.cavnac.com](http://www.cavnac.com)



## What Does Business Interruption Cover?

In the event an insured location is damaged by a covered peril, a business may suffer a loss of income, a loss of rental income and/or incur extraordinary operating expenses to get back into business. These are the subjects of BI insurance.

**1. Business Income** is defined as “net income that would have been earned, plus continuing normal operating expenses, including payroll,” in other words, loss of profit plus continuing expenses.

**2. Rental Value** equals the rents you would have received during the period of restoration.

**3. Extra Expense** is defined as “necessary expenses you incur during the ‘Period of Restoration’ (how long it should take to restore your premises to its pre-loss condition) that you would not have incurred if there had been no damage to your property.”

### Business Interruption *(continued from page 1)*

penalties. Many businesses that suffer major damage to their facilities never recover. If BI limits are not adequate the odds of recovery are even more remote.

Before you invest any more time in this article, I encourage you to review your current BI coverage. Many service-type industries, such as architects, engineers, attorneys, and retailers, have their property and liability coverages written on a Business Owners Policy (BOP). Most BOP policies automatically include BI coverage for up to a year on an “Actual Loss Sustained” basis. In other words, you don’t have to go through the process of setting a separate limit because there is no maximum. You will have coverage for your actual loss of business income for up to 12 months. So as long as you can resume operations within a year, your coverage is adequate.

For the vast majority of businesses, however, the amount of BI exposure needs to be determined. This valuation is critical. As mentioned earlier, inadequate or lack of BI coverage can doom a company that suffers a major loss.



## Cavnac & Associates

### Full Service Surety Department

**Need bonds?** We can help! We offer:

- Bid Bonds
- DRE Bonds
- Fiduciary Bonds
- License & Permit Bonds
- Notary Bonds
- Contract Bonds
- Fidelity Bonds
- Judicial Bonds
- Performance Bonds
- Subdivision Bonds

**Having trouble obtaining bonds?** We can assist you! Collectively, our Surety Department has over 95 years of surety knowledge and experience — we know how to get your company qualified for surety credit.

We have **access to all major surety markets**, including AIG, ARCH, Chubb, CNA, Great American, Hartford, ICW, IFIC, INSCO/DICO, Liberty Mutual, RLI, Safeco, Travelers, and Zurich among many others.

For more information, contact **Leslie Hahn**  
**619-744-0587 / lhahn@cavnac.com**



*Newsletter* of August 2006 ) is crucial to successfully resuming operations after a major loss and can also substantially reduce your exposure to loss.

## 2. Determine Your Loss of Profits

The second step is to determine what your loss of profits would be during the Period of Restoration.

## 3. Determine Your Continuing Operating Expenses

Third, what would your continuing operating expenses be? Note that *non* continuing expenses are *not* covered. For example, if you are a manufacturer and your operations are suspended, you would not have to purchase stock and some

of your utility expenses would disappear as well.

A major category of continuing operating expenses is payroll. You have the option of including or excluding "Ordinary Payroll." Ordinary payroll is defined as "*payroll expense of employees other than executives,*

**Business Interruption** (continued on page 4)

**Business Interruption** (continued from page 2)

## How to Calculate Your Exposure

The insurance industry is big on worksheets. The worksheet developed to calculate Business Income values (Form CP 15 15) is about as complicated and convoluted as they come. Most accountants – let alone insureds – don't understand the massive form. With this in mind, we developed a much simpler form that will help you arrive at an appropriate limit. A copy of the form is included on page 6.

### 1. Determine How Long You Will Be Out of Business

The first thing you need to figure out is exactly what you would do if your facility were damaged or destroyed. Would you retire? If so, you might not want to buy BI coverage.

However, if you want to remain in business, then you need to decide how long it would take you to get up and running again (the Period of Restoration). Would you suspend operations until you could reoccupy your current location? Would you search for an alternative permanent location? Could you use other premises to partially resume operations until your new permanent location is available?

All of these options need to be given consideration. A well written Disaster Recovery Program (see our *Commercial Update*

# 2007

## FOCUS Seminars

### Cavnac & Associates' FOCUS Room

Bank of America Plaza  
450 B Street, 18th Floor, San Diego, CA

- **HR 101 — Leave of Absence Bootcamp**  
Tuesday, April 24, 2007 — 8:00 AM to 9:30 AM
- **Hiring Practices for the Construction Industry**  
Friday, May 18th, 2007 — 9:00 AM to 11:00 AM
- **Sexual Harassment Prevention Training**  
Satisfies requirements for AB1825 Training  
Friday, June 15, 2007 — 9:00 AM to 11:00 AM

**All training sessions available to our clients  
Reserve early / seating is limited!**

#### For more information about upcoming seminars:

- Visit our Web site at <http://www.cavnac.com/home.html>
- Contact **Bethany Mongold** by e-mail [bethany@cavnac.com](mailto:bethany@cavnac.com) or by phone at **619-744-0540**

**Business Interruption** (continued from page 3)

*department managers, employees under contract and other important employees.”*

If your “ordinary” employees are important to your operation, you may want to keep them on your payroll until you are ready to reopen. Additionally, you can specify how long you might want to include them (i.e., 30, 60, 90 or 180 days).

Once you have determined your monthly exposure and how long it would take to get back in business, you multiply your monthly exposure by the number of months it will take to get back in business, which produces your Business Income Valuation for the period of restoration.

**4. Extended Period of Indemnity**

Some businesses might complete repairs and be ready to go. However, it may take additional time to get sales ramped up to what they were prior to the loss. The standard Insurance Services Office (ISO) Business Income Coverage Form (CP 0030 0402) provides an additional 30 days of coverage after the period of restoration. This is known as an “Extended Period of Indemnity.” This may not be enough, and a longer time frame may need to be endorsed onto your policy.

**5. Extra Expense**

The calculation of extra expense coverage can also be a challenge. Extra expense coverage reimburses you for expenses you incur during the “period of restoration” that you would not have incurred if there had been no direct physical loss. It includes expenses that help you avoid or minimize the suspension of your business, as well as expenses to continue operations at your original or replacement location. It also includes costs incurred to minimize the suspension of your business if you cannot continue your operations. We have included our simplified Extra Expense Worksheet on page 7 to assist in this calculation.

**6. Rental Value**

Rental value not only includes the loss of rental income during the period of restoration, but it also includes any continuing operating expenses (including payroll) as well as the amount of charges that are the legal obligation of the tenant(s) but would otherwise be your obligation.



If the building is owned by you or the other members of your company, but held under a separate legal entity, you need to make certain to include the rental value in your business income calculation.

Alternatively, if the building is owned by the same entity that occupies the facility, then there is no rental exposure.

**7. Your Business Income Limit of Coverage**

Once you have figured out an appropriate Period of Restoration and the monthly exposures for Business Income, Extra Expense and Rental Value, you can then calculate your total exposure.

It is important to know that the BI value sets a maximum limit of coverage. In the event of a loss, you will be compensated on an “actual loss sustained” basis up to your limit of coverage. Another point to remember is that if you elect not to go back into business, you will still recover the loss of business income that you would have earned during the period of restoration.

**8. Coinsurance**

Most underwriters want to see Business Income coverage written with coinsurance. Coinsurance is designed to encourage insurance

to value. Be wary of coinsurance — it can only penalize you! If you are underinsured at the time of a loss the coinsurance penalty will kick in and reduce your recovery, even for a partial loss. If you complete a worksheet to substantiate your valuation, most underwriters will agree to write coverage on an “Agreed Amount” basis. We strongly recommend that your coverage be endorsed accordingly.

## Cavignac & Associates

INSURANCE BROKERS

Happy to be Celebrating  
**15 Years**  
of Managing Risk and Negotiating Insurance  
for Our Clients



### Deductibles

The ISO BI form includes a 72-hour deductible. In other words, there is no coverage during the first 72 hours following the loss.

Companies who do not use ISO forms may have a different deductible but you should be aware that you can generally negotiate it. If you want to retain more risk, you may elect to lengthen the deductible period.

### Contingent Business Interruption

Some businesses are dependent on other companies for a significant part of their production or possibly a large percentage of their sales. A golf club manufacturer, for example, sourced their club heads from a facility in Australia. The Australian plant had a unique process to create the club head. If the facility in Australia were destroyed, the golf club manufacturer would suffer a major loss of income.

The basic BI policy is triggered *only* if there is *direct damage* to a covered facility. In this case, the Australian facility is not a covered location. A separate coverage known as “Contingent Business Interruption” is available for this kind of exposure.

### Civil Authority

The ISO Business Income form includes three weeks of coverage (beginning 72 hours after loss is suffered) if a civil authority prohibits access to your premises due to direct physical loss of or damage to property other than yours. Note that this damage must be caused by a covered peril. Civil authority coverage can be endorsed to last a longer period if necessary.

### Best Practices

1. Make certain you have an effective Disaster Recovery Program. This should include the specific steps you will need to take to get back into business and how you will accomplish them.
2. Take the time to complete both a Business Income and Extra Expense Worksheet. Recognize that most people tend to underinsure, but this is one coverage you want to be sure you have adequate limits for.

### Summary

Although business interruption is one of the most crucial coverages in your insurance portfolio, it is one of the least understood. In the event of major damage to your facility, appropriate business interruption coverage can make the difference between getting back in business or folding your tent. ✂

**Disclaimer:** This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

# Cavignac & Associates

INSURANCE BROKERS

License No. OA99520

450 B Street, Suite 1800 San Diego, CA 92101-8005

Phone 619-234-6848 <> Fax 619-234-8601 <> Web Site www.cavignac.com

## Loss of Income Worksheet

Insured \_\_\_\_\_ Date \_\_\_\_\_

In the event your premises are damaged or destroyed by a covered peril, you may be forced to shut down operations for a period of time. This would result in a loss of income.

Loss of income equals net profit or loss (before income taxes) that would have been earned had no loss occurred, plus any normal operating expenses that would continue during the period of restoration.

**I. Net Profit or Loss – Monthly** \$ \_\_\_\_\_  
(Before income taxes that would have been earned had no loss occurred)

**II. Continuing Normal Operating Expenses – Monthly**

	Item	Estimated Monthly Cost
A.	Owners, officers, and key employee salaries	\$
B.	Ordinary payroll	\$
C.	Rent or real estate taxes	\$
D.	Necessary light, heat and power	\$
E.	Contractual obligations	\$
F.	Dividends to stockholders	\$
G.	Insurance premiums	\$
H.	Unemployment and security taxes	\$
I.	Repairs and maintenance	\$
J.	Membership dues and fees	\$
K.	Depreciation and expansion expenses	\$
L.	Interest on indebtedness	\$
M.	Professional fees	\$
N.	Mortgage payments	\$
O.	Other continuing expenses	\$

**Sub-Total** \$ \_\_\_\_\_

**III. Monthly Loss of Income (I + II)** \$ \_\_\_\_\_  
**IV. Maximum Probable Period of Interruption (number of months)** \_\_\_\_\_ x \_\_\_\_\_  
**V. Loss of Income Exposure (multiply III x IV)** \$ \_\_\_\_\_  
**VI. Extra Expense** (see Extra Expense Worksheet) + \_\_\_\_\_  
**VII. Total** \$ \_\_\_\_\_

Signature \_\_\_\_\_ Date \_\_\_\_\_

# Cavignac & Associates

I N S U R A N C E   B R O K E R S

License No. OA99520

450 B Street, Suite 1800   San Diego, CA 92101-8005

Phone 619-234-6848   <>   Fax 619-234-8601   <>   Web Site www.cavignac.com

## Extra Expense Worksheet

**Insured** \_\_\_\_\_ **Date** \_\_\_\_\_

In the event your premises are damaged or destroyed by a covered peril, you may have to temporarily relocate your facility while your premises are being repaired.

Extra expenses include necessary expenses you incur during the period of restoration that you would not have incurred had no loss occurred.

The worksheet should be completed on a per month basis.

### I. Extra Expenses

Extra Expense Item		Estimated Cost	
		First Month	Subsequent Months
A.	Employee overtime costs	\$	\$
B.	Additional rent (over cost of normal rent)	\$	\$
C.	Additional advertising, announcements, mailing expenses	\$	\$
D.	Installation of additional telephones	\$	\$
E.	Rental of office equipment, such as computers, etc.	\$	\$
F.	Rental of other equipment	\$	\$
G.	Moving expenses	\$	\$
H.	Additional costs to have work done	\$	\$
I.	Expediting costs	\$	\$
J.	Travel expenses	\$	\$
K.	Other extra expenses	\$	\$
<b>Total Monthly Extra Expense</b>		\$	\$

### II. Extra Expense Calculation

Maximum Probable Period of Interruption (total number of months)	
First Month's Estimated Cost	\$
Total # of Subsequent Months x Amount Per Month	+
<b>Total Extra Expense</b>	<b>\$</b>

**Signature** \_\_\_\_\_ **Date** \_\_\_\_\_

# Eat Well, Live Well

Article courtesy of MyWave  
Cavnagac & Associates' Employee Benefits Department



If changing eating habits were easy, many more people would be fit and healthy. One key to making lasting improvements is to make changes in stages.

Start with something simple and stick to it for a week. After your family has mastered one change, add another.

## Some Ideas to Get You Started

- Substitute water for one sugary drink each day
- Eat 1-2 more fruits or vegetables each day
- Plan a healthy snack for each day of the week
- Switch to a low-fat version of a favorite food
- Eat breakfast
- Plan three meals and two snacks every day
- Plan a home cooked meal – they usually have fewer calories, more reasonable portions, and cost less than typical meals eaten at restaurants

## Set the Example

Parents play a big role in guiding their children's eating habits – by the examples they set, by the foods they make available in the home, and by the mealtime experiences they create for their families.

Offer healthy snacks such as fruit, low-fat cottage cheese or yogurt, frozen juice bars, applesauce, celery or apples and peanut butter, raw

vegetables, graham crackers, fig bars or whole wheat crackers and low-fat cheese.

Large portions mean too many calories. A snack for a typical adult may be a carton of yogurt but for a preschooler, two or three tablespoons of yogurt is about right.

## Make Eating an Enjoyable Activity for the Whole Family

Family meals can be a time to monitor what children are eating and reconnect to each other. The idea is to build healthy life-long eating habits.

Sit down with children when they eat. Involve children in food preparation and clean-up. Teens who eat dinner with their families six or seven times a week are about half as likely to abuse alcohol and drugs.

Some tips for healthy eating:

- Eat plenty of fruits and vegetables – five servings a day for children ages 2 to 6 and 7 to 9 servings a day for older children
- Beware of sweetened drinks – sodas and sports drinks are high in calories and too much juice can quickly add too many calories to a child's diet
- Eat sensibly when eating out

## Healthy Food Tips When Eating Out

- Ask if you don't know what is in a dish or the serving size
- Eat the same portion you would at home
- Ask for sauces, gravy and dressings on the side
- Order foods that are not breaded or fried
- Order fruit for an appetizer or for dessert
- Ask for substitutions. Ask for a vegetable instead of fries, or ask for the high fat food to be left off the plate
- Ask for low calorie versions of food. Vinegar and oil or a squeeze of lemon is better than high-fat dressings or sauces ✂

## Did you know...?

**A**mericans eat an average of 4.2 commercially prepared meals each week. Processed foods are likely to be higher in calories, fat, and salt and lower in fiber than natural meals prepared at home.