

# UPDATE

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*from Swerling Milton Winnick*



**SMW**

## CP and BUSINESSOWNER FORMS: SOME MAJOR, YET SUBTLE, CHANGES IN COVERAGE

For over 100 years, Swerling Milton Winnick has worked on behalf of owners of property and businesses to secure responsive and satisfactory settlements of their insurance claims. The firm's mission has been and continues to be the delivery of consistently superior client service while developing the respect of insurance company personnel and obtaining fair settlements which enable insurance consumers to resume their normal business operations or lifestyle.

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*Welcome to the first edition of UPDATE. As specialists in time element loss adjustments, SMW Adjusters, Inc. has become aware of some major, yet subtle, changes in this coverage in both the Commercial Property (CP's) and BusinessOwner Forms (BP's). In the course of adjusting these losses, we have observed some basic policy deficiencies, so I would like to share our observations to assist you in recommending the proper time element coverage to your clients.*

*If you have any questions or comments once you've read the article or know anyone who would be interested in receiving a copy, please feel free to contact me.*

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## GROSS EARNINGS/BUSINESS INCOME AND EXTRA EXPENSE COVERAGE:

There are two basic types of Business Income and Extra Expense Coverage available under the CP 00 30 and CP 00 32, one with Extra Expense and the other without Extra Expense, aka Expenses to Reduce Loss. These are the former Gross Earnings forms, now called Business Income, which include coverage with a coinsurance clause or the Monthly Period of Indemnity. Both options have their advantages and disadvantages.

I prefer the classic Gross Earnings coverage, now called Business Income, because it takes into account seasonality and has no time limit other than the Period of Restoration definition. On occasion, I hear that there is a one-year limit – which is **not** true. While the Monthly Period of Indemnity Coverage can be limiting, the advantage is that there is no Coinsurance Clause.

## INSUFFICIENT LIMITS ON BUSINESS INCOME COVERAGE:

With the Business Income coverage, we continue to find limits that are insufficient to comply with the coinsurance clause. This may happen because agents fail to provide clients with the

Business Income Worksheet Form and/or the clients never fill it out. The latter can result from insureds who are just negligent or, perhaps, cannot understand it.

I prefer to think of the insurable value as plain old “Gross Profit”, which is generally defined as Sales less Cost of Goods Sold. In the case of a manufacturer, **do not** subtract the category of Manufacturing Expenses.

## **N**EVER SUBTRACT ANY PAYROLL UNLESS YOU ARE EXCLUDING IT:

Never subtract payroll unless you are excluding it, because most losses are partial in nature and businesses tend to retain their employees during the Period of Restoration. If your clients are considering excluding Ordinary Payroll, I suggest that you show them the definition of Key Payroll. Key Payroll (which is very restrictive and could be interpreted to exclude key employees who are not departmental heads) and Office Staff are categories that usually continue regardless of the severity of a loss. This is especially true for all labor in today’s labor market.

## **D**ETERMINING INSURABLE VALUE - SALES LESS VARIABLE EXPENSES:

If you are talking to the insured’s accountant or financial executive, another simple definition of insurable value is sales less variable expenses for the twelve month period of the policy. This would include but not be limited to such expenses as bad debts, credit & collection, freight-out, outside commissions. It is the variable expenses that you subtract to determine the insurable value, not the potential abated expenses in the case of a loss.

## **V**ALUATION OF LOSS

The way to eliminate the potential coinsurance problem is to include an Agreed Amount Endorsement. When computing the loss, the

policy defines the criteria for coverage by the formula of Net Income plus Continuing Normal Operating Expenses, including payroll. We “old-timers” continue to use the “Gross Earnings less Abated Expenses” as the measure because it is simpler and quicker to calculate. There are some insurers who fail to recognize that you will arrive at exactly the same amount with either definition, which ISO has confirmed.

## **W**HEN TO OPT FOR BUSINESS INCOME AND/OR RENTAL VALUE:

The policy contains three options, (i) Business Income including “Rental Value”, (ii) Business Income Other than “Rental Value”, and (iii) “Rental Value”.

- If you are insuring the building and business under the same policy, opt for **(i) Business Income including “Rental Value”**. Be sure to include the name of both the realty owner and business owner, usually with an “ATIMA”.
- If the insured’s business is just a tenant, then opt for **(ii) Business Income Other than “Rental Value”**. **If you are insuring the building under the same policy, never choose this option.**
- If you are just insuring the building, then opt for **(iii) “Rental Value”**.

There is a serious interpretation issue with “Rental Value”. Whereas the policy states “If option (iii) above is selected, the term Business Income will mean ‘Rental Value’ only”, we interpret this to mean that abated expenses do not apply, which insurers generally resist. Since Rental Value is enclosed with quotation marks, you must read the definition that is included in the form.

Please note that the definition includes:

- a. Total anticipated rental income from tenant occupancy of the premises described in the Declarations as furnished and equipped by you, and
- b. Amount of all charges which are the legal obligation of the tenant(s) and which would otherwise be your obligations, and
- c. Fair rental value of any portion of the described premises which is occupied by you.

So make certain that your insured includes all of these components when calculating the insurable value for the year of the policy.

## **D**OWNSIDES TO THE MONTHLY PERIOD OF INDEMNITY:

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Because there is no coinsurance applicable, the Monthly Period of Indemnity appears attractive, however there are a number of downsides.

- When you select a basic Monthly Period, calculated by multiplying the Limit by the fraction shown, typically 1/3 and 1/4 in the Declarations, it is important that the resulting **dollar limit be high enough to cover the peak months**, i.e., November and December for retail businesses.
- Since the fraction ultimately can determine the amount of time that the insurance will be available, it is important to **estimate the worst case**. In other words, if the building in which this business is located suffers a severe or total loss, how long will it take to restore **this property i.e., the insured location**? A good example of this is the recent catastrophic fire in Chestnut Hill, MA.
- It is difficult to imagine that most premises can be rebuilt within 3 or 4 months, which is inferred with a 1/3 and 1/4 fraction (by the denominator). Between the time to adjust, make funds available, and totally rebuild, **six months is probably an absolute minimum** in most, if not all, cases.

## **P**ERIOD OF RESTORATION CHANGES:

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**In January 1996**, ISO made some major changes that included a 2nd option to the Period of Restoration and the language “Ends on the earlier of”. Below is the old definition (1) and the added definition (2):

- (1) The date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality; or
- (2) The date when business is resumed at a new permanent location.

If a business were able to move to a new, **permanent** location in less time than it would take to rebuild/repair the old location, the insurer now benefits by this shortened period. For those businesses that are unable immediately to return to both their normal revenue levels and operating expenses, they will be at a disadvantage. We have been in discussion with ISO for over a year, asking them to review this change.

If I were involved in a situation like this, I would first attempt to obtain the insurer's assent that the Period of Restoration be (1), the time to repair, rebuild or replace the damaged location. Otherwise it might be financially impractical for an insured to relocate. By agreeing to this, the insurer really has nothing to lose and everything to gain.

It has also been our experience that regardless of how much effort insureds expend resuming partial operations, (which is their obligation), the insurer always seems to find a way to argue that it should have taken less time. Insurers tend to ignore the adjustment and payment components, which should be considered in calculating the Period of Restoration. There is no legal precedent of which we are aware that supports the insurers' position. On the other hand, there are legal cases that include these components when insurers are the cause of such delays.

## **C**HANGE IN THE DEFINITION OF “PROPERTY” OR “PREMISES”:

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The other major change deals with the definition of “property” or “premises”. It now reads as follows:

If you are a tenant, your premises is the portion of the building which you rent, lease or occupy, including:

1. All routes within the building to gain access to the described premises; and
2. Your personal property in the open (or in a vehicle) within 100 feet.

Your clients might be tenants in a building and suffer no damage to the portion of the building that they occupy and access routes might not be affected; yet the building is shut down. This would be true in the case of damage to the main

utilities. Some insurers argue that Dependent Property Coverage remedies this problem. Does this mean that you must purchase Dependent Property Coverage against every tenant in the building? For example, if your customer has a restaurant on the ground floor and there is damage on the upper floor(s) that causes tenants to vacate, apparently no coverage. After talking to counsel, we believe that a Court might reject the intent of both of these changes.

## **R**ECOMMEND ADDITIONAL EXTENDED BUSINESS INCOME:

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Most extended Business Income includes 30 extra days of coverage after reopening subject to the policy language. Most businesses and rental properties take longer to return to normal after reopening, so you might consider recommending buying extra Extended Business Income.

## **B**LANKET COVERAGE FOR BUSINESSES WITH MORE THAN ONE LOCATION:

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For retail businesses with one or more locations and a separate distribution center or manufacturers with multiple locations, it is very important to **blanket the coverage** in order for the policy to respond to a loss of profit that is incurred at both locations.

## **O**RDINANCE OR LAW – INCREASED PERIOD OF RESTORATION CP 15 31:

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Last but not least. It is very common today to see Ordinance or Law, Demolition, and Increased Cost of Construction Coverages. Are you aware that the basic Business Income Coverage excludes the extra period of time associated with this phase of the repairs? Recently, we have been involved in a number of cases where this was a prime factor. There is an endorsement Ordinance or Law - Increased Period of Restoration CP 15 31 that deletes this exclusion. It must go hand-in-hand with Ordinance or Law Coverage.



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