

Property Insurance “Gotchas”

Lots of operators out there have no idea that their property insurance policy is just teeming with “gotchas” that our industry calls exclusions, limitations and conditions. There are also coinsurance and protective safeguard endorsements that can be problematic. Understanding and dealing with these issues is a matter of knowing they are there and reacting to the exposure before a loss occurs. I’m not going to say that folks don’t read their policies, but I’ve yet to have anyone “confess” to reading the contract. Oh, by the way, the skating industry is not the only group that doesn’t spend much time familiarizing themselves with their policies. Very few people read the jumble of legalese that makes up the contract. Why would they, it is incredibly difficult to understand. We start by giving you everything, then progressively take coverage away through the policy provisions, exclusions and exceptions to exclusions. Without a specific loss to research, reading a property policy can be an exercise in frustration.

The Gotchas, as I call them, are warranties that you make when purchasing a property policy. Normally a warranty is a good thing, but when you warrant something to an insurer you have to make good on your warranty, or you get PENALIZED. For instance, let’s say you get a great price for property insurance simply because your building has a sprinkler system. That is usually all the operator would know and would assume this is just a rating tool. Nay, Nay, the insurance company will attach a form (IL 04 15) with the following wording:

“As a condition of this insurance, you are required to maintain the protective devices or services listed in the schedule above.”

The policy then describes a number of items that you could be required to maintain. They include but are not limited to:

- An Automatic Sprinkler System
- An Automatic Fire Alarm connected to a central station
- A Security Service or Service Contract
- An Automatic Fire Suppression System (Over a cooking area)

The company can also “describe a protective system” and write that item onto the form. Usually you will receive some type of discount in premium associated with the items they are requiring you to maintain. Below is actual wording from this form:

We will not pay for loss or damage caused by or resulting from fire if, prior to the fire, you:
1. Knew of any suspension or impairment in any protective safeguard listed in the Schedule above and failed to notify us of that fact; or

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2. Failed to maintain any protective safeguard listed in the Schedule above, and over which you had control, in complete working order.

If part of an Automatic Sprinkler System is shut off due to breakage, leakage, freezing conditions or opening of sprinkler heads, notification to us will not be necessary if you can restore full protection within 48 hours.

When a form starts off with “We will NOT PAY” it better get our attention, and that’s exactly what this one does. The system must be in “complete working order” according to the form. If you failed to have your hood & duct system inspected, it had BETTER work in case of a fire. Do you think a company would enforce this provision of your policy in case of a major loss? This is a case where knowledge is power, look for this form and know its provisions.

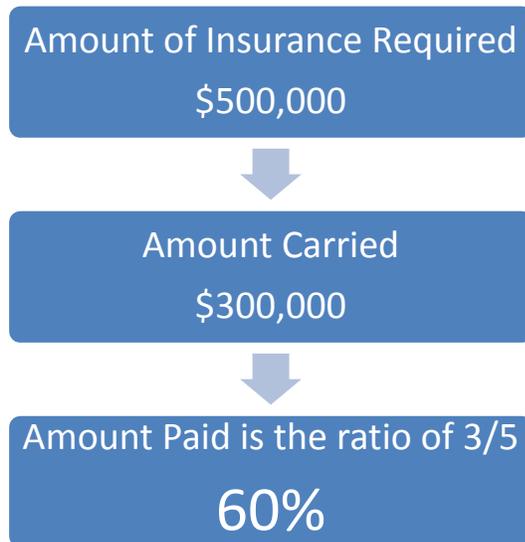
Lets talk about a couple other items that can cause problems at loss time. I’m sure everyone has seen (and perhaps even wondered what it meant) the number expressed as a percentage after the amount of coverage shown on their property policy. It will likely say either 80% or 90% and is referred to as Co-Insurance. What exactly does this innocuous looking number mean? To answer this rhetorical question, it is another warranty that you are making to the insurance company and it is important enough that the policy contain an entire page of examples of how it works and how you can be penalized. It even works problems to illustrate the penalties that could be involved. While the first “gotcha” we looked at only applies to fire losses, this one applies to any covered peril. For purposes of this article we will assume you purchased replacement cost coverage and 80% coinsurance. What we have done is guarantee to the insurance company that the amount of coverage on your building is at LEAST 80% of its replacement cost. The insurance company determines the replacement cost AFTER THE LOSS OCCURS. That information should raise a red flag in your mind and the realization that you had better know the replacement cost of your building in advance of a loss. The form essentially says the following:

Assuming the replacement cost of your building is \$1,000,000, you would be required to insure it for at least 80% of that amount, or \$800,000. Let’s say that you insured it for \$400,000 because that’s all you owe on the building. All we need now is a covered loss of some amount, let’s assume \$200,000 in damage from a tornado or hail storm. The coinsurance PENALTY would be triggered. YOU warranted that you would insure the building for 80% of the replacement cost but in fact you insured it for much less. The amount you carried is expressed as a fraction to the amount required; in this case exactly half (\$400K versus \$800K required). That is what gets paid, 50% of the loss, or \$100,000, LESS your deductible. Most operators would be a bit annoyed when they receive ½ of the amount of their loss, but this provision of the policy is enforced. The answer is to remain adequately insured. There are industry standards to determine a reasonable replacement cost and there is an endorsement that waives this provision of the policy completely. It is called an agreed amount endorsement. Most companies are very reluctant to give you this endorsement. Fortunately, the RSA endorsed carrier will provide it on most policies.

The last “gotcha” we’ll discuss this month is another type of coinsurance penalty and involves business income or business interruption coverage. After wading through the other penalty described above, this one is simple. Your policy may show that you have business interruption insurance and list a coinsurance amount of from 50% to 100%. The penalty works EXACTLY like the one on your building and is determined by your gross earnings (sales less cost of goods sold). If gross earnings are \$1,000,000 and

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you have a 50% coinsurance form attached then the required amount of coverage is \$500,000. Anything less and you get penalized. A simple chart illustrates this provision.



This time the answer is to be very careful how much coverage you purchase for business income. Discuss the amount of coverage needed with your agent and your accountant. Once again, there are other ways to provide this coverage and avoid the coinsurance provisions. Which way works best for you is determined by your unique situation and beyond the scope of this article.

An insurance contract is a complex document, but the mine field of “gotcha’s” can be avoided with a bit of planning. Unfortunately, I see improperly issued policies on a regular basis. Drag that document out and look at it with the things we’ve reviewed in mind. If you don’t like what you see, it’s time to talk to your insurance professional.

