



Dan Lawrie Insurance Brokers Ltd.

The Name You Can Trust For Insurance

105 Main Street East • Suite 1400 Hamilton, Ontario L8N 1G6 • Tel: (905) 525-7259 • Fax: (905) 521-7989
Toll Free: 1-800-661-1518 • E-mail: dli@danlawrie.com • Website: www.danlawrie.com

Business Insurance

R E V I E W

Important aspects of insurance and loss prevention for business owners and managers

What to do immediately after the loss

The obvious first step is to ensure employee safety; then notify the local authorities and your insurance broker or agent without delay. Next, set your business continuity plan in motion. If you don't have one, your loss could conceivably be aggravated. You could also face a dispute with your insurer over your lack of due diligence to reduce the amount of your claim. Check with the adjuster as early as possible to confirm that the loss is covered by your policies. That said, Don A. Wilks, National Director of Business Consulting, Deloitte & Touche LLP lists five steps you can take immediately after a loss. These excerpts from his comments are reproduced with his kind permission.

“1. SECURE THE SITE. First, after the immediate cause of loss is stopped, ensure that the site is secure and protected. Protection of property is required by virtually all (property) insurance policies; however, the reason to (do so) is to expedite the company's return to normal business operations.

Next, secure the area of damage to ensure the site remains intact for investigation and

calculation of losses. Examples include extra security and temporary fencing. Ensure that the damaged area is not tampered with..... Retail establishments should take extra care to avoid looting. Activities undertaken during the initial days after a loss may include:

- Analysis of the cause and origin of the loss.” (This may involve outside investigators such as the Fire Marshal and Police. If so, they will probably take yet more of your time just when you can least spare it.)
- “Structural analysis of the remaining facilities.
- Determination of the scope of physical damage.
- Consensus on scope of damage with insurer's representative.
- Conducting a count of damaged and/or destroyed inventory.

I often recommend that the insured videotape the damage as soon after the loss as possible. Once the above items are completed, the company should quickly begin repairs;

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and a video provides an inexpensive ounce of prevention if there are future disputes with insurers about specific damage. I recommend hiring a professional videographer who will have the know-how and ability to thoroughly document the damage. (He) should be accompanied by an employee who knows the facilities best such as the facilities manager, head of operations or plant manager. This individual should serve as the recorded video narrator by orally describing what area and specific damage is being filmed. Often, damage is so severe that, without an explanation, the video is incomprehensible to subsequent viewers.

2. FORM A RECOVERY TASK FORCE. (This) is the first step to recovering your operations. (It) should include:

- Personnel from the damaged operations of your business.
- Those responsible for the rebuilding process.
- Construction contractor representative;
- Risk Manager, or the person in charge of insurance;
- Key personnel with regard to providing goods and services to customers.
- Financial/accounting liaison, or “Gatekeeper” who will be discussed later; and
- Consultants retained to assist in recovery.

The job of the task force is to get your company back up and running. The goal is to reestablish the revenue stream from its customers. You can expect competitors to take advantage of your misfortune and attempt to satisfy your customers. The best defence is a solid plan of recovery, clear communication with your customers, and a fast return to operations.” (A senior staff member should be assigned to provide up-to-date information to the media, employees and their families, customers and suppliers).

“3. DEVELOP A PRELIMINARY ESTIMATE OF THE LOSS.

This is a step often overlooked by insureds or one that is frequently left in the hands of the insurance company adjuster and its accountants. When an insured has a loss, it must be recognized by the (insurer). Insurers do this by establishing a “reserve” or initial estimate of the loss. As more information becomes available, the adjuster may report a revision of his reserve to the (insurer). The reserve is an important number because it establishes the expectation of the insurance company and their representatives at the home office who may never visit the loss site.

It is important that (you) be involved in the initial estimates of the loss; (you) know the facilities and its business operations much more intimately than anyone with only a

few days exposure.

An estimate prepared by you is likely to be more complete and accurate. For the property damage estimate, (you) may know about such things as:

- building materials,
- design,
- availability and cost of replacement machinery, and
- potential alternate or temporary locations.

The business interruption estimate may include knowledge of items such as:

- recently awarded contracts,
- new customers,
- new products,
- recently implemented or soon to be implemented cost savings or efficiencies.
- existing customer and product data.

There are many more items that may significantly impact the ultimate amount of the loss, and a knowledgeable estimate will ensure the right information is (given to the insurer).

4. ESTABLISH A LOSS ACCOUNTING SYSTEM. The two most common errors insureds make when establishing a system to account for the expenditures related to a loss are:

1. opening a single account titled, for example, “Fire Loss”; and
2. opening 95 separate accounts to record every foreseeable type of expenditure.

The solution is a set of accounts that follows the coverages in the policy and provides the detail necessary to document and support the claim. Examples of systems that simplify the accounting for a loss include:

- Creating a set of charge codes within the chart of accounts;
- Establishment of a project work order as if the repair was a normal project; and
- Establishing separate cost centres for each expense category.

There are many ways to account for a loss, but the best practice is to make it simple, and establish a system that follows the normal day-to-day activities as closely as possible.”

“As loss-related expenses are incurred and invoices processed, the project manager or those in the field who are approving the expenses should code them. The invoices are then routed to the “Gatekeeper” before making their way to accounts payable. The Gatekeeper is an individual, usually in the management of the accounting department, often the controller or chief accountant. This individual reviews each invoice for completeness including, for example, does (it);

- specify the materials of services provided in detail?

- specify the date material was delivered or service provided?
- state the area of repair, i.e., which machine, what building, etc.?
- specify the use of the expense?
- contain the correct loss accounting code?
- include materials or services ... not related to the loss?

The job of the Gatekeeper is to ensure that all is in order before the invoice is paid so that the insurer can reimburse the expenditure. If further detail is required from the vendor, it is often much easier to get the necessary information before the invoice is paid rather than after the cheque has been cashed.

5. GET PROFESSIONAL HELP. The recovery from a loss is a traumatic and potentially significant event. For some companies, major losses threaten their very existence and a full recovery determines survival or extinction. Additionally, the insurance claim process is complicated and time consuming. The insurance company will deploy adjusters, accountants and engineers who deal with claims every day; a best practice for you is to get help from professionals who specialize in assisting clients in the financial recovery from losses. These professionals (will) ensure your company's best interests are looked after....."

"The professional fees incurred as a result of the loss can be covered by the insurance policy with a "Professional Fee" endorsement. The inclusion of this endorsement is a best practice to ensure that such loss-related costs are reimbursed." (Note that your property, business interruption, boiler & machinery and crime policies should all be endorsed.)

"..... decide who your help is going to be well in advance of the loss. The time to interview professionals (for this purpose) is not the day after the loss when there are many critical items to attend to. I recommend that risk managers determine all of their potentially critical contractors, e.g. construction contractors, restoration contractors, substitute vendors, etc., as part of a comprehensive business continuity plan. Your selection of helpers should include insurance claim professionals." (Get an estimate of their likely fee or basis for their charges so you can add sufficient amounts to your policies to cover them.)

"The first days following a loss are critical to a smooth and expedited recovery. By reviewing and following the best practices discussed above, risk managers (and business owners) can anticipate, prepare for and expedite their company's recovery from a major loss. A well thought out and thoroughly documented business continuity plan should incorporate those best practices, tailored to your company's specific circumstances."

Do you know...

THE IMPORTANCE OF "INDEMNITY PERIOD" IN YOUR BUSINESS INTERRUPTION POLICIES?

The critical element affecting the return of your business to normal after a loss is the time it will take for your turnover to get to the level it would have reached if no loss had occurred. Estimating this period is one of the key decisions you must make when deciding how much insurance to carry. Unfortunately, there is no foolproof formula you can follow to arrive at the figure with 100% accuracy. One thing is certain, however. If you underestimate its duration, your insurance recovery will be cut off at the end of the period stated in your policies (known as the Indemnity Period), even if you have not used up all your insurance.

"Boilerplate" Business Interruption policies generally provide an Indemnity Period of 12 months. For many businesses, this may be adequate. However, you should not take this for granted. Remember that Profits policies reimburse you past the time it takes for you to re-open for business with all damage repaired or replaced. Beyond this, it takes into account you will likely lose customers and business after the loss and that you need to collect insurance while you get them back or replace them.

Estimating an adequate Indemnity Period calls for you to take a liberal view of how long all this will take. Professional property appraisers can project realistically the time needed to rebuild your facility if it is totally destroyed. No one else is in a better position than you are to decide how much extra time you may need till your bottom line recovers.

Once you have decided on the Indemnity Period, your policy can be changed if need be. To settle on the sum to insure, you must project your total Gross Profit as defined in the policy, **for the entire Indemnity Period, beginning on the expiry date of your policy.** The reason for this is to make sure you have sufficient insurance if a loss should occur on the day before your policy expires.

The Profits Policy is subject to 100% Co-insurance and contains a Premium Adjustment clause. If you insure for more than your actual Gross Profit during the term of the policy, you can be re-imbursed up to 50% of the premium you paid. If you carry insufficient insurance, you will be penalized proportionately in the settlement of any claim, irrespective of its size. Setting the appropriate Indemnity Period is one vital step you need to take to avoid this latter unhappy possibility.

Q. Brown Fabricators, manufacturers, carry a Broad Form Property policy. Following a severe fire, the ruins of the plant are declared unsafe by the local authority and are ordered demolished. A municipal by-law passed after Brown built these premises prohibits the plant being rebuilt in the same area due to a change in Zoning. What affect will these events have on Brown's insurance?

A. The building will be considered a total loss. However, even if the policies contain a standard Replacement Cost (R.C.) clause, Brown will only receive its Actual Cash Value. This is because the R.C. wording requires that reconstruction be on the same site or on an adjacent one.

When taking out the policies Brown would have needed to negotiate for the "same site" requirement to be deleted from the wording to avoid this potential gap in coverage.

The cost of demolition of the building and removal of the debris will be covered too, if there is sufficient amount of insurance.

Environmental concerns will stall property transactions

If you intend to buy or sell a commercial or industrial property, you should be prepared for the transaction to be held up while potential pollution exposures are investigated. Problems can stem from the failure of prior occupants or owners of the property to deal with pollution problems and comply with environmental regulations. Exposures may be obvious in the case of industrial properties. Leaking underground storage tanks and piping, hazardous waste disposal pits, improper disposal of solvents leading to soil and groundwater contamination are just three self-evident exposures to liability. However, buildings housing retail, office and similarly less hazardous occupancies can be at risk too. The most likely is sick building syndrome. This is the result of poorly maintained heating, ventilation or air conditioning systems.

If any pollution exposure is discovered, costly clean up and remediation costs will have to be incurred by the vendor before a

purchaser or lender is likely to commit to a real estate transaction. As a purchaser, you would be taking a big risk today to proceed with a transaction without having an environmental audit carried out on your account. This should investigate the source of any contamination discovered as well as its extent. Frequently, adjacent properties run off effluent into a neighbour's and are found to be the origin of the problem. In such a case, you would have legal recourse against the polluter but at the undoubted cost of delaying the sale.

As a vendor, you will find no coverage for liability exposures under your Commercial General Liability policy. You need the appropriate form of Environmental Liability coverage to protect you. Its exact scope will vary from case to case so you should ask for a specimen policy wording to accompany any premium quotation you obtain. We will be happy to help you understand its terms and conditions before you choose a policy to suit your needs.

105 Main Street East • 14th Floor
Hamilton, Ontario L8N 1G6

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Fax: (905) 521-7989 E-mail: dli@danlawrie.com
www.danlawrie.com



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