



From: [Architectural Lighting January-February 2013](#)

Posted on: February 15, 2013

professional practice

Preparing for the Unexpected

After last year's superstorm, ask yourself, 'Does my current insurance coverage adequately protect me?'

By [Peter J. Lamont](#)

This past October, the East Coast found itself in the crosshairs of a “perfect storm”—Hurricane Sandy. It brought gale-force winds, flooding, heavy rain, and snow to much of the Eastern Seaboard and the Northeast. While this superstorm was devastating for residents, it also took a significant toll on businesses, including a number of lighting design firms throughout the New York metropolitan area. Some researchers suggest that storms such as Hurricane Sandy are not a fluke, but rather the shape of things to come. Researchers from Princeton University and the Massachusetts Institute of Technology have released findings, published in the February 2012 issue of the journal *Nature Climate Change*, that correlate storm surge impact with climate change. What was once considered the “100-year-storm” could now occur every three to 20 years.

Unfortunately, many business owners affected by Hurricane Sandy did not have adequate or proper insurance, or they failed to fully understand the limits of their policy. With no insurance to cover the damages sustained, some small businesses were forced to permanently shut their doors.

Following a disaster such as this, firm principals should evaluate whether their current insurance policies provide adequate protection and coverage against such catastrophes. If not, they should attempt to maximize their insurance coverage immediately.

Evaluating Coverage

When evaluating the adequacy of a company's insurance, the business's owners must first determine what type of policy is necessary and then determine how much is sufficient. While there are a number of different insurance policies and riders available to businesses, two types of coverage—Property Policies and Business Interruption, which are most often triggered by catastrophic weather—are the policies that most businesses should make sure that they have.

As for the amount of insurance needed, this depends on the content of the premises and the perceived risk. For example, a lighting designer who is seeking to insure a basic office might only need enough to cover his office equipment. But a design firm that has offices and a showroom will likely require more insurance. Ultimately, the amount of coverage needed is something that lighting designers should discuss with their insurance brokers.

Property Policies

Property insurance, which is often part of a commercial general liability policy or business owner's policy, is the most basic type of insurance that a business owner should have to protect his company's property and its contents. Property insurance will generally provide coverage for damaged office furniture and equipment, including computers and hard drives.

But not all property insurance is created equal. Business owners must decide whether they need coverage based on the actual value of their property or the replacement value. In essence, there are two "values" to a piece of property. The first is the actual value—the depreciated, current value of your property. The second value is what it would cost to replace the property if it was damaged due to severe weather or some other unfortunate circumstance. If you cannot afford to replace computers, office equipment, office furniture, and related items, you should opt to insure your property for its replacement value.

Of course, insuring property for its replacement value instead of its actual value will increase your premium. Nevertheless, there may be little benefit to insuring office equipment for its actual value since this value is continually depreciating. For example, assume your property policy provides coverage for the actual value of your business's property, and you have four high-end computers that you paid \$2,200 a piece for 12 months ago. These computers are damaged when the roof leaked during a severe storm. When you submit your insurance claim you may be shocked to find out your high-end computers now only have a value of \$500 a piece, leaving you to make up the difference. But if you insured your office property for its replacement value and the above scenario occurred, you would be reimbursed for the actual cost of buying the same or similar computers.

Business Interrupted

Business interruption coverage is often misunderstood to be a separate policy of insurance, but it is part of a general commercial liability or property insurance policy. In fact, it is rarely, if ever, sold as an individual policy, but rather can be purchased as an "add-on" to an existing business policy.

The purpose of this type of policy is to reimburse the policyholder for income that is lost when an insured event, which leads to loss of property, interrupts his business. The policy is intended to provide the business owner the profit that he would have earned, had business not been interrupted. But remember, the most important point here is that payment on the business interruption insurance policy is only triggered if the interruption is a result of property damage caused by a covered event. So, if your business does not sustain physical damage, you cannot make a claim under the policy.

For example, while many businesses suffered property damage as a result of Hurricane Sandy, many more were forced to close for a number of days because the electricity had been turned off. Many of these businesses submitted claims under their business' interruption coverage only to be denied because they did not sustain physical damage.

In general, business interruption insurance coverage is only triggered in three limited circumstances:

1. There is physical damage to the property, and it is of such magnitude that it causes the business to have to shut down.
2. There is physical damage to other property, caused by a covered event, 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 covered event, and this prevents customers or employees from gaining access to the premises.

It is important to note that even when business interruption coverage is triggered, most policies have a waiting period of several days before the carrier will begin reimbursing lost profits. This coverage is also

not retroactive to the day of the event.

Separately, business interruption policies provide for the loss of net income, temporary relocation expenses, and ongoing expenses such as payroll—enabling a business to continue paying employees instead of having to lay them off. The company must be able to prove, typically by submitting financial statements, all of its business interruption losses. Most policies will then generally continue to make these payments until the business is back up and running—but this usually does not extend beyond 12 months.

While business interruption policies are limited in scope, they are critical to most small businesses. Lighting design firms, especially, should include one of these in their commercial general liability policies. Often, it can be the difference between staying afloat or going under.

Here's an example. As a result of Hurricane Sandy, a design firm in New York City was forced to temporarily shut down its office and small showroom because their building had lost electricity. The firm had property insurance, which included business interruption coverage. During the course of the power outage, pipes located in the unit above the design firm froze and ruptured, which caused a significant amount of water to leak through the firm's ceiling and destroy their office and showroom. The firm's owners immediately contacted their insurance broker and started a claim.

It took more than three months to rebuild the office and showroom, and the event had a major impact on the firm's ability to earn revenue. But because they had business interruption insurance, they were reimbursed for three months of lost profit, as well as their payroll expenses. This allowed the firm to continue operating despite the less-than-ideal circumstances.

It is not enough just to have insurance. You must have the appropriate policies and you must understand each policy's limitations. If your coverage does not include property damage or business interruption insurance, it may be wise to speak with your broker and add it. If you are not sure what your policy covers, speak with an attorney or your broker to obtain the information. Hurricane Sandy should be an important reminder to all business owners to review their current policies and take the steps to make the necessary adjustments. When the next superstorm occurs, you don't want to see the design practice you have worked so hard to build be put in jeopardy.

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