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Dependent Property Exposures

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The Institutes

Planned shopping malls typically have one or more major retailers serving as anchor stores to provide tempting shopping experiences to prospective customers and to draw retail traffic to the smaller, specialized shops located within the mall. Because the smaller shop owners depend on the anchor stores' viability for their own commercial success, how can they protect their businesses from losses caused by, for example, an anchor closing for an extended period of time after sustaining significant damage from a serious fire?

This scenario provides only one example of a dependent property exposure. A dependent property exposure is the possibility of an organization incurring business income loss or extra expenses because of physical loss occurring at the premises of some other organization that the first organization does not own or control. The other organization might be a key supplier, an important buyer, or an anchor in a mall that includes several smaller stores.

These dependent property exposures (also called contingent business income exposures) can often be overlooked when assessing net income loss exposures. Risk management professionals must carefully consider how damage to the property of others can affect an organization, particularly because these loss exposures are not as obvious as business income loss resulting from damage to the organization's own property.

Insurance for contingent business income loss exposures may include any of three endorsements to standard ISO forms. The first two endorsements can be attached to either the Business Income (and Extra Expense) Coverage Form or the Business Income (Without Extra Expense) Coverage Form. The third endorsement can be attached to the Extra Expense Coverage Form.

- **Business Income From Dependent Properties—Broad Form** (CP 15 08). This endorsement is used when the insured wants the same limit that applies to business income loss resulting from damage at its own premises to apply to business income loss resulting from damage to other properties as well.
- **Business Income From Dependent properties—Limited Form** (CP 15 09). This endorsement is used when separate limits are preferred. It is also used when the insured wants coverage only for dependent property exposures.
- **Extra Expense From Dependent Properties** (CP 15 34). This endorsement modifies the Extra Expense Coverage Form to apply to dependent properties. Because the preceding endorsements do not include extra expense coverage, an insured that wants extra expense coverage for dependent properties must purchase the coverage separately. Some independently developed forms offer combined business income and extra expense coverage for dependent properties, which is preferable from an insured's viewpoint.

Each endorsement lists the following four types of dependent property:

1. Contributing locations—Deliver materials or services to the insured. These do not include utility services, which can be covered under another endorsement nor does it apply to Internet or network access.
2. Recipient locations—Receive products or services from the insured.
3. Manufacturing locations—Manufacture products for delivery to the insured's customers under contract of sale.
4. Leader locations—Attract customers to the insured's business.

The amount of insurance for dependent properties should be selected based on analysis of the business income and extra expense losses that could arise from damage or destruction of the locations on which the insured is dependent.

The insured should also consider noninsurance risk management techniques. For example, an organization that is dependent on a key supplier could develop additional sources of supply or stockpile parts supplied by others.

The dependent property endorsements cover business income losses resulting from suspension of the insured's operations because of physical loss of or damage to the dependent property described in the endorsement schedule. The dependent property must not be owned, controlled, or operated by the insured. If it is, an unmodified business income form, arranged on a blanket basis, is appropriate.

The choice between broad form and limited form depends on whether the amount of insurance needed is equal to the total amount of business income insurance. If it is, as might be the case when a leader location is key to providing traffic for the insured's business, broad form may be the better choice. For most insureds, the dependent property exposure will be less than the business income exposure and therefore the limited form may be less expensive; however, it may be necessary to calculate the rate for both forms to determine the better choice.

The endorsement does not require that operations at the specified dependent location be completely shut down. An insured's loss of profit, loss of revenue, or incurred extra expenses resulting from physical loss occurring at the premises of some other organization outside the control of the insured determine coverage. If a total shutdown at a contributing property has no effect on the insured's business, there would be no coverage.

The endorsement limits compensation to the actual loss of business income necessarily sustained by the insured during the period of restoration, which is the amount of time required, with reasonable speed and similar materials, to repair or replace the *damaged dependent property*. Coverage does not apply when the only loss to dependent property is loss or damage to electronic data (including corruption or destruction).

In today's global economy, many organizations source goods and services from different locations around the world. To recognize this growing global expansion of US businesses, ISO has developed dependent properties forms that provide international coverage: Business Income From Dependent Properties Limited International Coverage (CP 15 01) and Extra Expense From Dependent Properties Limited International Coverage (CP 15 02).

With the international endorsements, the insured must select a specific limit for contributing locations or manufacturing locations. The endorsements provide no option to cover recipient locations or leader locations. The selected causes of loss—basic, broad, or special—as well as any endorsements supplementing or restricting the covered causes of loss applying to these coverages must be indicated on the endorsement's schedule (or on the declarations page).

Arthur L. Flitner, CPCU, ARM, AIC, is Sr. Director of Knowledge Resources at the American Institute for CPCU and Insurance Institute of America (the Institutes) in Malvern, Pennsylvania. The material in this article is primarily based on Commercial Property Risk Management and Insurance, a textbook for the Chartered Property Casualty Underwriter (CPCU®) program Flitner co-wrote with Jerome Trupin, CPCU, CLU, ChFC, a nationally recognized expert on commercial insurance and principal of Trupin Insurance Services. Material in this article is also covered in the Associate in Risk Management designation program, which, along with the CPCU program, is among the Institutes' numerous educational offerings. The Institutes are independent, not-for-profit organizations offering educational programs, professional certification, and research to people who practice or have an interest in risk management and/or property-casualty insurance.

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