



## Current Articles 2006 – May

### Business Interruption – Don't forget it!

The largest cause of an Errors or Omissions claim is insufficient coverage or the complete lack of coverage for a loss situation. Of all the different types of coverage to which this would apply, Business Interruption is the class that exceeds all other classes. Errors and Omission claims come from the lack of Business Interruption coverage or a coinsurance penalty.

The two major forms of Business Interruption are the Gross Earnings Form and the Profits Form. Both of these forms are subject to a Co-insurance clause. The Gross Earnings form can be written with either a 50% Coinsurance clause or an 80% Coinsurance provision. Although the Profits form does not include a Co-insurance clause by name, the Turnover clause has the same effect as a 100% Co-insurance Clause. There is no question that the Profits form is the superior product but care must be exercised in arriving at the correct amount of insurance. When it is subject to a 100% clause there is no margin for error!

The Gross Earnings form does not include a specific period of indemnity but will respond until all the operations have resumed and are back to normal. The Profits form usually will limit coverage to a 12-month period of indemnity. This may be extended to 18 months, 24 months, 30 months, etc. When offering the Profits form your risk analysis must consider whether the business can be fully restored within the 12-month period. If the risk is a manufacturer and uses custom built manufacturing equipment that could take longer than 12 months to build and install, if the period of indemnity has not been extended and a loss occurs, there could be a problem for the broker.

Ordinary Payroll is included in the Gross Earnings Form. However if the Gross Earnings is written with an 80% Coinsurance, it is possible to exclude the ordinary payroll. This may be applicable to a risk that can easily replace the defined ordinary payroll employees. You should consider the labour laws as to whether a release of an employee for whatever cause including damages to the business which results in the business being shut down, may require a considerable severance allowance. Ordinary Payroll is NOT a Standing Charge for the Profits Form. The policy specifically states that Standing Charges do NOT include bad debts, depreciation or ordinary payroll. This can be added for 90 or 180 days by endorsement. Some insurers may allow ordinary payroll as a Standing Charge but unless the policy is properly amended, you could have a problem.

The "safety valve" to underinsurance or a coinsurance penalty is the Premium Adjustment Endorsement. Some insurers build this into their wording but indicate that the clause must be triggered on the Dec page. Others add it by endorsement. When you attempt to select a limit for Business Interruption you are relying on how good your client's crystal ball is in projecting future (as much as 24 months into the future) profits. The Premium Adjustment Clause allows you to over insure the needs and then after the policy has expired and when we have "hard numbers" we can determine the actual limits required. If the limit on the policy is higher than determined by completing the adjustment application after the policy expires the client will receive a refund of premium of up to 50% of what was originally paid.

Many years ago, an accountant by the name of Hal Pringle who was considered the guru of Business Interruption made the comment in his presentations and his book "Business Interruption Insurance – some of the mysteries removed" stated that every Business Interruption Policy should include a Premium Adjustment Endorsement. Hal has been retired for a number of years but his message should be loud and clear!

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