

RIMS 31ST ANNUAL RIMS CONFERENCE

APRIL 25-30, 1993

ORLANDO, FL

Speaker's Name(s): Jeffrey J. Smith

Session Number: IM Session Name: Business interrupted  
101 coverage / claims

Date: Wednesday Time: 9-11 A.M.  
April 28

**ARKWRIGHT**

Arkwright Mutual  
Insurance Company  
225 Wyman Street  
PO Box 9198  
Waltham, MA 02254-9198  
617 890 9300

April 7, 1993

Mr. Donald Kyle  
Assistant Director - Public Affairs  
Risk and Insurance Management Society, Inc.  
205 East 42nd Street  
New York, NY 10017

Subject: 1993 RIMS Annual Conference  
Conference Speaker

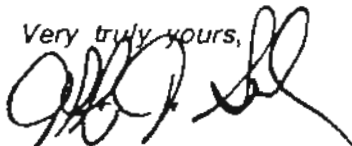
Business Interruption Coverage / Claims - Managing the Monster  
Session no.: IN 101

Dear Mr. Kyle;

This is in response to yours of March 31, 1993.

As requested, I am attaching a copy of the handout materials that I will be utilizing in conjunction with my participation in the captioned session.

Very truly yours,



Jeffrey J. Smrek  
Assistant Vice President/  
Staff Supervisor - Claims

enclosure: presentation handout material

## ***BUSINESS INTERRUPTION***

### ***Coverage and Claims; The Basics***

***For Distribution @ RIMS 31st Annual Conference  
April 25-30, 1993  
Orlando, FL***

***By: Jeffrey J. Smrek  
Assistant Vice President / Staff Supervisor - Claims  
ARKWRIGHT MUTUAL INSURANCE COMPANY  
(617) 890-9300***

A PRIMER ON BUSINESS INTERRUPTION COVERAGE AND CLAIMS

- *Purpose of Business Interruption Insurance  
(pages 1 through 4)*
  
- *Business Interruption Exposure Identification  
(pages 5 through 14)*
  
- *Business Interruption Exposure Valuation  
(pages 15 through 20B)*
  
- *Common Coverage Exclusions and Typical Pitfalls  
(pages 21 through 22)*
  
- *Preparing for a Claim Before the Loss Occurs  
(pages 23 through 26)*

## HISTORICAL BACKGROUND

The earliest reference to "Business Interruption" coverage is found in England in the early 1820's. Coverage was offered to protect rental income, as well as, the income of trades people whose business was impaired by fire. However, little of such coverage was written at that time. Subsequently, attempts were made to recover business interruption losses under ordinary fire contracts. While courts held that business losses were insurable, it was also held that such would not be covered under the normal fire policy. Rather, special policies would be needed.

In the 1860's, "chomage" insurance was introduced in France. The word means "cessation of work" and the coverage was originally devised to protect the worker's income from loss by fire at his place of work. The indemnity was first geared percentage-wise to the actual property fire damage.

In the United States, an entirely different concept was adopted; that of insuring the profits of a mill by issuing a policy for a certain amount, this face amount being reduced pro rata each day during the policy term. Hence, if a mill were destroyed half-way through the policy term, the Insured would recover half the face value of the policy. If the fire occurred two days before the expiration of the policy, his recovery would be only the remaining two days' proration. In 1880, the Valued form came into being, with a specific daily indemnity for complete impairment and pro rata recovery for partial impairment.

Profits insurance was introduced in England in 1899 and has remained a popular type of coverage in that country. This type of policy is geared to sales. The impairment period is not the time needed to restore the property, but rather, the time required to bring the business back to normal.

In order to overcome certain objections to the Valued forms, the Actual Loss Sustained form was developed in the late 1920's and early 1930's. Such forms, in the earlier days, required periodic reports of values and the policy offered recovery on the basis of actual loss sustained. First covering only profits and fixed charges, the form was later altered to the two item style by adding coverage for payroll.

Competition in providing Business Interruption coverage in the 1950's resulted in development of the Gross Earnings form. This coverage typically combined the business interruption / ordinary payroll into a one item form.

To this day, the Gross Profits (sales based) coverages are favored in Europe and, to a lesser degree, in Canada. The use of and demand for this coverage in the U. S. is rather limited.

## PURPOSE OF BUSINESS INTERRUPTION INSURANCE

### Who Needs Business Interruption Insurance?

Any business or entity that produces revenues or earns income through the use of physical assets should consider Business Interruption coverage. Damage to or destruction of said assets could render them non-productive, thus disrupting the revenue flow. Such disruption of the revenue flow could involve direct loss of income and / or increased cost of continuing to operate.

### What is the Intent of Business Interruption Insurance?

The subject of Business Interruption insurance is income or earnings derived from the use of property. An adequately placed Business Interruption coverage should, in the event of loss, do financially for the Insured just what their business would have done for them had the loss not occurred. There are, of course, limitations as will be further discussed, herein.

### What is the difference between Business Interruption and Time Element coverages?

Business Interruption is one type of the broader classification of Time Element coverages. In addition to Business Interruption, Time Element coverages also include Extra Expense, Contingent Business Interruption / Time Element, Service Interruption (Time Element), Leasehold Interest, Rental Insurance, Commissions & Profits, Tuition Fees and other types of similar coverages. The term "Time Element" is reflective of the basic concept that the degree of loss sustained (either direct income loss or additional operating expenses) is contingent upon the length of time that it takes to restore the property and resume normal operations.

This discussion will concentrate on Business Interruption. However, where appropriate, other forms of Time Element coverages may be mentioned to compliment the discussion. Hopefully, this will help bring into focus the limitations of the Business Interruption coverage as well as point out the coverages available to minimize the potential of uninsured loss.

### B. I.?

For sake of brevity, you will often hear of Business Interruption referred to as B.I. As this may be appropriate to those in the insurance business that deals solely in the field of property insurance, it can, however, become confusing in the broader spectrum of the entire insurance field. Some possibilities; bodily injury, Business Insurance, etc. Therefore, to avoid confusion, we will minimize the use of such jargon in our discussions or in further references to Business Interruption, herein.

## Basic Concepts of Business Interruption

### *Insurable Interest:*

An entity has an insurable interest under this type of coverage when damage to or destruction of the property described in the Policy would result in a loss of income (or increase in the cost of doing business) derived from using that property. Unlike Property Damage insurable interest, it is not a requirement that the property involved either be owned by the Insured or that they be contractually obligated to insure it.

The income insured under this type of coverage is operating income or earnings. Business Interruption insurance does not contemplate coverage of capital gains or losses, income from investments, and the like.

### *Types of Insurable Income:*

The types of income most commonly insured under Business Interruption coverage are those from manufacturing or service businesses or operations, mercantile concerns and rental properties.

The insurable interest from a manufacturing operation is in the increase in value of material through the manufacturing facility's operations. Raw material or stock is purchased and subjected to processes and operations to increase its value. The difference between the original value and this increased value is the spread of insurable interest under Business Interruption coverage.

Other businesses derive income from the rendering of service. Doctors, lawyers, laundries, and banks are just a few of the professions or businesses of this type, using their property and knowledge to earn a fee or charge. This charge or fee is an insurable income.

A mercantile business produces income through the purchase and resale of merchandise. The difference between the cost and selling price of the goods represents the income insurable interest.

The owner or operator of a building may use this property to produce income in the form of rents. Office buildings, warehouses, and apartments, to name a few. The owner of furnishings and equipment may lease them to produce income.

In all of the above cases, income is derived through the use of property. The basic consideration for an understanding of this coverage is what and how income is produced and what effects impairment of the property has upon income and expenses.

Business Interruption is often referred to as the financial loss sustained due to an interruption of business operation.

### Basic Concepts of Business Interruption (cont.)

#### *Actual Loss Sustained:*

Perhaps the no. 1 concept in Business Interruption insurance is the principle of ACTUAL LOSS SUSTAINED. While the parties to the insurance contract can discuss how long it will take to make repairs, the effect on operations, etc., all of this becomes meaningless if there is no actual loss sustained.

Actual Loss Sustained goes to the heart of the indemnity principle of insurance. An Insured is entitled to be compensated or indemnified only to the extent of the loss they sustain. An Insured is not entitled to make a financial gain or be placed in a better operating position than before the loss.

- Insurance should make the Insured "whole"; that is, do what the business would have done had there been no loss:
  - 1.) Insured should not profit from a loss
  - 2.) Consideration of deductibles, indirect and remote loss issues, aside
- Actual Loss Sustained can result from any of the following:
  - 1.) decrease in sales
  - 2.) increase in expenses
  - 3.) decrease in efficiency
- Insured's obligation to minimize loss through:
  - 1.) use of other owned facilities
  - 2.) use of non-owned facilities or services
  - 3.) working extra time or overtime
  - 4.) use of inventory

\*Note\* The basic Business Interruption form will cover additional expenses incurred, to the extent they reduce the loss that would have otherwise been payable; that is, spend a dollar or less to save a dollar.

#### *Indemnity Period / Period of Interruption / Period of Restoration:*

TIME is the next major consideration. It is sometimes said that "this is how long the meter is running" under the insurance policy.

For most types of Business Interruption policies, the Indemnity Period runs from the time of physical damage to the time when with the use of due diligence and dispatch, the damaged property could be repaired or replaced and made ready for operations under the same or equivalent physical and operating conditions that existed prior to the damage.



Basic Concepts of Business Interruption (cont.)

*Indemnity Period / Period of Interruption: (cont.)*

- *Indemnity Period / Period of Interruption includes time for:*
  - 1.) *repair and / or replacement of the damaged buildings and equipment*
  - 2.) *restoring stock in process to the pre-loss stage of processing*
  - 3.) *replacing damaged / destroyed mercantile stock*
  - 4.) *replacing damaged raw materials and supplies*

*The Indemnity Period:*

- *Ends, under production based forms, when the property is repaired to pre-loss operating condition, not when sales are back to normal*
- *Does not include any extra time due to the Insured's delay; making changes or improvements to damaged property, not starting repairs promptly, etc.*
- *Does not end when the policy expires*
- *Does not include "idle periods"; that time when business operations would not have continued for any reason other than the covered loss*
- *Does not include additional time, if any, required for re-staffing and retraining employees*
- *Does not include the time required for the reproduction of lost or damaged finished products*

*Physical Loss or Damage:*

*This is the final basic concept to be discussed. It is a requirement of Business Interruption insurance coverage that the sustained loss must result directly from **PHYSICAL LOSS OR DAMAGE** (at the locations insured) of the type insured by the specific policy involved.*

*Physical loss or damages is actual, substantive changes to property that reduce its worth or usefulness. It can also involve the physical dispossession of property without the consent of the owner or user.*

*Physical damage is required because there are many causes for business losses. To be insurable, losses must be definite as to cause, time and place.*

*Civil Authority, Loss of Access, Service Interruption and Contingent Time Element coverage extensions can be exceptions to the requirement that the physical damage occur at the insured locations.*

## BUSINESS INTERRUPTION EXPOSURE IDENTIFICATION

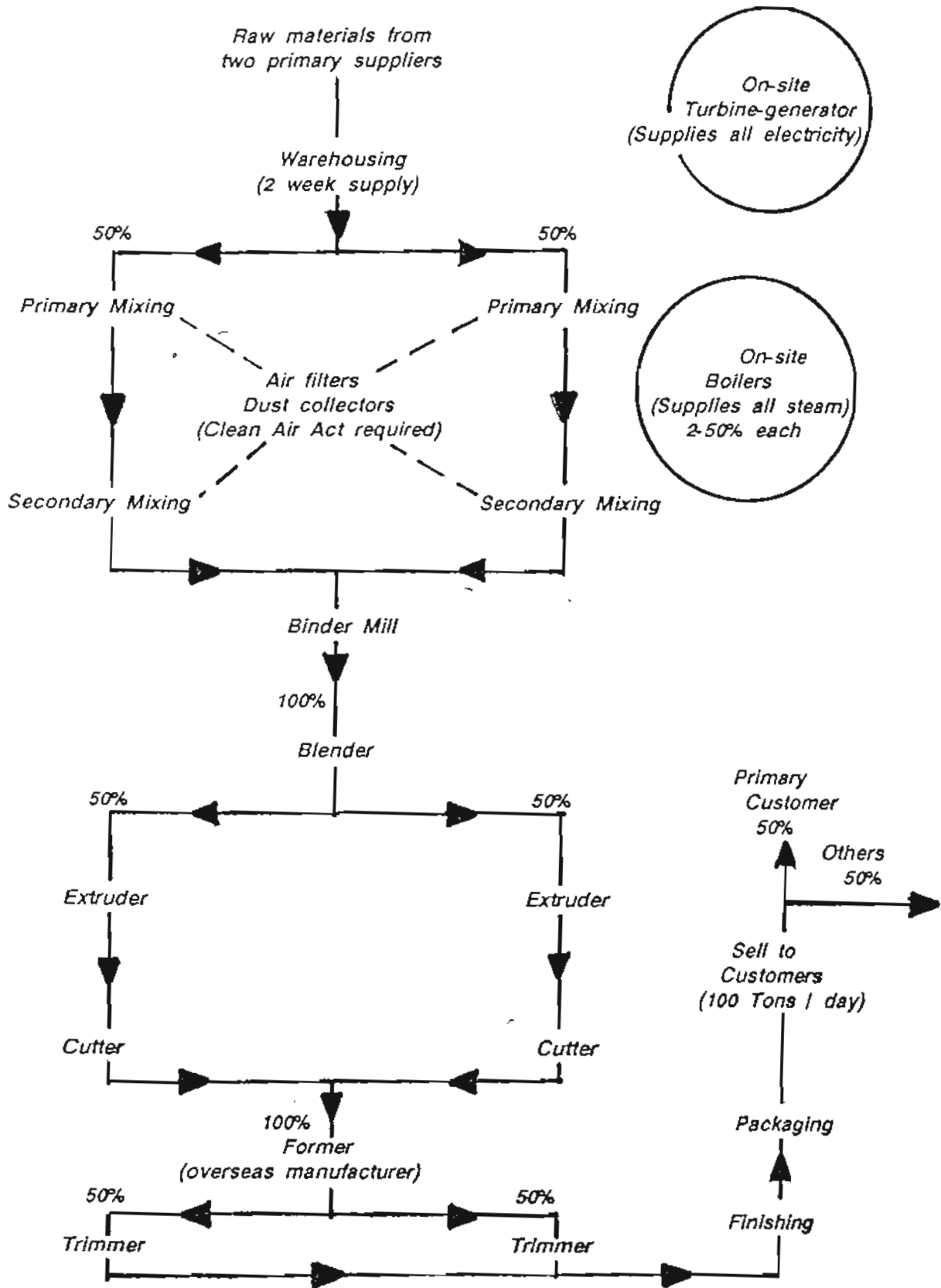
Property Damage coverage will respond to the repair or replacement of the damaged or destroyed property. However, during the course of repairs, the involved property will be unavailable for production or operational purposes. The result could be a loss of income, the incurring of additional expenses, or a combination of both. As previously discussed, the degree of loss that may be sustained will be a function of the time it takes to make the necessary repairs and restore pre-loss operations. It is this Time Element loss exposure that needs to be ascertained.

In order to evaluate the exposure, it is necessary to have a thorough understanding of the business or operations involved. This would include a wide range of processes from raw material procurement through to distribution of the finished product. Or, it could be incoming data and information through to the distribution of specialized services. Within these business operations will likely be a myriad of complex product and / or information flows, the interruption of which could be financially catastrophic. (See the Production Flow Chart on page 6)

To evaluate the exposure and its severity, some things to keep in mind:

- Identify suppliers and sources of raw material, data and information. Some supplies may be rare or subject to seasonal availability. Incoming information may be subject to the availability of phone services and lines.
- Pinpoint key operating equipment which might be a bottleneck to continued operations. In this age of technological advancement, computer dependent processes are prevalent. Equipment may be manufactured in distant countries and be difficult to replace.
- Operations for which there are no alternate facilities take on an added degree of urgency.
- Due to the cyclical nature of many businesses, a loss at a certain time of the year can impact operations differently.
- Interdependency between operations and facilities may exist; one plant being dependent on one or more other plants for goods or services in order to continue operation.
- Most business operations are in some way dependent upon incoming utility services. The degree of dependence may vary from complete to situational; back-up or supplemental service.

PRODUCTION FLOW CHART



## Business Interruption Forms

Since there are a number of different Business Interruption and Time Element coverages available, a review of these coverage forms will provide a basic understanding as to differences between them will assist in the approach to evaluating exposures.

There are two broad classifications of Business Interruption forms.

These are:

- Valued - often referred to as per diem, these forms pay an amount specified for each day of complete interruption and pro rata for partial interruptions

*Advantages* - ease of loss measurement, particularly in cases of total shutdown. Also, the loss can be adjusted immediately as the downtime period elapses.

*Disadvantages* - is not flexible in addressing the ups and downs of the business cycles that most operations are subject to. Additionally, it does not provide the coverage needed when operations are subject to partial outages. To some degree, the ease of loss measurement is also reduced in cases of partial disruptions to operations involving multiple products and / or lines of goods. And, the concept is contrary to the indemnity principle upon which insurance is based and could create a moral hazard.

- Actual Loss Sustained - the Insurer's liability is limited to the amount actually lost by the Insured

*Advantages* - provides for loss measurements that reflect business volume changes and realistically approaches the problem of loss of earnings resulting from partial disruptions.

*Disadvantages* - can require considerable analysis of a business to determine the coverage needed and they can involve complex loss measurements, thus delaying loss settlement and indemnity.

### Actual Loss Sustained Forms

Actual Loss Sustained forms are available in two categories:

- Production based forms

- net profit (before taxes) and fixed charges form;  
ordinary payroll is optional. [two item]

- Often referred to as an "additive" Business Interruption form, recognizing the computation of loss based upon the sum of the net profit and fixed / continuing charges.

- gross earnings form including ordinary payroll. [one item]

- Often referred to as a "deductive" Business Interruption form, recognizing the computation of loss based upon Gross Earnings (net sales value less raw stock, materials, supplies and all other non-continuing charges) less charges that do not necessarily continue

- gross earnings form with ordinary payroll optional (see above) [two item]

- \*NOTE\* The payable loss under the above noted production based forms are the same, provided ordinary payroll is included.

- Sales type forms

- gross profits

Comparison of production vs. sales based forms:

- Production based forms - the Indemnity Period is computed from the time of the physical damage of the type insured to the time the property is repaired to pre-loss operating conditions, without any pre-established time limitation. There is no coverage for consequential sales losses (market loss) and other indirect or remote losses.
- Sales type forms - the Indemnity Period is computed from the time of physical damage of the type insured against and continuing during the period that the results of the business are directly affected by such damage; however, not to exceed a pre-established time limitation (typically 12 months). Coverage for most consequential sales / market losses are covered to the extent they fall within the pre-established time limitation.

Other Time Element forms:

- Extra Expense - can be purchased on a stand-alone basis or in combination with Business Interruption. This coverage addresses the reasonable and necessary extra expenses incurred to either temporarily continue as nearly normal as practicable the conduct of the Insured's business and / or extra costs of temporarily using alternative property. It does not cover loss of income, which is the reason it is often purchased to supplement a Business Interruption form. As previously noted, the Business Interruption form has a type of built-in extra expense feature. The extra expense coverage afforded, therein, is limited to the amount of Business Interruption loss mitigated. In case of loss, the Extra Expense coverage would usually apply excess of the coverage available under the Business Interruption form.
- Rental Insurance - this type of insurance can be used to cover either:
  1. the landlord's reduction in rental income resulting from a covered loss, or
  2. the tenant's continuing lease obligations even though a covered loss renders the premises unusable

\*NOTE\* Business Interruption coverage, if provided, can be used to address the above items either in the context of insured income or a continuing / fixed charge.

- Service Interruption / Off Premises Power (Time Element) - this insurance provides coverage for Business Interruption (and possibly other Time Element) losses which result from damage to or destruction of the equipment or facilities of public utility incoming services. Typical exposures would be electricity, water, steam, telephone services, etc.
- Contingent Business Interruption / Time Element - this insurance provides coverage for Business Interruption (and possibly other Time Element) losses resulting from damage to facilities which either
  - sell / supply goods and or product to the Insured
  - or
  - buy from / are a Customer of the Insured

The coverage will respond to the resulting Time Element loss "contingent" upon the unavailability of these customer and / or supplier facilities.

A "contingent" exposure can also exist in shopping malls and similar locations where damage to "key" or "anchor" facilities can cause a contingent loss at other establishments within the facility or area.

Other Time Element Forms; (cont.)

- Commissions or selling agents - this coverage is for the income (commissions) of selling agents which may be lost as a result of the unavailability of goods to sell. The unavailability would have to, of course, result from a covered loss.
- Leasehold Interest - provides protection against loss of favorable lease considerations following damage to or destruction of leased premises.
- Tuition Fees - this coverage is for universities and other like institutions which rely heavily on tuitions as a source of revenue. The coverage is not intended to replace Business Interruption coverage, but rather, compliment it.
- Agreed Value / Amount Provision - this is an amendment to the basic Business Interruption form which would waive any applicable coinsurance provisions.
- Extended Period of Indemnity - this is typically provided as an endorsement to the basic production based Business Interruption forms. It is intended to provide a specified period of time (beyond the indemnity period of the basic Business Interruption form) for which consequential sales losses / loss of market would be recoverable
- Expediting Expenses - Coverage for extra costs of temporary repair of the physical damages to the property and / or the extra costs of expediting the permanent repairs or replacement. This may also appear as a coverage extension under many Property Damage forms.

Checklist of Items to Consider: (cont.)

- Determine if any operations are reliant upon single or limited customer bases for the sale of their goods or services.

*If yes, consider Contingent Business Interruption / Time Element coverage.*

- Determine if delays in the completion of facilities under construction could result in loss of revenues.

*If yes, consider "builders risk" Business Interruption / Time Element coverage.*

- Determine if any facilities that present a Business Interruption / Time Element exposure are subject to laws or ordinances which regulate the type and degree of reconstruction required if the facility is destroyed or substantially damaged.

*If yes, determine if the applicable Time Element coverages address increase in loss due to delays in reconstruction necessitated by compliance with laws or ordinances.*

- Determine if any facilities have skilled, hourly, production or services personnel which, in case of loss, you would not want to lay-off, for fear of losing them and / or being unable to readily locate capable replacements.

*If yes, consider providing ordinary payroll coverage (if optional) to cover the potential of continuing payments to these skilled personnel (during the outage) to ensure the retention of their services after reconstruction is completed.*

- Determine if any operations are highly dependent upon Electronic Data Processing Equipment and related data, programs and software.

*If yes, consider Business Interruption / Time Element coverage for this exposure.*

- Determine if any operations are subject to nuisance (high frequency / short duration) outages.

*If yes, make this a consideration in the choosing of a deductible; do you want these type of losses covered, or, are you primarily looking for catastrophic coverage?*



Suggestions to Address Exposures  
Noted in the Prior Diagram

- *Business Interruption coverage for the Assembly Plant in the amount of \$15 million*
- *Business Interruption coverage for the Parts Plant in the amount of \$10 million*
- *Business Interruption coverage on the Public Warehouse*
- *Along with Business Interruption coverage on the the above-noted facilities, include a blanketing provision in the policy to address the interdependency between them and afford combined limits of at least \$25 million*
- *Service Interruption coverage for the Electric Utility (and any other utilities that might be critical to operations)*
- *Contingent Business Interruption for the Parts Supplier, if either a sole or critical source provider*
- *Contingent Business Interruption for the Customer, if either a sole or critical destination buyer*

BUSINESS INTERRUPTION EXPOSURE VALUATION

BREAKDOWN OF SALES DOLLAR

*NET PROFIT*

+

*FIXED COSTS*

+

*VARIABLE COSTS*

=

*100% SALES VALUE*

*Costs, as referred to here, are actual costs vs. standard costs.*

## TYPICAL VARIABLE COSTS

- *Raw Materials*
- *Packaging Materials*
- *Ordinary Payroll*
- *Fuel and Power for Production and Operations*
- *Discounts to Customers*
- *Returns of Unacceptable Product*

*Variable costs, also referred to as variable expenses or discontinuing charges, involve those expenses which would discontinue in case of shutdown.*

*Costs, as referred to here, are actual costs vs. standard costs.*

## *SEMI-VARIABLE COSTS*

- *Heating of Buildings*
- *Lighting Expenses*
- *Maintenance Expenses*

*Semi-variable expenses are those costs and charges that do not completely fit into either the Fixed Costs or Variable Costs categories. In case of shutdown, a portion of these costs may continue and a portion may cease.*

*Costs, as referred to here, are actual costs vs. standard costs.*

### Valuation of Exposure

The preceding discussion of the Sales Dollar will serve as a basis for evaluating the VALUE of the loss exposure.

Under a two-item "income" form, the basis of exposure (and loss) computation is:

Net Profit plus Fixed Charges plus Ordinary Payroll (if applicable)

equals the amount of Business Interruption exposure

\*NOTE\* (if the business is operating at a loss, fixed charges would be covered and should be reported only to the extent they would be earned)

Under a "Gross Earnings" form, the basis of exposure (and loss) computation is:

Gross Earnings (1) minus discontinuing Charges

equals the amount of Business Interruption exposure

(1) Gross Earnings is defined as:

- for manufacturing operations, the net sales value of production less the cost of raw stock, materials and supplies utilized in such production
- for mercantile or non-manufacturing operations, the total net sales less the cost of merchandise sold, materials and supplies consumed in the operations or services rendered

Using either of the noted ACTUAL LOSS SUSTAINED, production based forms, the end result should be the same, provided ordinary payroll is included under the two-item form. The only difference is one is done on an additive accounting basis and the other is done on a deductive accounting basis.

If a VALUED FORM is desired, the basis for determining the amount of per diem coverage required would still be the same.

Under a GROSS PROFITS (sales based) form, Net Profit and Fixed Charges are the basis of valuation.

Regardless of the type of coverage applicable, the completion of a Business Interruption worksheet is a first step in the process. Worksheets will typically request "actual" values for the prior year and "estimated" values for the upcoming year. The rationale, here, lies in a basic Business Interruption concept of using historical data as one of the key criteria for evaluating future expected performance. Business Interruption forms typically contain language something to the effect, "in determining the indemnity payable, due consideration shall be given to the experience of the business before the loss as well as the probable experience thereafter. This concept is often referred to as "trending".

### Business Interruption Worksheet

The Worksheet is not typically a part of the insurance policy. The values developed by using the worksheet are designed to help establish the amount of insurance necessary to comply with the policy reporting provisions and/or coinsurance requirements.

Two sample Business Interruption worksheets follow. The first is on an additive or build-up basis, to be used with a two-item income form. The other is on a deductive basis, to be used with a gross earnings form.

In completing a Business Interruption worksheet, there are some basic steps that should be considered. Unless otherwise noted, the worksheets typically encompass a twelve month period of time.

- secure the most recent operating statement (Profit & Loss Statement) for the entity involved
- rearrange the Profit & Loss statement to correspond with the policy form loss measurement definitions
- based on a combination of past experience and presently known conditions, make a projection of the anticipated business activity and experience for the upcoming twelve month period.

\*NOTE\* there are two methods of demonstrating the financial operations of a business. The first is the accrual method under which income and expenses are shown in the period in which the income is actually earned and the expenses are incurred. The second is the cash method which shows only cash receipts and disbursements. This method eliminates certain items earned or incurred in the period and, on the other hand, includes certain items which concern the previous accounting period.

The accrual method is the generally accepted basis for Business Interruption insurance purposes.

### Amount of Insurance

The completion of the Business Interruption worksheet is only one component of the formula in determining the amount of insurance to be procured to protect against a potentially catastrophic loss. The other component is time. How long would or could the operations be shutdown by an insured loss?

Some key considerations to be made:

- how long will it take to repair, rebuild or possibly relocate?
- how long will it take to replace key machinery and equipment?
- how long will it take to replenish raw materials and merchandise?

The two components of value and time are necessary to determine the limits of insurance that may be necessary.

Policy No. \_\_\_\_\_  
Account No. \_\_\_\_\_  
Date \_\_\_\_\_

Insured \_\_\_\_\_  
Location(s) \_\_\_\_\_

Manufacturing or Non-Manufacturing  
Locations - Build-up Basis

	Actual Value for ____ Months ending	Estimated Value for ____ Months ending
--	--	---

Item 1

A. NET PROFITS, without deductions for Income taxes _____	\$ _____	\$ _____
B. FIXED CHARGES AND OTHER EXPENSES:		
1. Interest _____	_____	_____
2. Taxes _____	_____	_____
3. Rentals _____	_____	_____
4. Advertising & Publicity _____	_____	_____
5. Total salaries and wages of officers, executives and employees whose services would be retained during suspension of business _____	_____	_____
6. Total salaries and wages payable under contracts guaranteeing annual compensation (not including any salaries and wages contained in Item No. 5) _____	_____	_____
7. Compensation Insurance Premiums, Social Security, Unemployment Insurance and Other Charges allocated to salaries and wages in 5 & 6 above _____	_____	_____
8. Sundry operating expenses (including delivery service) _____	_____	_____
9. Donations, membership fees, etc. _____	_____	_____
10. Heat, Light and Power (Plant not operating) _____	_____	_____
11. Insurance Premiums and Payments to Pension Plan _____	_____	_____
12. Postage, telephone and telegraph _____	_____	_____
13. Professional Services _____	_____	_____
14. Repairs and depreciation of buildings, fixtures and equipment _____	_____	_____
15. Royalties (Minimum contract payments) _____	_____	_____
16. Traveling Expenses _____	_____	_____
17. _____	_____	_____
18. _____	_____	_____
C. TOTAL GROSS BUSINESS INTERRUPTION VALUE** _____	\$ _____	\$ _____

Item 2

D. ORDINARY PAYROLL*		
1. Ordinary Payroll _____	_____	_____
2. Compensation Insurance Premiums, Social Security, Unemployment Insurance and Other Charges allocated to Ordinary Payroll _____	_____	_____
TOTAL ORDINARY PAYROLL _____	\$ _____	\$ _____
E. TOTAL NUMBER OF WORKING DAYS (for the Periods Specified above)		
_____	_____	_____

You are hereby authorized to effect additional insurance based on the Values indicated in Column 2.

\*If Ordinary Payroll Coverage is not desired leave Item 2 blank.

\*\*BUSINESS INTERRUPTION AND PAYROLL ITEMS AT OTHER OWNED AND CONTROLLED LOCATIONS (SUCH AS BRANCH STORES, OTHER SALES OUTLETS AND OTHER PLANTS NOT SPECIFICALLY MENTIONED IN THE POLICY) AT WHICH BUSINESS INTERRUPTION AND PAYROLL LOSS WOULD RESULT FROM INTERRUPTION OF OPERATIONS AT THE LOCATIONS NAMED IN THIS POLICY:  
\_\_\_\_\_ are included \_\_\_\_\_ are not included

(Signature of Official and Title) \_\_\_\_\_

Policy No. \_\_\_\_\_  
Account No. \_\_\_\_\_  
Date \_\_\_\_\_

Insured \_\_\_\_\_  
Location(s) \_\_\_\_\_

Manufacturing Locations - Deduction Basis	Actual Value for ____ Months ending	Estimated Value for ____ Months ending
<b>Item 1</b>		
A. NET SALE VALUE OF PRODUCTION at plant (calculated at gross sales price less discounts and allowances for bad debts, returns, sales taxes and prepaid freight, if included in sales price) _____	\$ _____	\$ _____
<b>B. DEDUCT</b>		
1. Cost of Materials and Supplies _____	_____	_____
2. Ordinary Payroll - Do not deduct wages of anyone under guaranteed annual compensation contracts or who would be retained during suspension of business operations _____	_____	_____
3. Compensation Insurance Premiums, Social Security, Unemployment Insurance and Other Charges allocated to Ordinary Payroll _____	_____	_____
4. Royalties in excess of contract minimum _____	_____	_____
5. Light, heat and power (in excess of requirements for non-operating condition) _____	_____	_____
Total Deductions _____	\$ _____	\$ _____
C. NET SALE VALUE LESS TOTAL DEDUCTIONS _____	\$ _____	\$ _____
D. ADD - All Other Earnings derived from operation of the business _____	_____	_____
E. GROSS BUSINESS INTERRUPTION VALUE** _____	\$ _____	\$ _____
<b>Item 2</b>		
<b>F. ORDINARY PAYROLL*</b>		
1. Ordinary Payroll (B-2 above) _____	_____	_____
2. Compensation Insurance Premiums, Social Security, Unemployment Insurance and Other Charges allocated to Ordinary Payroll (B-3 above) _____	_____	_____
TOTAL ORDINARY PAYROLL _____	\$ _____	\$ _____
G. TOTAL NUMBER OF WORKING DAYS (for the Periods Specified above) _____	_____	_____

You are hereby authorized to effect additional insurance based on the Values indicated in Column 2.

\*If Ordinary Payroll Coverage is not desired leave Item 2 blank.

\*\*BUSINESS INTERRUPTION AND PAYROLL ITEMS AT OTHER OWNED AND CONTROLLED LOCATIONS (SUCH AS BRANCH STORES, OTHER SALES OUTLETS AND OTHER PLANTS NOT SPECIFICALLY MENTIONED IN THE POLICY) AT WHICH BUSINESS INTERRUPTION AND PAYROLL LOSS WOULD RESULT FROM INTERRUPTION OF OPERATIONS AT THE LOCATIONS NAMED IN THIS POLICY:

\_\_\_\_\_ are included      \_\_\_\_\_ are not included

(Signature of Official and Title) \_\_\_\_\_



## COMMON COVERAGE EXCLUSIONS AND TYPICAL PITFALLS

### Some Common Policy Exclusions:

*The policy may not cover:*

- *Additional downtime to make changes or alterations to what existed prior to loss*
- *Additional downtime required to make alterations or changes required by laws or ordinances*
- *Additional downtime due to strikes*
- *Additional downtime due to the need to restaff and / or retrain employees*
- *Additional downtime because repairs and / or replacement were not undertaken using due diligence and dispatch*
- *Idle periods (period of time in which goods would not have been produced or business operations or services would not have been maintained for any reason other than the physical damage of the type insured by the policy)*
- *Increase of loss due to suspension, cancellation or lapse of a lease, contract, license or order*
- *Loss resulting from fines or damages for breach of contract or for late or non-completion of orders*
- *Penalties*
- *Consequential sales losses (loss of market). An exception would be the Gross Profits form which, with time limits, provides this coverage*
- *loss resulting from loss or damage to finished products nor for the time required to reproduce them*
- *costs associated with assembling and documenting the claim*
- *other indirect and remote losses*

### Pitfalls

- *Coinsurance penalties, resulting from the under-reporting of Business Interruption values*
- *Inadequate limits*
- *Interdependency of facilities not "blanketed"*
- *Confusion between accounting and insurance terms*
- *Inappropriate application of accounting principles to insurance matters; cash vs. accrual methods, standard vs. actual costs*
- *Coverage under Business Interruption forms that do not "fit" the needs of the business involved*
- *Loss of market potential associated with businesses in highly competitive businesses or industries not recognized*
- *Discounting warehouses as not having Business Interruption potential*
- *No identification of specific needs, such as research and development facilities*
- *Valuation of finished goods in combination with exclusions of the Business Interruption form*
- *Deductibles not appropriate for the exposure*
- *Need for ordinary payroll coverage not recognized*

### Some Possible Solutions to Pitfalls

- *Blanketing Insurance - if operations consist of more than one location, with interdependency between the locations, "blanket" coverage encompassing the combined limits of all locations should be considered as a means to prevent inadequate limits.*
- *Agreed value / amount clauses - waives the coinsurance provisions of the policy.*
- *Extended period of Indemnity - provides for certain consequential sales losses (loss of market) for a specified period of additional time beyond the indemnity period of the basic Business Interruption form.*

## PREPARING FOR A CLAIM BEFORE THE LOSS OCCURS

### Contingency Planning:

At most insured properties, losses are few and far between. Hence, when there is a loss, it's something out of the ordinary for the business. Questions are bound to arise on how it should be handled.

Each loss will create its own set of unique facts and circumstances. Each loss poses its own specific problems that must be worked out by the Insured and the adjuster. No amount of planning will eliminate all problems, but a well thought out contingency and emergency action plan will keep the problems to a minimum.

In setting out to develop a contingency plan, you should ask the question, "If we had a disastrous loss tomorrow at any given facility, what would we do to maintain (or expedite the resumption of) operations?" To identify potential problem areas, an analysis of a Production / Operations Flow Chart (page 6) can be useful.

At the facility level, supplies should be available and personnel trained to use them. Waterproof covers or tarpaulins for covering equipment, wiping rags, sawdust, oil, rust inhibitors and similar items. Their mere existence is not sufficient. Personnel must be trained to know where they are kept and how to use them.

Plans for emergency electrical power, wiring diagrams of control panels, portable lighting equipment and portable pumps for basement areas may be desirable. Don't overlook a supply of extra sprinkler heads and fire extinguisher recharge kits.

Everyone will, or should, have contacts with contractors for general repairs that might be needed to buildings, utilities and equipment. A listing of reputable and reliable general contractors, electricians, riggers, boiler repair shops, heating and ventilation specialists, plumbers and the like should be readily available and kept up to date.

Safeguard building plans. Restoration of facilities can be hastened by observing some advance planning. If buildings and equipment are old, management has doubtless planned certain reconstruction, rehabilitation, relocation or other improvements. After a disaster, such plans can be implemented. The secret is to keep future planning up to date and on paper. If the facilities are relatively new, all relative building plans should be kept in a safe place remote from the facility they are for. In this manner, they can be readily accessible, if needed.

Machinery and equipment layouts should be kept current and safely stored. Shop drawings will be a critical item. Spare parts and stand-by equipment, kept at a separate location, might be a wise consideration for key operations. This is especially true of dated or foreign-made machinery.

Develop plans for the contingent use of other facilities either owned by you or available to you, where operations may either be relocated to or temporarily maintained. It may even be possible to work out prearranged reciprocal agreements with competitors.

### Contingency Planning:(cont.)

Include in any contingency plans for the potential of job-shopping of certain operations. In this manner, if a loss only effects certain operations, full or substantial production may still be possible through such an effort.

As Electronic Data Processing plays an ever more important role in all aspects of business and industry, prearranged contingency plans with equipment manufacturers and suppliers are very important. Also, plans for protecting this equipment from further damage in cases of exposure loss are a wise idea.

As is the case with any plan, any and all key personnel must be involved in its development and its ultimate implementation.

Sales and marketing personnel are critical with respect to knowledge of customer needs and demands.

- Sales executives
- Marketing managers

Engineering personnel can provide invaluable insight as to the infrastructure.

Accounting and financial personnel will be key to disbursement of funds for repairs and the like. They will also be needed to set up the necessary cost accumulation, formulation and documentation of the Business Interruption / Time Element claim. Involve those people initially associated with evaluating the exposure / completing worksheets / etc.

- Financial officer
- Treasurer
- Controller
- Chief accountant

Risk management personnel, with their in-depth knowledge of the coverages and their application.

Operations personnel provide invaluable input.

- Plant manager
- General manager
- Maintenance supervisor

Production personnel.

- Production supervisor
- Foremen

Also, the involvement of outside expertise, such as the insurance company, contractors, and the like.

### The adjuster:

In case of loss, the insurance company should be promptly notified so that they can be made an integral part of the recovery plans. The adjuster, with their wealth of experience, can be of considerable assistance. Make the adjuster a member of the recovery effort team. Involve them in the recovery decision making. Make use of that wealth of experience while also ensuring that the plan of action undertaken has the insurance company's agreement. This will avoid unilateral decision making that could lead to controversies as to the extent of coverage applicable, etc.

### Responsibilities of the Insured:

*In case of loss, the Insured must recognize that there are certain responsibilities that they will be expected to fulfill. Among these are:*

- *Prompt notification (of loss) to the insurance company*
- *Minimizing the loss through*
  - temporary repairs*
  - expediting repairs*
  - using alternate facilities*
  - working additional time and / or overtime*
- *Documenting the loss (putting the claim together); relative to Business Interruption claims, this might include analysis of many of the following:*
  - production records*
  - budgets and schedules*
  - production estimates*
  - estimate vs. actual comparisons*
  - production capacity reports*
  - operating statements*
  - income statements*
  - other financial statements*
  - general ledger*
  - subsidiary ledgers*
  - product line reports*
  - income tax returns*
  - trend analyses*
  - sales forecasts*
  - forecast vs. actual analysis*
- *Submission of the claim / proof of loss*
- *Participation in settlement negotiations*

### General Pre-loss Advice:

- *Have a sound knowledge of the policy provisions by reviewing the policy with the appropriate insurance company personnel*
- *Know your underwriter:*
  - who to contact in case of loss*
  - who has decision making authority relative to loss matters*
  - what are their claim filing requirements*
  - what are their advance payment guidelines*
- *The wording of the policy should be reviewed with the "financial types" within the business to highlight the meaning of various terms and the differences from like accounting terms. Include stressing that any loss settlement will be premised upon "actual" costs (vs. standard costs) and the demonstration of financial operations be on an accrual basis (vs. cash method)*

General Pre-Loss Advice (cont.)

- *Consider the development of contingency plans, including the concept of Loss Handling or Emergency Response Teams. The Loss Handling Teams would have pre-designated primary and alternative members from all major business disciplines within the organization, trained to act in a coordinated response to a loss situation*