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BUSINESS INCOME COVERAGE: A CRITICAL AND OFTEN OVERLOOKED AREA OF PROPERTY INSURANCE

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We are always amazed that while lenders and business advisors insist that business owners carry adequate all-risk (open peril) fire insurance, they often overlook business income and extra expense coverage. Commercial landlords often include lease terms that require tenants to carry fire insurance (especially on a triple net lease), but they typically do not also require insurance for business income or a loss of rental income.

The main purpose of owning commercial property is to receive the revenue it generates, and if that revenue is not insured, the effects can be catastrophic. Thus, it is important for business owners and those with an interest in their properties to make sure their investment is fully protected, not only with insurance for the brick and mortar property itself, but also for the stream of revenue it generates. This article highlights a few key features of business income coverage, with a focus on how the coverages work and key provisions to evaluate in putting together a well thought out property insurance program.

The Basic Coverage Grant

The specific scope and terms of business income coverage vary from one policy form to the next, but most are built around a common coverage grant. The standard Insurance Services Office ("ISO") policy form promises to pay as follows:

> We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business In-come Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss.

Basically, this coverage is designed to do for the policyholder what its business would have done had no loss occurred.

Particular attention should be paid, however, to the term "suspension" when included in the coverage grant. For many years, insurance companies have tried to argue – with some success – that "suspension" means "total cessation" and thus business income coverage is triggered only where the policyholder's operations come to a complete standstill, and that coverage is forfeited should the policyholder be able to continue operations at least in a limited way after the loss.

Of course, most modern businesses are fully capable of conducting some business despite even catastrophic destruction of their premises. Indeed, most polices – as well as common law – impose upon the policyholder an obligation to mitigate its losses by conducting business using undamaged property at alternate locations to the extent possible. Accordingly, ISO has adopted an updated definition of "suspension" in its standard form policy that expressly makes clear that business income coverage includes lost profits during slowdowns. Nevertheless, policyholders should beware of insurance company arguments that invoke a "total cessation" standard and push back on them whenever asserted. When purchasing coverage, policyholders should insist on a definition of "suspension" that makes clear that partial suspensions of operations are covered.idely understood that such an interpretation was inconsistent with the custom and practice of the construction industry.

Period of Restoration

A major component of a business income claim is the period of restoration, also known as the period of indemnity. The definition is often in the last page of the business income form and often states that coverage begins 72 hours after a loss – which serves as a sort of hidden deductible for business income claims. The first three days after a loss often create a major financial burden. Savvy policyholders can "buy down" that gap in coverage, and should consider doing so depending on their operations and the cost of insurance.

The period of restoration generally ends on the date when the damaged property should be repaired or replaced with reasonable speed and with materials of similar quality. If the policyholder chooses not to resume operations it can still make a business income claim, but it will be limited to the theoretical period of restoration.

If the policyholder relocates to a new permanent location, the period of restoration should continue until all of the equipment has been restored, inventory replenished, etc. Policy language opens the door, however, to highly subjective measurement of the period of restoration. Insurance company adjusters will often say the policyholder should have been operational sooner than it actually was. In such circumstances, the policyholder simply must demonstrate that it proceeded with reasonable speed in making repairs after the loss. The time it takes to achieve an insurance settlement (as long as the policyholder did not create the delay) should be considered in determining the period of restoration.

Some policies place a time limit on the period of restoration, e.g., 12 or 24 months. Many policies, however, do not. Under such unlimited policies, we were able to make recovery for several years of business income losses suffered in the wake of 9/11. In polices that do limit the period of restoration, the policyholder may have the option of buying additional time. We sometimes see the period extended 180 days, or longer.

Extended Business Income Coverage

For many policyholders, business income losses do not immediately cease once the doors reopen. Indeed, for most businesses, there is a period of time needed to ramp up operations before business levels return to normal. The continuing losses during this period are covered via extended business income coverage. Under the ISO form, coverage is extended for the actual loss of business income you incur during the period that:

(a) Begins on the date property is actually repaired, rebuilt or replaced and "operations" are resumed; and

(b) Ends on the earlier of:

(i) The date you could restore your "operations," with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage had occurred; or

(ii) 60 consecutive days after the date determined in (1)(a) above.

For many policyholders, this coverage can be very valuable, but its ultimate value often is truncated by the 60day or other cap on the length of the coverage.

Extra Expense

Policies often include extra expense coverage as well as expense to reduce loss coverage – valuable provisions that cover expenses the policyholder incurs to keep their business running and mitigate business income losses. If the policyholder spends more money to mitigate than they would have lost if it actually were shut down, that expense over and above the savings would only be covered under the extra expense coverage. In addition, it is important to remember that extra expense coverage begins immediately after the loss without a waiting period or other time-based "deductible."

Conclusion

There is a reason why insurance is called "the least read best seller" – few policyholders read their policies until after a loss occurs. Policyholders should anticipate their insurance needs and review their business income coverage prior to a loss. In doing so, it is advisable for policyholders to consult with their insurance consultants, brokers, accountants, coverage counsel, or licensed public adjusters, and fully understands their needs for coverage and the way their insurance will respond if needed.

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