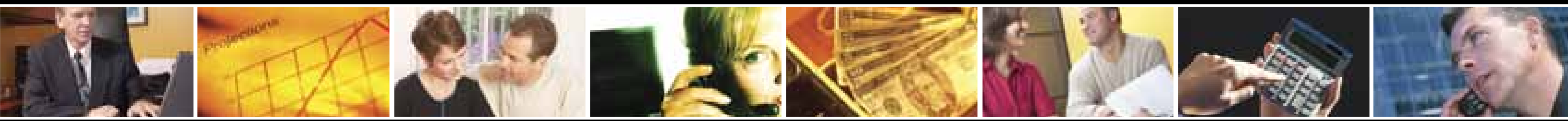
Volume 1, Number 1

Risk Monitor



Inside...

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Do You Really Need Full Replacement Insurance on Your Current Building?

The owners of a new company found a building on the market for an affordable price, so they bought it. Built in the 1940's to manufacture aircraft for the war effort, the metal structure had a large open space. The company occupying this space was in the software development business and the building was much larger than it needed, but the price made it seem like a sensible move. However, the owners got a surprise from their insurance agent about property coverage. Insurance companies base limits of insurance on the cost of replacing a building exactly as it was before the loss. The cost of reconstructing this old building was much higher than both its purchase price and that of other suitable properties. The company did not need that much insurance, and paying the higher premium for it would have been wasteful, so the owners asked the agent for alternatives. What if, they asked, we don't rebuild our building as it was?

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After a fire or some other catastrophe destroys a building, its owners may decide not to rebuild or replace with a similar structure for a number of reasons.

- As was the case with the software company, the current building's design may be impractical. The company bought the building because of a good price, not because of its large open space. A software developer ordinarily does not need that much space; if it were to rebuild, it would almost certainly choose a smaller building with a different layout. Also, very old buildings often include materials that builders do not commonly use today, such as plaster and lathe. Reconstruction with these materials is expensive and often unnecessary for the continued operation of the business.
- The company may decide to consolidate the operations of two locations into one. The second location may have the capacity to absorb the first one's operations, and management may feel that it will gain efficiencies by consolidating.
- Depending on the building's age, it may not meet current building codes. The local govern-

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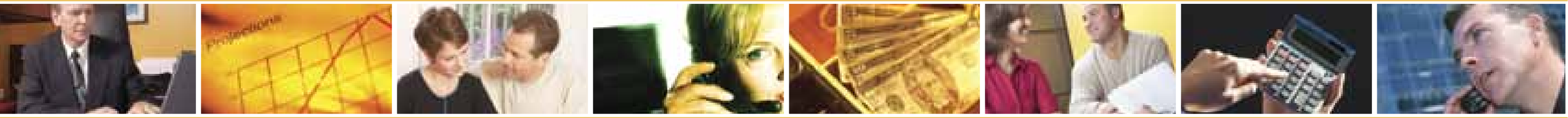

Employee or Independent Contractor?

A common scenario many business owners face is hiring an independent contractor, who operates as a sole proprietor, for a task where the possibility for injury exists. Yet, you fail to obtain workers' compensation coverage for this person because you assume if they were injured on the job, their independent contractor status would prohibit a claim against your insurance.

What you may not realize, however, is that just because someone is a sole proprietor of a business doesn't automatically make them an independent contractor if they come to work for you. They may very well be considered an employee.

Determining whether someone is an employee or independent contractor is complicated by the fact that three separate agencies, your state Workers' Compensation Board, your state Department of Labor and the IRS, each make a determination of status based on their own criteria. The IRS requirements can be found online at http://www.irs.gov. You can obtain state requirements by contacting your local Workers' Compensation Board and Department of Labor office.

In spite of all of this seeming confusion, there are general rules of thumb you can utilize to determine if a worker should be considered an employee. The commonality among these criteria is that the employer directly controls the how, what, and when of the worker's employment.

Direct Evidence Of The Right To Control

- Do you have the right to require compliance with your instructions?
- Will you be training this person through meetings, classes, or apprenticeship with a more experienced worker?
- Will the worker's services be integrated into your overall business operations?
- Do you set the number of hours this person will work?
- Will the worker devote full time hours to your business?
- Do you determine the order or sequence in which the worker's tasks are performed?
- Is the worker required to submit regular oral or written reports?
- Do you pay the worker's business expenses?

Method Of Payment

- Do you provide this person with hourly, weekly, daily, monthly or other regular periodic payments?

  FURNISHING OF EQUIPMENT

- Is the work being performed on your premises?
- Do you provide the worker with tools, materials, or other equipment?

Right To Terminate Relationship Without Liability

- Do you have an ongoing relationship with the worker?
- Do you have the right to discharge the worker without liability?

The general criteria for determining whether a worker should be considered an independent contractor or employee are as follows:

- Does the worker perform services for several unrelated persons or firms at the same time?

- Does the worker make their services available to the general public on a regular and consistent basis?
- Does the worker realize profit or suffer a loss as a result of his/her services beyond the profit or loss ordinarily realized by employees?
- Does the worker invest in facilities used in performing services that are not typically maintained by employees?
- Will the sale of business assets provide the worker with a gain or recovery?
- If the worker suddenly stops working, is there contractual liability?

Remember, a worker's status is subject to the particulars of the specific work to be performed. While someone may qualify as an independent contractor for one assignment, they may become an employee for the next job. Therefore, you must always re-evaluate the worker's status on regular basis to ensure compliance.

Business Interruption Insurance: A Lifeline for Your Company

A severe property loss, such as damage from a fire or explosion, can cause significant financial hardship. While most companies have property insurance in place to protect themselves against such losses, the income lost during a shutdown can be even more devastating. Without the right coverage in place, the company may suffer a blow from which it will be difficult to recover. Business interruption insurance may be the one thing that keeps the company in business.

The standard business interruption policy promises to pay for business income lost due to a necessary suspension of operations caused by loss of or damage to the business premises. For coverage to apply, the cause of loss must be one the policy insures against, such as fire, lightning, windstorm, or aircraft. It is important to understand that "business income" does not necessarily mean "profits." The policy defines "business income" as the net income (profit or loss before income tax) that the firm would have earned, plus continuing normal operating expenses. Therefore, the policy will not bail out a company that was headed for a period of unprofitability. If the company was expecting a $100,000 loss and continuing expenses (including payroll) of $150,000, the most the policy will pay is $50,000 ($150,000 expenses less $100,000 loss.)

When a loss occurs, the insurer will determine the actual loss the business sustained. To do this, it will examine the company's financial statements for the time periods leading up to the loss. It will determine which costs were fixed, such as debt payments, permits, and salaries. It will also separate out costs directly tied to sales, such as the cost of producing goods not yet produced. Finally, it will calculate the company's expected profit or loss for the period. The sum of expected profit or loss and normal continuing expenses equals the actual loss sustained.

The actual period of the loss may differ from the period the insurer calculates. The insurer will pay for business income lost during the "period of restoration." This period begins 72 hours after the damage occurs to the premises. It ends on the date the damaged property should be repaired, rebuilt or replaced with reasonable speed and similar quality or on the date when business resumes at a new permanent location, whichever is earlier. If the business owner is slow to approve architectural plans or if rebuilding takes longer because the owner decided to make improvements, the insurer will not pay for the entire period of loss. Also, the insurer will reduce the loss period if the company can reasonably take steps to shorten it. These steps might include using temporary facilities, shifting work to undamaged sections of the building, or adding work shifts to make up for lost production.

If the company has to spend extra funds to reduce the amount of lost income, the insurer will cover at least some of them. Examples are additional rent for a temporary location, express shipping charges necessary to get machinery in place sooner, and increased construction costs to hasten the repairs. The insurer will not pay more than the amount of income the company would have lost, and it will only pay for expenses that actually reduce the business income loss.

Many options are available with business interruption insurance, having to do with the length of the recovery period, amounts available each month, required amounts of insurance, and others. To help determine those options that a firm might need, a thorough discussion with an insurance agent is in order. This coverage is too important to a firm's survival for anyone to treat it casually.

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ment may require any new buildings to meet expensive new codes.

The standard business property insurance policy states that the insurance company will pay "actual cash value" -- the cost of replacing the property minus an amount for depreciation. However, it offers the option of valuing a loss at replacement cost without deduction for depreciation. A business that chooses this option will need to purchase the amount of insurance equal to the cost of replacing the building "as is." The company will pay the difference between the actual cash value and the replacement cost only if the property owner actually rebuilds or replaces the property, and then only if he does so as soon as reasonably possible after the loss. The policy also provides a small amount of additional insurance (typically the lesser of five percent of the insurance on the building or $10,000) to cover the increased cost of construction resulting from changes in building codes.

Businesses like the software company, who do not need an exact replacement of their current buildings, should ask their agent about adding a "functional building valuation" endorsement to their policies. It establishes a limit of insurance somewhere between actual cash value and full replacement cost and allows the property owner to replace the building with one that fulfills the same function as the old one at a lesser cost. The discussion with the agent should also include increased "ordinance or law" coverage to provide additional insurance for increased costs from new building codes. With the right attention to detail, a business can get the property insurance it needs without having to waste money on unnecessary coverage.

How Much Liability Insurance Is Enough?

There aren't many activities in life riskier than starting your own business. Two of the biggest risks any business faces are the loss of essential property and personal injury claims. In minor cases, these risks can cause loss of income, but in the worst-case scenario, they can bring your business operations to a screeching halt and force you to close the doors.

Obviously, your success is dependent upon keeping risks and losses to a minimum. Liability insurance helps you lower vulnerability to risk by transferring some or all of the risk responsibility to your insurance carrier. The more risk you can transfer, the less vulnerable you become. That's why it is so important to evaluate your operation frequently to determine where there is potential risk. Through a risk analysis, you consider all possible risks and determine which are the most significant for your particular business.

There are many types of third-party liabilities that businesses should be covered against. In addition to property loss and personal injury, businesses should be protected against claims such as damage to the property of others, allegations of false advertising, and legal liability stemming from employment practices. In the event that a claim is filed against you, liability insurance will provide you with a legal defense. Should the judgment go against you, your liability insurance will pick up the tab for covered damages up to the policy's limits. Keep in mind that liability insurance can also serve as the collateral needed to post an appeal bond. A large award can be potentially reduced or reversed on appeal. Without the ability to post a bond, however, your company will not be able to start the appeal process.

Evaluating your level of risk is a complex issue. Although young companies generally have a low level of liability risk, you should buy coverage with an eye toward the future. This is especially important if you are developing products with the potential to impact a large number of people. The greater the potential impact, the greater the possibility your company will find itself as the defendant in a class action lawsuit. Other factors you need to consider include the size of your company's operations, geographic locations, industry trends, organizational structure, amount of capital at stake, you and your staff's degree of experience and expertise in the field, and any general industry hazards.

Determining the amount of liability coverage you need should be considered a work in progress. As you expand, you will encounter situations that necessitate increasing your coverage. A review of your risk analysis should be done periodically, perhaps at each renewal. You should also review your insurance needs whenever you business changes in size, diversifies into new markets, or relocates.

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