

## The ABC's of Rental Value Insurance

By John B. Berringer and R. Mark Keenan<sup>1</sup>

September 11th and its aftermath have confirmed that, more than ever, companies must focus on—and understand—the contours of their insurance programs. One potential avenue of insurance protection often purchased as an extension of “business income insurance” is “rental value” insurance.

### *What does Business Income Insurance Cover*

With business income insurance, the insurance company agrees to pay for “actual loss” of “business income” that the policyholder sustains due to the suspension of “operations” during a period of “restoration”. In order for the loss to be covered, the suspension generally must result from physical loss or damage to the policyholder’s property caused by a covered loss.

As one court put it, business income coverage “is designed to do for the insured in the event of business interruption caused by [a covered loss] just what the business itself would have done if no interruption had occurred . . . .”

### *Rental Value Insurance*

The Business Income policy defines rental value as including anticipated rental income from tenants *and* charges that are legally required to be paid by tenants which otherwise would have been the legal obligation of the landlord—for example, real estate taxes and electrical charges. Rental value also includes the fair rental value of the portion of the premises occupied by the insured.

There generally are three options concerning rental value coverage:

- Rental Value Only
- Business Income without Rental Value coverage
- Rental Value and Business Income

The third alternative is most appropriate for a landlord that owns and operates out of an office building and also rents to other tenants. The Business Income insurance would pay for the landlord’s loss of business income from its own operations, while the rental value coverage picks up the tab for the lost rental income from the other tenants.

Business income and rental value coverage are often the subject of litigation between the policyholder and the insurance company. Not surprisingly, the greater the claim, the greater the likelihood the insurance company will fight—despite the merits of a policyholder’s claim.

There are two areas which often are the subject of disputes: (1) the “actual loss” sustained by the policyholder, and (2) the appropriate period of “restoration”.

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### Actual Loss

The primary factor in adjusting a business interruption loss is the actual experience of the policyholders business. In *Eastern Associated Coal Corp. v. Aetna Casualty & Sur. Co.*, the Third Circuit Court of Appeals calculated the actual loss sustained "... by determining the receipts of the [policyholder's] operation before the interruption and extrapolating future receipts from this figure in light of the business circumstances of the insured's business during the period of interruption."

Alternatively, the policyholder can purchase "valued" business insurance coverage which will pay an agreed amount for each day that the business is interrupted.

### Period of Restoration

The period of restoration is typically defined as beginning on the date when physical damage is sustained and ending on the date on which the damaged property could be repaired or replaced "with reasonable speed and similar quality". This is a theoretical period which could be shorter or longer than the actual period of interruption.

As an example, if the tenants of an office building cancel their leases after an electrical fire, the policy will cover the lost rental income only during the period of restoration. If it takes a longer period for the landlord, i.e. after restoration, to rent out the building to the occupancy level that existed before the fire, the policy will not cover the losses suffered after physical restoration.

It should not be a great surprise that insurance companies will often argue for whatever period, "actual" or theoretical, is the shortest. In one case, *Beautytuft, Inc. v. Factory Ins. Ass.*, the insurance company argued that the shorter "actual" period should apply because the policyholder had used substitute buildings and equipment. The court disagreed, holding that a policyholder's use of substitute facilities does not terminate the period of interruption and, if losses continue after the use of substitute facilities, coverage is mandated for those losses.

### Conclusion

Business income and rental value insurance provides a critical part of a company's total insurance protection. As with all insurance claims, preparation is key in order to fully support and document all the requisite components of your business interruption claim. ■

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