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Watch Your Step — Insurance Pitfalls Threaten Even the Strongest Turnaround Strategy

BY HARVEY TOPITZ, CPA

Insufficient insurance coverage can be the undetected landmine in a turnaround strategy. Harvey Topitz explains that relying on Certificates of Insurance or Declaration Pages to ensure complete insurance can expose the business — and the turnaround professional — to liabilities presented by endorsements, exclusions and omissions. In short, the large print giveth and the small print taketh away.

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Bill Buckner was an accomplished major league baseball player — an All-Star who amassed 2,700 hits during his career and earned the reputation of a quality fielder. Yet on October 25, 1986, while playing for the Boston Red Sox in Game 6 of the World Series, Buckner committed what has become one of the most famous errors in sports history, allowing a routine groundball beneath his glove at first base when an out would have won the deciding game for the Sox. The New York Mets went on to win the game and then the Series in Game 7. Bucker's infamy has lasted and even widened, as this spring — 26 years later — a group of students in Kenya reenacted the play.

In 1962, the Mariner 1 space probe was launched by NASA for a trip to Venus. The probe quickly veered off course and just 294 seconds into its flight was destroyed — at a cost of more than $18 million. The cause of the failure is believed to have been an oversight in transcription of a handwritten computer code, with a necessary overbar or hyphen omitted. No one noticed the minor — but crucial — detail.

Insurance coverage can be just such a weak seam, yet insurance is often overlooked by turnaround managers that are not trained in this arena. Too often turnaround managers rely on a Certificate of Insurance or a Declaration Page to verify that insurance is in force before moving on to more pressing concerns.

As Buckner and NASA discovered, you are only as good as your last play and the devil is in the details. This is a sobering message for turnaround professionals asked to right a floundering ship taking on water through several gaping holes. The turnaround expert is adept at taking charge of the crew, rescuing the passengers and saving the ship by both plugging the ruptures and setting a new course. Yet it may be just a weak seam held together with rusty rivets that eventually dooms the voyage.

Insurance coverage can be just such a weak seam, yet insurance is often overlooked by turnaround managers that are not trained in this arena. Too often turnaround managers rely on a Certificate of Insurance or a Declaration Page to verify that insurance is in force before moving on to more pressing concerns.

Yet a Certificate of Insurance or Declaration Page does not tell the whole story of an insurance policy. Missing from these documents are the endorsements, exclusions and omissions that truly define the level of coverage a business will have in the case of an event. As such, it is endorsements, exclusions and omissions that might leave a company — and a turnaround professional — exposed.

In short, the large print giveth and the small print taketh away.

Death by Endorsement

Consider these scenarios of endorsements or exclusions in effect within a property and casualty or liability insurance policy that might spell disaster for a business and result in its inability to remain a going concern following a problem.

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Acme Lighting Company — Acme Lighting rents a warehouse for storage and rotation of inventory that is the company's lifeblood. The Declaration Page of its policy shows the building and its contents are insured for flooding but the endorsements within the policy exclude flood zones A & V, in which the warehouse is located. As a hurricane slowly moves along the East Coast, rain pelts the area for eight consecutive days. The ground cannot absorb all the rain and the warehouse floods, damaging the building and destroying the inventory. Due to the endorsement, Acme has no coverage for the damages.

Better Building Construction — Better Building employs subcontractors on many of its projects. The company's Certificate of Insurance shows liability coverage that requires all subcontractors to have their own $1 million in liability coverage. Yet an endorsement in the policy requires subcontractors' coverage and at least $1 million limits are in place at the time of any claim against Better Building for the coverage to be in force. If a subcontractor is not sufficiently covered even after a job is completed and a claim comes in, Better Building is not covered due to the endorsement.

Comfortable Living Apartments — Comfortable Living owns and operates three apartment buildings. The Certificate of Insurance shows the buildings are covered for damage under the company's property and casualty policy. Thieves break into the buildings and steal the copper tubing, causing severe damage. The P&C policy has an exclusion for theft. Not only is the loss of the copper pipes not covered, but the damage caused by the theft is excluded, as well.

Turnaround professionals are excellent at their profession … Yet they are not insurance experts … By turning to an insurance specialist to review policies and their details, turnaround managers can identify and remedy these exposures in coverage and focus on those areas where their skills are most in need.

Delicious Delights Bakery — Delicious Delights has been in business for 35 years. The bakery has a fire that significantly damages the building, which new town ordinances require to be rebuilt to meet current codes. While the Declaration Page of the bakery's insurance policy shows coverage for fire damage, an exclusion removes coverage for updated town or state building codes. Delicious Delights falls flat.

Such endorsements, exclusions and omissions are common and commonly missed by non-insurance experts, even the most experienced turnaround professional. They often are in place simply due to an oversight by the business owner or insurance broker.

But not always. Distressed companies rarely bring in a turnaround expert until their situation is dire. Prior to the turnaround manager's arrival the business likely will have looked for ways to cut expenses. In fact, *Business Insider* lists focusing too much on savings as #3 in its Top 10 Reasons Businesses Fail.

Insurance offers short-sighted businesses a plethora of opportunities to cut costs. For example, a business may opt to move from a Special Risk policy that provides broad coverage to a basic policy that excludes many situations. A bowling alley with a roof that collapses from the weight of snow would have damage to its equipment covered under a Special Risk insurance policy but likely not under a basic policy. When faced with the option of closing its doors or living without an insurance net, very often the business will opt for the latter and hope for the best.

Yet if the worst comes after a turnaround manager has been brought in, he or she is now exposed.

Pitfalls of Peril

The list of potential insurance pitfalls that await a turnaround professional when taking a new assignment is both long and complicated. However, in addition to those cited above some of the endorsements and exclusions typically not listed on a Certificate of Insurance or Declaration Page might include:

- High Deductibles — Perhaps one of the first things a business owner in distress will do is direct the broker to cut insurance costs. One way to reduce premiums is by raising deductibles. Can the business survive if a claim payment does not come close to covering the loss?
- Damage that occurs as a result of rain, snow and hail — This is a very dangerous exclusion!
- Classification Limitation — Providing coverage of only operations specifically listed on the policy. So a commercial builder trying his hand in residential construction is exposed.
- No flood coverage at all – Think Las Vegas, located in a desert. Who needs flood insurance?
- Business Interruption, including extended period of indemnity — Going back to Delicious Delights, even if it can afford to rebuild, where will the money come from during the six months it is closed in addition to the six months it will need to rebuild clientele after opening?
- Valuation clauses for replacement cost versus depreciated value — A commercial printer has presses that are 40 years old and valued after depreciation at a fraction of what replacement presses will cost. The definition of Replacement Cost is "New For Old."
- True umbrella policy versus simply an excess liability policy — Are the 18- and 19-year-olds driving the company delivery vans sufficiently covered? An excess general liability policy does not sit over the auto and workers compensation polices like an umbrella would.
- Estimated versus actual revenue — If a policy is based on projected sales of $400,000 as reported by the business while actual revenues are $1.4 million, the company faces an audit and substantial charge from the carrier.

Turnaround professionals are excellent at their profession — taking a business in distress, evaluating its value and turning it around to allow the company to not only remain a going concern but once again thrive. They are able to uncover inefficiencies, manage change and repair a company's culture and devise and implement a business plan that turns a downward spiral into an ascending pathway.

Yet they are not insurance experts. By relying on Certificates of Insurance or Declaration Pages to ensure a business has sufficient insurance in force, they leave themselves exposed to the liabilities presented by endorsements, exclusions and omissions that in the event of a problem or disaster can threaten the company's ability to remain a going concern.

By turning to an insurance specialist to review policies and their details, turnaround managers can identify and remedy these exposures in coverage and focus on those areas where their skills are most in need. abfj

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