American Insurance Association

BUSINESS INTERRUPTION INSURANCE

I. What is Business Interruption Coverage?

Business interruption coverage is a tightly constructed part of broader commercial insurance policies. This coverage is most commonly found in commercial property insurance policies and business owner's policies (a package policy for small businesses, often referred to as a "BOP"). There are four critical elements to business interruption insurance:

- It is only triggered in three limited circumstances:
    1. There is physical damage to the premises of such magnitude that the business must suspend its operations.
    2. There is physical damage to other property caused by a loss that would be covered under the company's insurance policy, and that damage totally or partially prevents customers or employees from gaining access to the business.
    3. The government shuts down an area due to property damage caused by a peril covered by the company's insurance policy that prevents customers or employees from gaining access to the premises.

- Even after a covered event, most policies have a waiting period of several days before business interruption coverage comes into play. Once it is in play, the coverage is not retroactive to the day of the event.

- Coverage is limited. Specifically, after the waiting period expires, coverage is provided for lost net income, temporary relocation expenses (designed to reduce overall costs), and ongoing expenses such as payroll that enables businesses to continue paying employees rather than laying them off.

- Coverage is not open-ended. Coverage is available only for as long as it is necessary to get the business running again, and usually not longer than 12 months. In addition, the business is required to prove all business interruption losses to its insurer.

II. Business Interruption Coverage is Limited

Business interruption coverage is a limited form of coverage, and is not a blank check for every business disruption. In addition to the above limitations, standard business interruption coverage is restricted in the following ways:

- Suspension of Operations – Suspensions, slowdowns and cessations by a covered event are covered.
- Unfavorable Business Conditions Not Covered - However, lost net income due to unfavorable business conditions following a loss is not covered.

III. Misconceptions and Truths About Business Interruption Coverage

Several misconceptions about business interruption insurance have surfaced.

- Misconception – Business interruption insurance serves no useful purpose.
- Truth – This insurance provides vital protection when a business falls victim to circumstances outside of its control. The purpose of this coverage is to protect the business against losses arising from its inability to continue normal operations, and its inability to occupy its premises.

- Misconception – Business interruption insurance creates a disincentive to mitigate against losses.
- Truth – The insurance pricing system already provides a built-in incentive for businesses to mitigate against future losses. For example, when pricing a commercial insurance policy that includes business interruption coverage, an insurer takes into consideration such factors as whether there are sprinkler systems and security systems, and human factors such as whether the business has implemented an emergency evacuation plan and contingency plans following a catastrophe. In addition, as a condition of coverage, the insurance policy requires the insured to resume its operations as quickly as possible, and to take all reasonable steps to prevent future losses.

- Misconception – Business interruption insurance should not cover ongoing expenses such as payroll because workers can collect unemployment insurance benefits.
- Truth – First, unemployment benefits are always lower than workers' actual wages or salary, and are inadequate to cover the displaced worker's ongoing obligations, such as mortgage and child care expenses. Second, a worker should not be required to claim unemployment benefits if their employer cannot pay them because of a covered business interruption loss. Third, it is less disruptive to both the worker and the business for the employer to continue paying the worker during the time it takes to get the business up and running.