Insurance Newsletter
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Business Interruption Insurance

The earliest types of insurance were property insurance policies, from Lloyds of London, insuring sailing ships, to the earliest U.S. colonial era fire insurance companies, insuring homes and buildings. The value of property insurance covering direct damage or loss to insured property is well understood; less so is the importance of property insurance covering indirect or consequential loss.

Broadly described as business interruption insurance, these forms of property coverage provide additional protection for financial loss for other than direct damage to property. It's not difficult to imagine how a relatively small loss to a small part of a building, perhaps a single room or even a single machine, could lead to a significant impact on business operations. For a recent example think of the almost total shutdown of all flight operations that afflicted Delta Air Lines in early August. That massive interruption to their business operations was reportedly traced to breakdown of or damage to a single server. It's no stretch to imagine a lightning strike, electrical short, small smoky fire, or plumbing leak or water damage causing a similar event…a small amount of direct physical damage but major business interruption and consequential loss.

Especially in this time of highly automated manufacturing, business processes and data management, business interruption insurance has become an essential risk transfer tool. This coverage provides resources that aid any business in recovery following a catastrophic event and can help get a company back on its feet quickly, enabling it to pay staff, meet credit obligations, and provide peace of mind for employees and shareholders.

Business interruption coverage can best be thought of as having two distinct parts or types of coverage – *business income* and *extra expense*. Business income coverage insures net income that would have been earned had no loss occurred. "Would" is the key word here because unlike a loss due to physical damage, business income is based on assumptions of what *would* have happened had there been no loss. Business income insurance provides coverage for operating expenses that continue even after a loss, such as payroll, leases and mortgages, debt service and employee benefits, to name just a few. For many businesses in areas where finding and retaining qualified employees is an issue, the coverage for ongoing payroll expenses is, by itself, a strong argument for carrying business income insurance, since it lets you hold onto your labor force rather than seeing employees drift away to other jobs. And, it also insures the profit that would have been earned had no loss occurred.

Extra expense coverage is another important component of business interruption insurance. This covers potential costs over and above normal operating expenses that helps avoid or minimize business downtime and allow operations to continue. This is important especially to many service type businesses that really can't afford to shut down after a loss, but must make every effort to continue operations to service clients and customers. For instance, extra costs to rent, equip and operate a replacement or temporary location, extra costs to replace vital equipment, parts or stock on a rush basis, overtime to perform tasks manually while automated systems are restored, and so forth, would all be covered extra expenses if they allowed you to continue operations.

Traditional insured property perils have always been a good reason for this type of insurance, but recent news headlines put the emphasis on an additional component of business interruption coverage that should be considered: coverage for the acts of civil authority, which covers a loss of business triggered by a governmental action (law enforcement, civil authorities, etc.) that restricts access to the insured premises. Think of the many businesses, large and small, that were affected by such restrictions after such events as 9/11 or the Boston Marathon bombing. Another example would be an ordered evacuation ahead of a hurricane that's about to come ashore, or restricted access to an area after such a storm or natural catastrophe.

Determining the exact business interruption coverages you need can be a rather complex process; it takes time to do disaster planning and work through the various potential scenarios that could affect a business. While many business owners and executives might not want to consider these pessimistic scenarios, taking a hard look at such possibilities is a smart thing to do. Think of it as advanced preparation that just might help your business survive if a disaster strikes.

There are also numerous different optional coverages and endorsements that can better tailor these types of coverages to better fit your specific needs, most at little of no additional cost. With the frequency and severity of property losses increasing in recent years and the evolution of business to more data intensive processes which are more vulnerable to interruption and loss, this often overlooked coverage is well worth another look. We'll be happy to sit down with you and come up with some options.

Claims Made Policy Renewal: Danger Time

Claims made policies have become ubiquitous. Formerly found only in certain specialized niches, these days many common and necessary policies are written on these forms. Employee benefits liability, employment practices, cyber, fiduciary, as well as D&O, E&O, and most forms of professional liability are almost always written on claims made forms. These days most organizations will have at least a couple of claims made policies in their insurance portfolio.

Unfortunately, most insurance buyers are still a bit cloudy about the significant differences between claims made policies and the far more common occurrence based liability policy forms they are familiar with. In particular, the key difference between the coverage trigger in a claims made policy, the claim (and not the occurrence that leads to a claim as in occurrence policies) presents significant challenges to properly managing these policies that policyholders need to understand.

Claims made policies are all nonstandard policies and can vary in significant ways, but in general they cover claims that are first made against the policyholder and reported to the insurance company while the policy is in force. No coverage may exist for a claim made against the policyholder during the policy period *but not reported* to the insurance company after the policy expires, thus, the danger zone. They also generally exclude claims arising out of prior and pending litigation, incidents reported to prior insurers as well excluding claims for which the named insured had prior knowledge of circumstances that may give rise to a claim.

Consider the practical implications of all this. Imagine your claims made policy with an expiration falling on a weekend or holiday. You are in the parking lot on a Friday afternoon getting into your car to head home when you are served with notice of a claim; how do you report that to the insurance company during the policy period? Or, you are sick, or out of town, or on vacation when a claim comes in the mail; will your staff know what to do with it and how to respond? In fact, there are many good faith reasons why you might not be able to report a claim to the insurance company within the policy period; does that mean no coverage?

Most claims made policies do contain a basic extended reporting period provision. These will typically provide an additional 30 or 60 days to report a claim first made against you during the policy period, and one could hope that would cover the situations described. Here's the catch, though…these provisions are frequently limited only to situations when the policy is cancelled or non-renewed. If you renew? No extended reporting period. Think about that for a minute. You don't renew your claims made policy, you fire your insurance company, and you get a free extended reporting period. Or, you're a good customer, you renew your policy…and you don't. The insurance company treats the customers they lose better than the customers they keep.

While on this subject there is one more red flag to beware of, that in the definition of “claim”. Insurance policies all have a section with definitions of key terms, and the definition of a claim in a claims made policy is a very important one. A claim will typically be described as a demand, proceeding, request and so forth, written, oral or either. What is frequently missing is any requirement that the insured have notice of it. A lawsuit might be filed or a proceeding initiated which would trigger coverage, but the actual documentation might not hit your desk until several weeks later. How are you supposed to report a claim you don’t even know about?

The lesson for all this is that any claims made policy renewals, even routine ones, need to be approached with caution. You should be on alert for any potential claims starting about 60 days out from renewal, and on high alert in the week or ten days prior to renewal. If you are unsure how any of this applies to you, give us a call.

Workers Compensation for Independent Contractors

Workers Compensation is social insurance, based on the fundamental principle of universal coverage of employees. Throughout the U.S. the various worker’s compensation acts of states or jurisdictions guarantees payment of benefits to employees who sustain injuries that arise out of and in the course of their employment. Employees get a guaranteed and timely benefit in the form of coverage for their job injury related medical expenses and compensation for lost earning capacity, without the need to go to court to prove negligence on the part of their employer; in exchange, the employer is immunized from the cost and unpredictability of tort suits alleging negligence in causing or contributing to an employee’s injury.

This system has worked well for over 100 years, even though there is a certain bias built into the system, a fundamental presumption in favor of the injured employee which can occasionally lead to some abuses by individuals so inclined. More recently, though, changing trends in the modern workforce have led to challenges to the way the WC system works. Larger numbers of self-employed individuals, acting as independent contractors, is one of those problems.

There is a clash in social values between universal protection for employees and individual freedom to make a living as a self-employed person. The basic premise of the WC system is that employers assume financial responsibility for paying WC benefits for work injuries to their employees, but independent contractors are not employees. WC laws also typically make the purchase of WC insurance optional for self-employed workers, sole proprietors and working owners of closely held business entities.

This exemption creates another set of problems. Workers compensation is actually a great deal for most self-employed individuals, a combination of 100% coverage for medical expenses from work injuries and a disability income component. It’s an even better deal when you consider that almost all health insurance plans exclude coverage for work injuries. But the average self-employed individual or sole proprietor is not sophisticated about insurance, may not have access to good advice, and generally resists the idea of spending the few hundred dollars a year a WC policy would cost. Consequently, most do not carry worker’s compensation insurance.

The point of WC is to cover injured workers with minimum fuss and no litigation, but absent any other factor, that would not happen for an independent contractor who is an uninsured sole proprietor. Remember the bias in the system, though; the WC system wants injured workers to be covered. The way most states do that is by including some provision that if an independent contractor not insured for WC is injured, they can make a claim for WC benefits on the policy of the company that contracted with them.

So, for this reason, in most jurisdictions if you engage the services of an independent contractor who does not have a WC policy, and they suffer a job related injury, you own that claim and it will be covered under your WC policy. This is why premium auditors will ask if you used any contractors. If you answer yes, they want to see insurance certificates from them showing they had WC coverage. If not, you'll be charged a premium for those uninsured contractors.

There is a simple solution to all these problems. Get evidence that any contractor you deal with carries WC insurance. Failing that, just understand that even though in all other respects they may qualify as an independent contractor, in the event of an on the job injury they could be treated just like one of your employees by your WC insurance company.

Rethinking TRIA

As most of our readers know, all major commercial insurance policies these days contain exclusions for claims arising out of acts of terrorism (workers compensation being the sole exception to this general rule). At each renewal for most property and liability policies, and certainly for your property insurance policies, you are offered the option to purchase terrorism coverage by deleting the terrorism exclusion, for an additional premium, of course. Industry reports indicate that approximately three in five policyholders nationally elect to buy terrorism coverage; 40% do not.

Some background: at the time of the 9/11 attacks policies did not contain terrorism exclusions. Some $30 billion in claims later the insurance industry concluded the potential magnitude of such losses was too great and unpredictable to insure and attached terrorism exclusions to all policies, WC excepted. In response, Congress passed a law, originally known as the Terrorism Risk Insurance Act (TRIA), to help insurers pay claims stemming from possibly catastrophic damage from future terrorist attacks. Current law now provides what is in essence federally backed reinsurance to insurance companies writing terrorism coverage.

To trigger terrorism coverage the government must certify that an event is an act of terrorism. By law, damages must exceed $5 million before the government can do so. If damages exceed $5 million and if the government certifies the event as a terrorist act, then insurance policy provisions relating to terrorism come into play.

The recent bombing in the Chelsea neighborhood in Manhattan offers an object lesson in how this coverage may work, or how it might come back to bite you. The suspected perpetrator is apparently an ISIS inspired self-radicalized home grown terrorist, who built his bombs out of locally sourced materials. The damage from the one that went off was reportedly limited to businesses and residences in the immediate vicinity. While press reports have pretty routinely referred to this event as a terrorist act, as of this writing damages do not appear to have reached the $5 million threshold; whether they do or not is still an open question. If they do, the government still has to decide if the will certify the event as an act of terrorism.

Why is this important? Many of the local property owners affected by the bombing reportedly did not buy terrorism insurance. As long as damage remains below $5 million, *or* the government does not certify the event as terrorism, this is no problem; their property insurance will pay for their losses. If the event is ultimately certified as terrorism related, the terrorism exclusions in their policies come into play…no coverage.

If you are one of the 40% who do not buy terrorism coverage, perhaps you might want to rethink that. The threat these days may not be so much from massive, 9/11 style attacks but more from the type of widely scattered, random lone wolf attacks so much in the news lately. And a $5 million threshold from one or a series of coordinated bombings isn't a high bar.

This is worth another look. Give us a call to discuss.