Insurance Buyers' News

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Business Income Coverage: Survival Plan for Small Business

In survey of business owners by Trusted Choice a few years ago, more than half of the owners said they didn't have business income coverage. But more than half of businesses without business income insurance will close within three years of a serious loss. Business income insurance would "have protected those small businesses from that fate," according to Trusted Choice spokesperson Madelyn Flanagan.

What Is Business Income Insurance?

Business income coverage (also known as business interruption coverage) protects your most valuable asset—your business income. It provides the cash you need to survive a shutdown or slowdown due to a covered cause of loss at an insured property. It can cover your payroll, continued operating expenses (such as rent), and lost net profits from the time your business shuts down until physical restoration of the property. Continuing to receive a near-normal income after a disaster helps you retain valued staff and maintain your financial stability during rebuilding.

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This Just In

You've probably seen the viral video of a passenger being forcibly removed from a United Airlines flight. United Airlines president Oscar Munoz' initial half-hearted apology made a bad situation worse. It took two full days after the altercation for Munoz to offer a full apology to the passenger.

In any kind of crisis involving a firm's reputation, it's essential to get in front of the issue and admit wrongdoing or negligence and take responsibility. This is not what United Airlines did, according to Ed Zitron, chief executive of PR firm EZPR in an interview with the Los Angeles Times.

"Here was a bunch of people who got together and failed to show any compassion and hu-

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The Limitations of Basic Business Income Coverage

Note the key phrases "insured property" and "covered cause of loss" above. To understand why these are important, let's say that heavy snowfall caused your plant's roof to collapse and forced a four-week closure for repairs. If your BOP covers this property, your business income coverage would apply.

Now let's imagine snow damage closed a key supplier's location. Even if you lost business as a result, your coverage would not apply, because the damage did not take place on your "insured premises." Likewise, a shop in a mall would lose income if the mall had to close due to roof damage. If the shop itself (the insured location) didn't have any damage, its business income coverage would not apply.

To cover these and similar situations, businesses can buy "contingent locations" coverage. This essential coverage protects businesses that depend on other businesses for their survival. These could be suppliers, key clients or even a neighboring business that draws customers to the area, such as an anchor store in a mall. If a covered loss closes or slows business at one of these "dependent properties," contingent business interruption coverage will cover your lost income. You can buy this coverage on a named property basis, which would cover you for losses at specific locations, or on a blanket basis.

The "Time Element" in Time Element Coverage

Some insurance experts call business income coverage a "time element coverage" because it takes time for a loss to develop. Policies usually have a 72-hour waiting period, meaning they will not pay for income lost in the first 72 hours after direct property damage. You can buy additional coverage to reduce or eliminate the waiting period. Your "period of restoration," or time the policy allows for rebuilding, begins after the waiting period. The policy covers your income lost during this time, usually 30 days.

After a major disaster, particularly one that affects a large geographic area, shortages of materials and skilled workers could make repairs drag on much longer than 30 days. To protect themselves from this risk exposure, businesses can buy coverage to extend the period of restoration for up to 360 days.

Most business income policy forms have a coinsurance provision. This requires the insured to buy insurance equaling net income and all operating expenses for a 12-month period, multiplied by the coinsurance percentage the insured selects. Coinsurance percentages range from 50 to 125 percent; the higher coinsurance percentage you select, the higher the premium credit your insurer will give.

Coinsurance percentages also affect how much your policy will pay at claim time. If you fail to maintain enough coverage, the insurer will pro-rate any claim payments, using the ratio of the insurance limit to the loss. Let's say your business has an insured property damage loss and no income at all during the period of recovery, losing a total of $250,000 in income over three months. If you have $750,000 in coverage, your policy would pay a maximum of 75 percent of your loss, or $187,500, since you should have had at least $1 million in coverage ($83,334 in income per month times 12 months).

Insurers will waive the coinsurance penalty if your policy has an "agreed value" provision and you submit a business income worksheet to your insurer each year. In this case, your policy limit will be the agreed value, with no deduction for a coinsurance penalty. For information about how to complete a business income worksheet, please contact us.

We can help you evaluate your business income loss exposures, including contingent business exposures, and design an insurance program to help you protect your business income.

This Just In

manity," Zitron told the Times. "A lot of CEOs and companies are terrified of apologies. They don't want to look weak. But they apparently don't mind looking horrible."

Like your buildings or inventory, your company's reputation is a valuable asset that deserves protection. Public relations, used properly, can help you protect this asset. Some insurers also offer limited coverage for crisis communications, which can even provide funds needed to help control bad news in a crisis. For more suggestions on protecting your reputation in a crisis, please call us.

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Why Private Companies Need D&O Insurance Too

Private corporations and nonprofits are less likely to be targeted in multi-million dollar directors and officers liability lawsuits than publicly traded companies. They still have risk exposures, though. In fact, in a recent survey by Advisen, 25 percent of D&O claims among private companies settled for $1 million or more. Could you protect your directors and officers from claims that large?

Directors and officers liability insurance, commonly known as D&O, protects corporate directors and officers from liability arising from acts or omissions they commit in the course of their official duties. Directors and officers owe the corporation they serve, and its shareholders, three fiduciary duties: the duty of care, or of acting with reasonable prudence in the performance of their duties; the duty of loyalty, or of putting the corporation's interests above their own; and the duty of obedience, or of acting within the scope of their authority. Directors who fail to carry out these responsibilities can be held personally liable if their errors or omissions result in a loss to the corporation or its shareholders.

In recent years, those "official duties" have become more onerous, due to increasing regulatory scrutiny. For example, in 2002, the Sarbanes-Oxley Act became law. In addition to tightening responsibilities for outside auditing companies, the law also placed greater financial oversight responsibility on a corporation's principal executive and financial officers. These individuals must now agree in writing that they have personally reviewed the corporation's annual or quarterly SEC filings and certify the information contained therein is true to the best of their knowledge. (The Dodd-Frank Act, which passed in 2010, has also increased responsibilities for directors and officers, but it primarily affects financial services companies.)

Publicly traded companies need D&O insurance to protect their directors and officers from the risk of shareholder suits. Privately held corporations have much lower exposures to shareholder suits. However, shareholders can—and sometimes do—sue directors and officers of private corporations.

Although nonprofits have no shareholders, directors and officers must manage the organization's assets well and in accordance with the bylaws. Considering that some nonprofits have multimillion dollar budgets, their directors' responsibilities can equal those of a publicly traded corporation. In fact, Sarbanes-Oxley's executive liability and whistleblower protection provisions apply to nonprofits as well as to for-profit corporations.

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Employees: A Private or Nonprofit Corporation's Greatest Risk

Still, for nonprofits and privately held companies, employees present the greatest liability threat to directors and officers. The majority of D&O claims among nonprofits and private companies involve employment practices liability claims filed against the entity and its directors and officers. Employment practices liability claims involve employment actions, which can include:

- Discrimination
- Harassment
- Wrongful termination
- Retaliation
- Wrongful discipline.

To address this need, insurers have developed specialized policies for private corporations and nonprofits that combine D&O coverage with employment practices liability insurance, or EPLI.

It's important to note that the D&O/EPLI policy covers only directors and officers—it will not cover managers or supervisors from employment practices claims. If you have significant employment practices liability exposures, you might need a separate EPLI policy.

Other Liability Exposures

That's not to say that private companies don't have exposures to shareholder lawsuits. According to a survey by Advisen, a company that provides information to assist in the underwriting, marketing and purchasing of commercial insurance, excluding employment practices liability claims, 46 percent of lawsuits filed against private companies participating in the survey were filed by shareholders, 33 percent were client-led, and 21 percent were vendor-led.

Private company shareholder suits most commonly involve claims from minority shareholders who claim the actions of majority shareholders benefitted themselves at the expense of minority shareholders. Companies planning merger or acquisition activity should protect themselves from this exposure.

The proper liability coverage can help your organization attract and retain qualified directors and officers. For a discussion of your risk exposures and analysis of your coverage needs, please contact us.

What's the Difference between Arbitration and Mediation?

How many times have you signed a contract that requires mediation or mandatory arbitration of disputes? Do you know what you're signing?

Both types of settlement procedures are referred to as alternative dispute resolution (ADR). This is where a neutral third party helps parties to a dispute reach a resolution outside of the court system. The most common types of ADR are mediation, arbitration and mini-trials.

Mediation lets two or more parties solve disputes through the use of a mediator, a trained neutral third party. The mediator opens the lines of communication and helps parties work out solutions in an informal, confidential and non-binding process.

You do not need an attorney for mediation, although you may have your attorney present. The mediator will decide what role attorneys will play during mediation. The mediator does not decide who is right or wrong or issue a decision. Because it's voluntary, parties to mediation may exit at any time. A decision arrived at through mediation does not legally bind the parties, so any party may choose to file a lawsuit after mediation.

Arbitration is the most common form of alternative dispute resolution. Many contracts require the use of binding arbitration, so it pays to know what exactly arbitration is.

More formal than mediation, arbitration involves a trained arbitrator, who listens to both parties to a dispute and issues a decision. The arbitrator's decision is final, binding and enforceable in a court of law.

Many arbitrators have expertise in technical or specialized areas. The parties involved can provide input into the selection of an ar-

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bitrator. If your dispute involves technical or specialized information, arbitration can save you time and money you'd otherwise spend educating a judge or jury.

Arbitration does not require formal discovery. However, most arbitrators follow the rules of the American Arbitration Association, which allow arbitrators to require parties to a dispute to produce relevant information and documents.

Mini trials involve a structured settlement process. The process begins with both parties (or their attorneys) presenting abbreviated summaries of their case to a panel. The panel consists of mediators, who advocate for their respective parties and work out a settlement. It may also include a neutral member, who serves as an expert or advisor on applicable law.

Summaries contain explicit information about the legal bases and the merits of the case. The process generally follows more relaxed rules for discovery and case presentation than found in a court, and parties usually agree on specific limited periods of time for presentations and arguments.

Your mediator will go into the process having authority to settle the matter according to criteria that you spell out—such as a specific dollar amount or other conditions. If mediators cannot come to a suitable resolution, they might ask the neutral advisor to predict the outcome of the case if it goes to litigation. Since mini trials are often used after a lawsuit has been filed, we'll focus the rest of our discussion on techniques you can use to avoid litigation.

What You Need to Know about ADR

Advantages of mediation: Court cases become a matter of public record, while mediation remains private. As a non-adversarial process, mediation allows two parties to reach a mutually agreeable solution and preserve a working relationship. It also costs less than litigation or arbitration, is less adversarial and usually takes less time. Mediation is not binding, so parties unsatisfied with mediation can bring their dispute to court.

Disadvantages of mediation: A mediator might not have the expertise or discovery and evidentiary resources of the court system to come to a decision that's truly fair to both parties. In a personal dispute, a more aggressive party might have an unfair advantage over a quieter, meeker one.

Advantages of arbitration: As with mediation, arbitration remains private and disputes do not become a matter of public record. However, decisions are enforceable by the courts.

Informal rules of evidence streamline the discovery process and allow the case to come to a decision faster. Arbitrators can have expertise in specialized areas, which could result in a fairer, more informed decision. That, and relaxed hearing procedure rules, can speed the process.

Finally, arbitration could limit settlement costs. Most arbitrators do not award attorney fees to the prevailing party. Some states prohibit arbitrators from awarding punitive damages for certain types of claims.

Disadvantages of arbitration: When you have an agreement that disputes must be resolved through arbitration, you do not have access to summary judgment or other tactics to dismiss a claim without a trial. Even frivolous claims will likely be heard on their merits.

Decisions rendered by an arbitrator are binding. You don't have access to a court appeal, except in very rare, limited circumstances.

Arbitration agreements can limit your legal rights. Before signing a contract with an arbitration clause, or before including an arbitration clause in your employment and other agreements, please ask an attorney for advice. For more information on protecting your organization from the high cost of legal disputes, please contact us.

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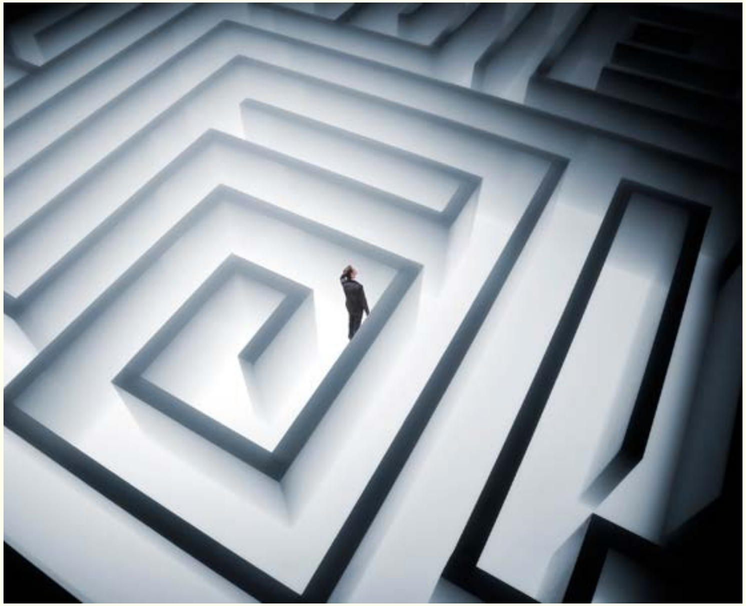
D&O Trends

These trends affect both public and private companies:

- **Regulatory enforcement.** The Department of Labor, Federal Trade Commission and other agencies have stepped up enforcement in recent years, which have resulted in claims of mismanagement against directors and officers who fail to prepare for this increased enforcement. However, a new report by Marsh has predicted that the impact of these and other regulations including under Sarbanes-Oakley and Dodd-Frank may be diminished as a result of actions taken by the Trump administration.
- **Emerging risks.** These include cyber liability, environmental liability, breach of privacy, reputation risks and more. Failure to take action to protect the company against these risks could result in claims of negligence against directors and officers. As more specific insurance for some of these risks, such as cyber and environmental liability, have been developed, some pressure on D&O policies and premiums have been reduced.
- **Changing policies.** Insurers have been adding exclusionary language to insurance policies the past few years, limiting coverage and leaving officers and directors personally responsible for claims not covered by those policies. The Marsh report has speculated, however, that reduced D&O claims and a better outlook for D&O insurance may result in companies offering to "sell back" some exclusionary terms and even offer reduced premiums.



Source: Marsh's full report is "The U.S. Financial and Professional Market in 2017: Our Top 10 List."

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