

# Recipe for Disaster Relief



**Insuring against potential devastation can save a bundle in the end.**

*By Thomas R. Wing Jr.*

**A** tornado sweeps through a Midwestern city and topples a transmission tower, silencing an all-news station for weeks. A plane slams into a 750-foot radio tower in California, killing the pilot and a passenger, and knocking a talk-show station temporarily off the air. A hurricane devastates a huge swath of the Gulf Coast, and a station in New Orleans labors to restore itself for over a year.

These incidents are all the stuff of nightmares, but they were very real and very devastating to the people and businesses that lived through them. And they speak to the reason why many companies obtain what's known as "business income/extra expense insurance."

This type of coverage also goes by a few other names. "Business-interruption insurance" is one. And it's also referred to as "time element insurance," because the amount of insurance a company needs depends upon what insurers call "duration of loss," referring to the length of time it will take to recover from a disaster.

Regardless of what one calls it, this type of insurance compensates businesses for lost income and helps pay for the expenses that companies are still responsible for, even though operations have been interrupted. Payroll, taxes, lease payments and utilities are just some of the types of expenses that are covered.

Business income/extra expense insurance applies from the time the insured's operations are interrupted by physical loss to plant or equipment until they are restored to the level that existed prior to the physical damage.

What goes into determining how much business income insurance a company needs? The first step is relatively easy: Calculate the annual income of a business, using a projected 12-month gross revenue figure. This should take into account gross sales, third-party rental revenue and all other income such as licensing fees and royalties. Then, subtract returns and allowances, discounts granted to customers and prepaid outgoing freight.

Theoretically, the calculation could stop here. An insurance limit representing one year's worth of business income could be established. But, is this what a broadcaster really needs? Is that the right amount of insurance to buy?

### **Gauging the Time Factor**

Calculating an annual projected business income amount is pretty straightforward. But estimating how long a business might be out of commission and how much that might cost, before a loss happens, is much tougher. In fact, the devil is in the details of determining what is actually going to happen – or not happen – following a catastrophic loss.

Typically, duration of loss runs from the time a property is damaged to when the business is restored to its pre-loss level. This can extend beyond physical rebuilding to embrace the process of recapturing lost market share, customers and sales. Worst-case scenarios are generally the best means of determining how long the duration should last.

While that's an important concept, most media companies underestimate how long it will take them to fully recover after a major blow. It pays to understand precisely what can contribute to the duration of a loss. Among the key factors are repair or replacement time, building permits, local requirements, restoration of operations and how long it will take to normalize sales.

If disaster strikes, property losses could range from downed transmission towers and ruined office equipment to partial or wholesale destruction of the transmission facility. Even mobile units can fall by the wayside. Since they often are parked on the company's premises, a tornado or fire could damage or destroy them, too.

Keep in mind that construction usually takes longer than most people expect. Erecting a new facility can easily take a year or longer—sometimes much longer. That's why it makes sense to consult a contractor before a loss occurs to get some idea of the cost and length of time for a potential rebuilding project.

As for personal property, insured parties have to weigh the problems they may face in obtaining specialized equipment. If their

equipment is imported or custom made, they may spend much longer locating replacements than if they simply bought items off supply-store shelves.

Another consideration is information technology equipment and data. If computers are lost and companies haven't backed up their specialized programming, it could take an inordinate amount of time to reprogram these applications.

Even before construction can begin, architectural plans must be submitted to the Federal Communications Com-

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mission and the local planning board for approval. Anticipate a wait of several months as those plans make their way through federal and local government bureaucracy. Even then, the length of the wait is contingent on the plan meeting all FCC requirements and local ordinances.

So in that same pre-loss conversation with a contractor, it's important to review the cost and time for obtaining a building permit.

When calculating how long it may take to repair or replace a facility, you should also anticipate additional time to comply with local ordinances.

Building codes may have changed dramatically since the original facility went up. If a business were allowed to rebuild exactly as it had been before the loss, it

might take just a year. But additional requirements from updated building codes can add months to the construction time.

Some businesses are ready to produce 100% of their pre-loss income the moment their property is restored. To achieve this goal, business owners must consider the steps necessary to restore market share and sales as quickly as possible. It simply can't be considered business as usual until the company has gained back all the customers it would have had if the loss had not occurred.

If the estimated loss duration is longer than 12 months, more business income insurance may be needed. Or less insurance may be needed if the length of time is likely to be shorter.

### **Reducing the Cost**

Regardless of the income amount estimated in the duration-of-loss analysis, there are two ways you can reduce the amount of business income insurance you need to recover from a disaster. The first is by excluding or limiting ordinary payroll expense, and the second is by incurring extra expenses.

Business owners have a choice in insuring ordinary payroll. On the one hand, if payroll is excluded from a business income policy, the insurance limit can be reduced by that amount.

Certainly, an insured business need not pay the ordinary payroll expense at the time of loss. The amount they don't spend on payroll can be used to pay a business income loss of longer-than-expected duration.

However, it's recommended that companies insure the payroll and continue to issue paychecks to skilled employees and other staff for the length of the interruption. Otherwise, it may be difficult to bring these people back once the business is ready to reopen.

### **Added Expenses**

Perhaps the most complicated piece of the business-income puzzle is determining what extra expenses are likely to be incurred. These are expenses above and beyond ordinary operating expenses and help a company stay in business and/or get

back into business as fast as possible.

By spending extra-expense dollars, an insured may be able to reduce their business income loss.

Essentially, extra expense insurance makes money available to fund a business continuation plan. In the planning stages, long before a loss may occur, it requires broadcasters or cable operators to envision what they would do during an interruption to either speed recovery or stay in the market as much as possible.

Here's one example: a radio broadcasting company has a 300-foot tower that allows its signal to reach residents in two states. Along comes a tornado that demolishes the tower.

The company may then choose to rent a portable, but shorter, tower on a temporary basis that will transmit to only half its audience. This way, the company has held onto at least some of its market, and the added expenditure has reduced its overall business income losses.

That's the way most companies approach business interruptions – by looking to get through the long-term process of returning their operations to good health, while trying on a short-term basis to do everything they can to stay in the game.

Business income and extra expense insurance work hand in hand and are often purchased together. It's now common for insurers to provide one single limit of insurance for business income and extra expense. With a single limit, businesses can use their claims dollars where they are most needed, whether it is for business income or extra expenses.

If broadcasters and cable companies want to get an even better handle on business-income insurance costs, carriers certainly can provide them with the methods for judging what they need. And agents can supply them with worksheets to help tally the extra expenses they would incur in the

first month after a loss, during the intervening months, and then in the last month before full operations resume.

Ultimately, however, it falls to the insured to fill in all the blanks correctly. He or she must do a good, honest job of trying to determine what the duration of their loss might be. And they must do an equally diligent and honest job of arriving at the amount of money they would expect to spend to shorten the time they could be out of business.

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