

CHAPTER 8: BUSINESS OWNER POLICY



Let's Begin...

Introduction



A businessowners policy (BOP) provides a broad package of coverages for small and medium-sized apartment buildings, offices, and retail stores. Each policy includes mandatory **property and liability coverages**, and offers optional coverages. Many standard conditions and exclusions apply. A BOP is a self-contained, complete package policy.

BOP forms are modeled after the coverage components of the commercial package policy program, and have similar exclusions and coverages A, B, and C of the CGL policy. The **same wording, organization of coverages, and design follow the CPP**. Businessowners coverage parts are attached to the policy declarations and a businessowners common conditions form. ISO has made recent changes in the BOP program as of 2002.

Eligibility



The types of risks which are eligible for a BOP include:

- **apartment** buildings which do not exceed six stories in height and do not have more than 60 dwelling units (incidental mercantile, service or processing risks which do not exceed 15,000 square feet, and incidental offices are permitted);
- **office** buildings which do not exceed six stories in height and do not exceed 100,000 square feet in total area (incidental mercantile, service or processing risks which do not exceed 15,000 square feet, and apartments within the office building are permitted);

- **mercantile** risks which do not exceed 25,000 square feet and do not have annual gross sales in excess of \$3 million;
- **service** or processing risks which do not exceed 25,000 square feet and do not have annual gross sales in excess of \$3 million, provided that no more than 25 percent of their gross sales is derived from off -premises operations; and
- **building owners and business operators** who are tenants are eligible. **Residential** condominium associations and office condominium associations are eligible. Service and processing risks are newly eligible for coverage (previously, mercantile risks involving retail sales of merchandise were eligible, but risks involving service or processing were not eligible).
- **Motels**
- **Self-storage facilities**
- **Contractors**
- **Fast food** and limited-cooking restaurants up to 7,500 square feet
- **Convenience stores** with gasoline sales of up to 75% of the total revenue
- **Dry cleaners** that clean on premises

The businessowners program is designed to provide coverage for a variety of landlords and business operators who have moderate insurance exposures. For this reason, eligibility is defined to exclude certain risks which do not fit the intended exposure pattern.

Ineligible Risks for BOP

The following risks are **ineligible** for coverage under the program:



- **automobile dealers and all types of automotive repair and service operations,**
- **banks and all types of financial institutions,**
- **places of amusement, and**
- **wholesalers.**

These types of risks all have special insurance exposures, and must be insured outside of the businessowners program.



Components of a Businessowners Policy

Each BOP is a complete contract and must include the following parts:

- the Businessowners policy **declarations**,
- the Businessowners Policy **Coverage form** (ISO BP 00 03 07 02)
- **endorsements** as required.

Policy Declarations

The policy declarations will show the policy number, name of the insurance company, name of producer, name and address of the named insured, and the policy period. Spaces are provided for a description of the business, the form of business, locations of described premises, and name and address of any mortgage holder.

Limits of insurance will be shown for buildings and for business personal property. Limits of insurance for optional coverages will be shown, and optional coverages will apply, only if the appropriate boxes are checked indicating that optional coverages apply.

Property Coverage Form- Section I



Standard vs. Special

Property coverage must be written on either the standard or the special property coverage form. The two forms may not be combined. Most coverages provided by the two forms are identical. The major differences are in the "covered causes of loss"—"standard" coverage is similar to "basic" coverage provided by other commercial forms, while "special" coverage means the same "open perils" type coverage provided by the special causes of loss form. There are minor differences in the optional coverages available with each form.

However, the major property coverages are the same and businessowners property coverage can be discussed as a single topic. Both businessowners forms provide the following two major coverages:

- Coverage A—Building(s), and
- Coverage B—Business Personal Property.

A limit of insurance must be shown in the declarations for each type of property covered. For example, an insured business that is a tenant would not require the building coverage.

Coverage A – Buildings

Building coverage means the buildings and structures described in the declarations. The coverage also applies to completed additions; fixtures, machinery and equipment which are permanently installed; the insured's personal property in apartments or rooms furnished by the insured as landlord; outdoor fixtures; and the insured's personal property used for service or

maintenance of the building or its premises (such as fire extinguishers, outdoor furniture, floor coverings and appliances used for refrigerating, ventilating, cooking, dishwashing or laundering).

If not covered by other insurance, building coverage also includes additions under construction, building alterations and repairs, and materials, equipment, supplies and temporary structures on or within 100 feet of the premises used for making additions, alterations or repairs to the buildings or structures.

Coverage B – Business Personal Property

Coverage for **business personal property** has traditionally been known as “contents” coverage. But it includes more than building contents because it applies to property of the named insured located in or on the described building, or within 100 feet of the described premises while in a vehicle or out in the open.

Personal property includes property owned by the insured and used in the insured’s business; property of others in the insured’s care, custody or control; and your interest as a tenant in “improvements and betterments” made at the insured’s own expense but which cannot be legally removed. Coverage for the property of others is limited to the amount for which the insured is legally liable, plus the cost of labor, materials or services furnished by the insured.

Additional Coverages



In addition to the coverage for direct loss to insured property by covered causes of loss, a BOP provides a number of additional coverages. The **standard policy form** has **six additional coverages**, and the **special form** adds two more for a **total of eight**.

The additional coverages are:

- debris removal expenses,
- loss to property while removed from the premises to preserve it from loss,
- fire department service charges,
- business income,
- extra expense,
- pollutant cleanup and removal,
- collapse (special form only), and
- damage by water or other substances (special form only).

In this chapter, we will only discuss the some of the most important additional coverages in detail.



Business Income

If it is necessary to suspend operations because of direct physical loss caused by a covered cause of loss, the insurance company will pay for loss of business income during a period of restoration.

It will only pay for loss of business income that occurs within 12 consecutive months after the date of loss. This additional coverage is not subject to the limits of insurance shown on the policy. Furthermore, the declaration page shows which causes of loss are covered.



Extra Expense

The insurance company will also pay extra expenses incurred during a period of restoration for the purpose of avoiding or minimizing a suspension of operations. This coverage also applies only during the 12 consecutive months following a direct loss, and is not subject to the limits of insurance.



Business Income from Dependent Properties

Coverage is provided for the insured's loss due to a loss at another property on which the insured depends to provide either materials or services to run the insured's business. The coverage is for \$5,000, but higher limits are available. There is also a 72-hour waiting period before this coverage begins.

Coverage Extensions

The businessowners standard and special property forms provide the same four extensions of coverage, which are in addition to the limits of insurance shown on the policy. The extensions of coverage available are:

- Personal property at newly acquired premises,
- Personal property off premises,
- Outdoor property,
- Personal effects
- Valuable papers and records
- Accounts receivables

These will be further discussed in the next pages.

Personal Property at Newly Acquired Premises

The insured may extend the coverage for buildings and business personal property to apply at any premises newly acquired. The most the insurance company will pay under this extension is **\$250,000 at each building** and **\$100,000 for business personal property at each premises**. Coverage under this extension will end as soon as any of the following occur: the policy expires, the insured reports actual values to the insurance company, or 30 days expire after the date the premises is acquired or construction begins. An additional premium will be charged from the date of acquisition for the new values reported.

Personal Property off Premises

The insured may extend the coverage for personal property to apply to covered business personal property, other than money or securities, while off premises in the course of transit or temporarily at a premises the insured does not own, lease or operate. The most the insurance company will pay for loss or damage under this extension is \$1,000.

Outdoor Property

The insured may extend the insurance to apply to outdoor property, such as fences, radio and television antennas, signs which are not attached to buildings, trees, shrubs, plants, including debris removal expense, for losses resulting from the specific perils of (1) fire, (2) lightning, (3) explosion, (4) riot or civil commotion, or (5) aircraft. The most the insurance company will pay for loss under this extension is \$2,500, and not more than \$500 for any one tree, shrub or plant.

Personal Effects

The insured may extend coverage that applies to business personal property to also apply to personal effects owned by the insured, officers, partners, or employees. But this extension of coverage does not apply to the peril of theft, or to tools or equipment used in the business. The maximum amount the insurance company will pay under this extension is \$2,500.

Valuable Papers and Records

The insured may extend the coverage that applies to business personal property to apply to the costs of researching, replacing or restoring the lost information on valuable papers and records which have suffered loss or damage, including those which exist on electronic or magnetic media for which duplicates do not exist. The most the insurance company will pay under this extension is \$10,000 at each described premises and \$5,000 at an off-premises location.

Accounts Receivable

The insured may extend coverage that applies to business personal property to also apply to accounts receivable. The most the insurance company will pay at the described premises is \$10,000 and off premises \$5,000. The insurance applies not only to the actual amounts owed to the insured by customers, but also to interest charges on loans needed to offset amounts the insured was not able to collect while waiting for the insurance payment, collection expenses in excess of normal collection expense, and other reasonable expenses to re-establish accounts receivable records.



Property Not Covered

Both businessowners forms list the same items as "property not covered." Some items are not insurable (i.e., contraband), while others are more appropriately the subject for other types of insurance (i.e., automobiles). Covered property **does not include**:

- aircraft, automobiles, motor trucks and other vehicles subject to motor vehicle registration,
- money and securities, except as provided in Optional Coverages
- contraband, or property in the course of illegal transportation or trade,
- land (including land on which the property is located), water, growing crops or lawns,
- outdoor fences, radio or television antennas, including lead-in wires, masts or towers, signs which are not attached to buildings, trees, shrubs or plants, except as provided in the Outdoor Property Coverage Endorsement or Outdoor Signs Optional Coverage,
- watercraft (including motors, equipment and accessories) while afloat,
- accounts, bills, other evidences of debt, accounts receivable or valuable papers and records
- computers which are permanently installed (or designed to be permanently installed) in any aircraft, watercraft, truck or other vehicle subject to motor vehicle registration.



Property Exclusions

Because this coverage form is an open perils policy, coverage is shaped by policy exclusions and limitations, much like coverages A, B, and C of the Commercial General Liability form. The businessowners coverage form excludes loss or damage caused by or resulting from:

- ordinance or law,
- earth movement (other than sinkhole collapse), including earthquake, volcanic eruption, landslide and mine subsidence,

- governmental action,
- nuclear hazard,
- power failure,
- war and military action,
- water (flood, waves, mudflow, etc.),
- certain computer-related losses, including hardware, software, operating systems, microprocessors, and other electronic equipment or components,
- electrical apparatus, including artificially generated current and arcing that disturbs electrical devices, appliances, or wires,
- consequential losses, including delay, loss of use, or loss of market,
- smoke, vapor or gas from agricultural smudging or industrial operations,
- explosion of steam boilers, steam pipes, steam engines or steam turbines which are owned, leased, operated or controlled by the named insured,
- frozen plumbing, including damage by leaking water, other liquids, powder or molten material from plumbing, heating, air conditioning or other equipment (except fire protective systems), unless the insured attempted to maintain heat in the building, or shut off the water supply and drained the equipment,
- dishonesty or criminal acts by the named insured, or the insured's partners, employees, directors, trustees, authorized representatives, or anyone entrusted with property,
- voluntary parting with property if induced to do so by any fraudulent scheme, trick, device or false pretense,
- rain, snow, ice or sleet to personal property out in the open,
- collapse, except as provided in the additional coverage for collapse,
- the release, discharge, dispersal, seepage, migration or release of pollutants, unless it is caused by one of the "specified causes of loss" which are defined in the policy (fire, lightning, extended coverage perils, vandalism, leakage from fire extinguishing equipment, sinkhole collapse, volcanic action, falling objects, weight of snow or ice or sleet, or water damage),
- neglect,
- maintenance types of losses, such as wear and tear, rust, corrosion, fungus, hidden defects, smog, settling or cracking, infestation by insects or birds or small animals, mechanical breakdown, dampness or dryness, changes in or extremes of temperature, and marring or scratching,
- errors or omissions of computer programming,
- installation, testing, and repair of computer installations,
- electrical disturbance if it causes damage to electronic media and records,
- weather conditions,
- acts or decisions, or the failure to act or decide, of any person, group, organization or government body, and

- faulty, inadequate or defective planning, zoning, development, design, workmanship, construction or repair (or materials used in construction, repair or remodeling), or maintenance.
- With respect to business income and extra expense coverages, the insurance company will not pay for any increase in the business income loss or the amount of the extra expenses resulting from (1) a delay in repairing, rebuilding or replacing property or restoring operations due to interference by strikers or other persons, or (2) suspension, lapse or cancellation of any license, lease or contract, or (3) any other consequential loss.
- With respect to accounts receivables, there is no coverage for electrical or magnetic injury or reassurance of electronic records caused by programming errors or improper machine instructions or poor installation.

Property Endorsements

Some optional coverages are not activated by declarations entries, and endorsements must be attached to make the coverage effective.

An endorsement may be used to attach **accounts receivable coverage** to a BOP. The coverage is very similar to what is provided by the monoline accounts receivable coverage form. When applicable, it will pay amounts due from the insured's customers which cannot be collected because of loss or damage to records by a covered cause of loss, plus interest charges on loans required to offset uncollectible accounts due, and collection expenses in excess of normal amounts.

Another endorsement provides **valuable papers and records coverage**, which is also similar to its monoline counterpart. Valuable papers and records coverage has traditionally been used to insure against loss or damage to inscribed, printed or written documents, manuscripts and records, such as books, deeds, drawings, films and mortgages. Coverage does not apply to money or securities.

With the latest revision of the policy forms, optional coverage is now also available for **electronic media** and records, such as data processing storage media, stored data, and programming records.

An **earthquake** form may be attached to a BOP to add coverage for earthquake and volcanic eruption losses. Coverage will continue for up to 168 hours after policy expiration if an earthquake or volcanic eruption "event" begins before the policy expires.

Among the other available endorsements are a number of forms for **condominium** risks. One provides condominium association coverage, while another provides coverage for condominium commercial unit-owners coverage. These forms follow their commercial property counterparts and alter certain policy provisions to address the unique ownership situation when condominiums are insured. Commercial condominium unit owners may also purchase a unit-owners optional coverages endorsement.

Liability Coverages- Section II



The Basics

The businessowners liability coverage form provides the following two major coverages:

- **business liability**, and
- **medical payments**.



The business liability insurance covers the insured's legal liability for damages because of bodily injury or property damage, and it also covers personal injury and advertising injury. This broad definition of "business liability" is very similar to the combination of Coverages A and B in a commercial general liability form. Businessowners coverage for bodily injury and property damage is always written on an "**occurrence**" basis. Coverage includes fire legal liability coverage, for which a separate limit of insurance for any one fire or explosion will be shown in the declarations.

The insurance company provides defense costs and the standard set of supplementary payments found on liability policies (i.e., cost of bail bonds, settlement expenses, loss of earnings, prejudgment and postjudgment interest on amounts awarded).

The medical expense insurance covers medical expenses for bodily injury caused by an accident on premises the insured owns or rents, including the ways next to such premises, or an accident because of the insured's operations. Medical expenses incurred within one year of the accident date are covered, and payments are made without regard to fault or negligence.

Liability Exclusions

The businessowners liability form includes a long list of exclusions. In total these are similar to the combined exclusions applicable to bodily injury and property damage liability, personal injury, advertising injury, and medical payment coverages found on commercial general liability forms. You should be aware of the types of exclusions applicable to these coverages. Some of the exclusions are complex and very detailed. Rather than repeat the entire exclusions, the following list is presented in summary fashion.

The businessowners liability coverage form does not cover:

- bodily injury or property damage expected or intended by the insured,
- bodily injury or property damage assumed under contract or agreement other than an "insured contract,"
- liquor liability (this only applies to an insured business that manufactures, distributes, sells, serves or furnishes alcoholic beverages),
- obligations under any workers compensation, disability benefits, unemployment compensation law or similar law,
- bodily injury to any employee arising out of and in the course of employment by the insured,
- bodily injury or property damage arising out of actual, alleged or threatened discharge, release or escape of pollutants,
- bodily injury or property damage arising out of the ownership, maintenance, use or entrustment to others of any aircraft, auto or watercraft owned or operated by, or rented or loaned to, an insured businessowner,
- bodily injury or property damage arising out of the transportation of mobile equipment by an auto owned or operated by, or rented or loaned to, an insured businessowner,
- bodily injury or property damage arising out of the use of mobile equipment in, or while in practice or preparation for, any prearranged race, speed or demolition contest, or any stunting activity,
- bodily injury or property damage due to war,
- bodily injury or property damage due to rendering or failing to render professional services,
- property damage to property the insured owns, rents or occupies, or property in the insured's care, custody or control,
- property damage to the insured's product,

- property damage to the insured's work arising out of any part of it and included in the "products-completed operations hazard,"
- property damage to "impaired property" or to property that has not been physically injured arising out of a defect or deficiency in your product or work, or a delay or failure to perform a contract or agreement,
- damages claimed for any loss, cost or expense because of loss of use, withdrawal, recall, repair, removal or disposal of your product, work, or impaired property,

Personal and Advertising Injury Exclusions

- personal or advertising injury arising out of publication of material by or at the insured's direction with the knowledge that it is false, or arising out of any willful violation of a penal statute or ordinance by or with the insured's consent,
- personal or advertising injury arising out of any material first published before the beginning of the policy period, or for which the insured has assumed liability under a contract or agreement,
- advertising injury arising out of breach of contract, or failure of goods, products or services to conform with advertised performance, or the wrong description of the price of goods, products or services,
- advertising injury arising out of an offense committed by an insured businessowner who is in the business of advertising, broadcasting, publishing or telecasting,



"Are you kidding?! Twenty-five bucks is a steal!
It's only been used twice!"

Medical Expense Exclusions

- medical expenses for bodily injury to the insured, or a person hired to work for the insured, or a tenant of any insured business owner,
- medical expenses for bodily injury to a person injured on that part of the insured's premises that the person normally occupies,
- medical expenses for bodily injury to any person if the bodily injury is covered by a workers compensation or disability benefits law, or similar law,
- medical expenses for bodily injury to any person injured while taking part in athletics,

- medical expenses for bodily injury to any person if the injury is excluded under the “business liability” coverage, or is included within the “products-completed operations hazard,” or is caused by war,

Business Liability and Medical Expense Exclusion

- business liability or medical expenses resulting from the hazardous properties of nuclear materials (this exclusion is not found on a CGL form, but the broad form nuclear energy liability exclusion endorsement is always attached to CGL coverage).

Liability Endorsements

Endorsements may be used to alter the coverage or to provide additional coverages.

A **hired auto and non-owned auto liability endorsement** may be used to add coverage for either or both of these automobile exposures if the insured does not have a commercial auto policy. If the insured has a commercial auto policy, the endorsement is not available for attachment to a BOP.

A **comprehensive business liability exclusion endorsement** may be used to exclude specific operations or locations from coverage. A limitation of coverage to designated premises or project endorsement may be used to exclude coverage except for the premises or projects specifically designated in the declarations.

A variety of different endorsements may be used to **add additional insured** parties to the policy. Special endorsements exist for managers or lessors, state or political subdivisions, townhouse associations, co-owners of premises, engineers, architects and surveyors, and others.



Business Interruption



Introduction



Imagine that you are the owner of a computer store that has just suffered a fire. The building, inventory, and business records are a total loss. Initially you are relieved because you are covered for all of the losses to property. However, your business was profitable and the contractor says that it will be at least six months before the building is reconstructed. How will you replace the income stream that was destroyed by the fire? Welcome to the world of business interruption insurance.

Standard commercial property policies provide protection against **direct** losses—actual physical damage to or destruction of property. The perils that cause direct damage can also cause **consequential, or indirect, losses** which result from the disrupting effects of property damage. Various indirect coverages are available, and the need for them is considerable.

For many businesses, the monetary value of an indirect loss can easily exceed the amount of the underlying direct loss. For example, a relatively small property loss in a critical area of business operations can bring activity to a stop and lead to a loss of sales and customers. Insurance against indirect losses falls into two general categories.

Time element coverages make up the most important group of consequential loss coverages. The term “time element” means that the amount of the loss is directly linked to the time it takes to repair, rebuild, or restore the damaged property. The most popular and most frequently written time element coverages protect against loss of income when a business is interrupted and protect

against the extra expenses that may be incurred when a business attempts to continue its operations following a property loss. Business interruption insurance is designed to cover many of the costs associated with temporary loss of access to office space, customer traffic, or the ability to satisfy customer needs.

Business Interruption Coverage Form

Coverage for business interruption losses is now written on the business income coverage form. This program was updated by ISO in 2000. The form includes a number of coverages and coverage options, which provide companies with a flexible package of time element coverages.

Coverage applies to the actual loss of business income sustained due to suspension of "operations," and to extra expenses incurred to avoid or minimize a suspension of "operations," during a "period of restoration." The suspension of operations must be caused by a direct physical loss of, or damage to, property at your premises (including personal property in the open or in a vehicle within 100 feet of the premises) caused by or resulting from a covered cause of loss.

The covered causes of loss and exclusions that apply to the underlying direct losses that produce the indirect losses are those shown on the applicable causes of loss form shown in the declarations.

This insurance applies to losses and expenses related to an interruption of normal business operations. Operations mean your business activities at the premises described in the declarations (and the "tenantability" of the premises if rental value coverage is being written). Only losses incurred during a period of restoration are covered.

The period of restoration begins on the date that the direct physical loss to property occurs, and it ends on the date that the damaged property "should be" repaired, rebuilt or replaced "with reasonable speed" and similar quality. You are not required to repair or replace the damaged property with speed, but the insurance company may limit the period of coverage if you do not use "reasonable speed" to restore the property when it could be restored.

Expiration of the policy will not cut short the period of restoration. The period of restoration does not include any increased period required due to any law regulating construction, use or repair, or requiring demolition of property, nor which requires you to test for, monitor, clean up, remove, contain, detoxify or neutralize the effect of pollutants.

Rental value means total anticipated rental income from tenant occupancy of the described premises, all other charges which are the legal obligation of tenants but which would otherwise be your obligations, and the fair rental value of any portion of the premises occupied by you. The most the insurance company will pay for loss in any one occurrence is the applicable limit of insurance shown in the declarations.



Business Income and Extra Expense Form

The business income and extra expense form (ISO CP00 30 10 00) includes **five types of coverages**. Four of these are identified as "additional coverages," but since none of the additional coverages increase the limit of insurance, they can all be considered together.

The five coverages are:

1. business income (three options are available regarding rental value);
2. extra expense;
3. civil authority (two weeks maximum);
4. alterations and new buildings; and
5. extended business income (maximum 30 days).



Business Income Coverage

Business income coverage pays the actual losses of business income, which is defined as net income (net profit or loss before income taxes) plus continuing operating expenses. Gross revenue is not covered because many expenses (i.e., electricity, heat) may be discontinued while the business is shut down. Continuing expenses (taxes, rent, debt payments) are covered because the net profit or loss is what is left after continuing expenses are paid. If the revenue to cover continuing expenses is not replaced, it reduces the net income.

For example, a business having monthly revenue of \$500,000 and total expenses of \$200,000 has a monthly net income of \$300,000. But the insurable business income amount is greater if there are continuing expenses. If \$100,000 of the expense continues during a shutdown, you would need to recover \$400,000 to be indemnified—\$400,000 minus \$100,000 for continuing expenses, equals \$300,000 of net income. Note that “net income” is defined as net “profit” or “loss.”

If a business is operating at a loss, it would suffer the same loss after being indemnified by the insurance (if net income was -\$100,000 and continuing expenses were \$300,000, it would recover only \$200,000).

The purpose of the business income coverage is to restore you to the position that would have existed had there been no disruption of operations.



Extra Expense Coverage

Extra expense coverage insures against the necessary extra expenses incurred during a period of restoration that would not have been incurred had there been no underlying direct property loss. Expenses incurred to avoid or minimize the suspension of operations are covered.

If business operations can be continued, expenses at the described premises or at a replacement premises or temporary location are covered. Expenses to repair or replace any property, or for research to replace or restore lost information on damaged records, will be covered to the extent that it reduces the amount of loss otherwise payable under this coverage part.

Civil Authority

If business is interrupted because a civil authority prohibits access to the described premises as a result of direct physical loss or property damage at a location other than the described premises due to a covered cause of loss, the lost income will be covered for a period of up to two weeks.

New Buildings

Actual losses of business income due to direct physical damage to new buildings or structures, or alterations or additions to existing buildings or structures, or machinery, equipment, supplies or building materials located on or within 100 feet of the described premises are covered. The direct loss must result from a covered cause of loss.

Losses resulting from damage to machinery, equipment, supplies and building materials are covered only if such items are being used in construction, alterations or additions, or are incidental to the occupancy of new buildings. If a direct loss delays the start of your operations, the period of restoration under this coverage will begin on the date operations would have begun if the direct loss had not occurred. After a period of restoration, there is coverage for an extended business income loss for a period that begins on the date property is actually repaired, rebuilt or replaced and operations are resumed.

Extended Period

This extended period ends on the earlier of (1) the date 30 consecutive days after it begins, or (2) the date you restore the business to the condition that would have existed if no direct loss or damage had occurred. This coverage reflects a recognition of the fact that a business may lose customers and markets during a shutdown, and that revenues may not reach previous levels immediately when operations are resumed.

Types of Business Income Coverage

A company has three options for the type of business income coverage that applies. One or more options may be selected if coverage applies at different locations. The options in effect are indicated by entries in the declarations. Business income coverage may be written to consist of:

- Option 1—Business income coverage including rental value
- Option 2—Business income coverage other than rental value
- Option 3—Rental value coverage exclusively

When option 1 is selected, the term "business income" will include "rental value." When option 2 is selected, the term "business income" will mean only "business income." When option 3 is selected, the term "business income" will mean only "rental value." Your choices will be determined by whether or not you have a rental value exposure, and whether it is the only type of business income exposure.

Many companies have a **rental value exposure**. If you own a building occupied by tenants, and if a direct loss results in a loss of rental income, the lost rental income could be covered as a business income loss. If you are an owner/occupant of a building, and if a direct loss makes the building uninhabitable and makes it necessary to rent alternative facilities, the rent could be covered as an extra expense. You would also recover rental income as a business income loss. If you are a tenant, and if a direct loss makes the premises uninhabitable but the lease requires the tenant to continue paying rent, the rent at a temporary replacement facility could be covered as an extra expense.



Loss Conditions

Appraisal

An **appraisal clause** will sometimes be referred to as an “arbitration clause.” Technically, there is some difference between appraisal and arbitration—but the two concepts are similar. The insurance company will make **loss payment within 30 days** after receiving a sworn statement of loss, if all coverage terms have been complied with and the insurance company and policyholder agree on the amount of loss or an appraisal award has been made. Either party may call for an **appraisal** if they cannot agree.

Duties in the Event of Loss

Your duties in the event of loss are similar to those that apply to coverage for buildings and personal property: prompt notice is required, the police must be notified if a law has been broken, you must cooperate with the insurance company, property must be protected from further loss, and a signed sworn statement of loss must be submitted within 60 days after the insurance company requests it.

However, there is an additional requirement that applies to business income and extra expense coverage—you must resume all or part of the business operations “as quickly as possible.” This is required because the size of the loss is directly related to the time the business is not fully operating.

Limitation- Electronic Media and Records

There is a loss condition that imposes a limitation on business income (but not extra expense) losses resulting from the direct physical loss of or damage to **electronic media** and records. Electronic media and records are defined as data and data systems: electronic data processing, recording or storage media, such as films, tapes, discs, drums or cells, including the data stored on such media, and programming records used for electronic data processing or electronically controlled equipment.

The insurance company will not pay for loss of business income caused by loss or damage to media and records after the longer of:

- 60 consecutive days after the date of direct physical loss or damage, or
- the period, beginning on the date of direct loss, necessary to repair, rebuild or replace with reasonable speed and similar quality property other than media or records which suffered loss or damage in the same occurrence.

The form includes two examples to clarify the intent of the limitation. In the case of damage to a computer, which is replaced three months later, coverage applies for the three months—but not beyond the date the computer is replaced, even if it takes another month to restore the lost data. In the case of loss of data processing programming records, which are replaced two-and-one-half months later, coverage applies only for 60 consecutive days—there is never coverage beyond 60 days unless something other than media and records (such as your building) was damaged and it takes longer to repair or replace that thing.

Value of Loss

The amount of a business income loss will be determined based on the net income of the business before the direct physical loss occurred and the likely net income of the business if no loss had occurred. Operating expenses, including payroll expenses, necessary to resume operations at the same quality of service existing before the direct loss occurred will be taken into account by the insurance company.

The insurance company will also consider other relevant information, including your financial records, accounting procedures, bills, invoices, vouchers, deeds, liens, and contracts. The amount of incurred extra expenses will be determined based on all necessary expenses that reduce the business income loss that would otherwise be sustained, and all expenses during the period of restoration that exceed the normal operating expenses that would have been incurred had no direct loss occurred. The insurance company will deduct from such expenses the **salvage value** of any property bought for temporary use during the period of restoration, and any extra expense paid by other insurance that is not written on the same basis as this coverage.

Coinsurance Condition

Business income coverage is usually written with a coinsurance requirement. If a coinsurance percentage is shown in the declarations, the coinsurance condition applies in addition to the common policy conditions and commercial property conditions.

The formula and examples of adequate and inadequate insurance are as follows:

$$\frac{\text{Insurance carried} \times \text{loss}}{\text{Insurance required}} = \text{Covered amount}^*$$

*(subject to limit of insurance)

Example 1—Adequate Insurance

Coinsurance percentage 50 %

Annual net income plus all expenses
\$300,000

Limit of insurance \$150,000
 Insurance required \$150,000
 Amount of loss \$100,000
 $\$150,000 \text{ carried} = 1 \times \$100,000 = \$100,000$
 \$150,000 required
 (Insurer pays \$100,000)

Example 2—Inadequate Insurance
 Coinsurance percentage 50 %

Annual net income plus all expenses
 \$960,000
 Limit of insurance \$400,000
 Insurance required \$480,000
 Amount of loss \$300,000
 $\$400,000 \text{ carried} = 6 \times \$300,000 = \$250,000$
 \$480,000 required
 (Insurer pays \$250,000)

One of the significant contrasts to property coverages is that a 50% coinsurance percentage is not unreasonable for business income coverage. In effect it provides full coverage for six months, and most businesses can restore full operations within that time. In the first example above, net income and expenses are about \$25,000 a month. The \$100,000 loss reflects a four-month shutdown and it is fully recovered. If the shutdown had continued for six months, the full amount of a \$150,000 loss would also be fully recovered. But if the shutdown had continued for seven months, the loss would have been \$175,000 and only \$150,000 (the policy limit) would be recovered.

Miscellaneous Consequential Loss Coverages

The following coverages serve special needs. They are not time element coverages, because the size of the losses discussed is not related to the time it takes to repair or replace property. Not all companies offer these coverages, and when they are written the insurance company is likely to use its own policy forms.

In some cases, **the loss of valuable papers** can be considered a direct loss. But the loss of accounts receivable may produce direct and indirect losses. Property coverages may cover the cost of blank media and the cost of labor to transcribe the records, if the information can be recovered from another source. If the information cannot be recovered, and receivables cannot be collected because the debtors are unknown, traditional property insurance will not cover the lost revenue. Special coverage is available to protect against such losses.

Items which are an integral part of **pairs or larger matched sets** have an unusual value relationship. The loss of any one part may reduce the value of the remaining part(s). Such risks are particularly present in the jewelry and clothing businesses.

Suppose a large clothing store sells men's suits, and the pants are valued at \$35 while the jackets are valued at \$65. If a fire destroys 1,000 pairs of pants, a direct damage policy would pay \$35,000 for the direct loss of the pants. But this leaves the store with 1,000 jackets that could not be sold for \$65 without matching pants. Instead, they might be marked down to \$40 and sold to an outlet that sells sports coats. Due to the loss of the pants, the store has suffered a \$25,000 consequential loss on the jackets. Special consequential loss forms can be used to protect against such losses.

Manufacturers may purchase insurance to cover the risk of lost **profit on finished goods**. When finished stock is damaged or destroyed, the direct loss will be settled on the basis of ACV or the manufacturer's replacement costs for the materials. The difference between the recovery amount and the price at which the finished goods could have been sold is therefore at risk. Coverage to protect the profits of finished goods may be sold under a variety of names—it may be called "profits" insurance, "market value of finished goods," etc.