

Staying in Business after a Loss

Surviving with business interruption insurance

Cash is King especially when you don't have any coming in. All companies large and small require cash flow to stay in business. They do not last long without a healthy cash flow. That's why a business "interruption" is so dangerous. Whether it's minor, such as a lightning strike that shuts down production for a day, the theft or destruction of essential Equipment, or major, such as a lengthy labor strike, a business interruption not only reduces income, but also simultaneously creates new expenses. The key to surviving a business interruption is to restore normal operations as quickly as possible. Insurance plays a critical role.

Business interruption insurance

Even if an interruption is caused by another party's negligence or other wrongful conduct, most businesses don't have the luxury of waiting for a settlement or court judgment. Business interruption insurance can replace lost income and cover extraordinary expenses, such as the cost of repairing a building or replacing damaged equipment, while management focuses on getting back to business as usual.

When a business interruption occurs, you should quickly establish the magnitude of the loss, review the scope of coverage under your business interruption policy to see what's covered, and put together an aggressive, but reasonable, claim.

Most policies require the insured to file a detailed "proof of loss" within a short period (30 days, for example) after a loss occurs. Then, after a preliminary review, the insurance carrier makes an initial estimate of the loss and establishes a loss reserve. Once this reserve is set, it can be difficult to convince the carrier to accept a larger claim, so make sure you document your losses as accurately as possible.

Estimating damages with a reasonable degree of accuracy in the early stages also demonstrates to the carrier that you're acting in good faith and supports requests for advance payments from the carrier — a boon for your company's cash flow. Throwing out a large number just to get something on paper and then filling in the blanks later is rarely effective.

Stake your claim

Make sure you get financial advisors involved soon after the loss occurs. The insurance company's experts have no incentive to interpret the facts in the insured's favor, so it's up to your experts to educate the carrier about the nature of your business and the financial impact of the business interruption.

Most policies reimburse the insured for some form of "lost business income," but regardless of how that term is defined, there's room for interpretation. Even an insured's method of accounting can have a significant impact. If its financial statements are prepared using the cash method, for example, the carrier's first impulse might be to calculate the loss on that basis. But the insured's financial experts may be able to demonstrate that the accrual method more accurately reflects its damages.

One of the biggest challenges in putting together a business interruption claim is establishing the insured's lost income. Insurers tend to focus on a company's track record to project what its revenues would have been but for the interruption. A financial expert who's familiar with the business and its industry may be able to point to certain factors — such as industry trends, market changes or company-specific developments — that indicate a higher level of growth going forward.

Determining your continuing and non continuing costs is another critical issue. Most business interruption policies compensate the insured only for the former. In other words, to calculate recoverable lost income, you'd take lost sales and then subtract non continuing costs. Continuing costs aren't subtracted because they're incurred despite the business interruption.

Suppose, for example, that a labor strike causes a manufacturer to shut down production for a month. Variable costs – which increase or decrease with the level of production – would be avoided during the interruption period and, therefore, wouldn't be reimbursed. But fixed costs, such as rent and other overhead, would continue. To make the manufacturer whole, therefore, these costs shouldn't be subtracted in determining its recoverable loss.

Mitigating the loss

The insured's duty to mitigate its loss is an area that's ripe for controversy. Although there are many actions a company can take to limit its damages, not all of them are reasonable. For example, you might be able to reduce your company's loss by laying off salespeople or other staff. But that may not be a smart move if the business interruption is relatively short, the cost of hiring replacements when normal operations resume is high, and the loss of experienced staff would hurt your company in the long term.

Make sure you address these issues early in the process, and educate the insurer about the costs and other implications of various mitigation strategies.

Establishing the loss period

The period of time that your business's operations are interrupted is also critical to measure. That's because you're entitled to recover business income you would have earned during that period but for the interruption.

A typical definition of the loss period is the "length of time that would be required with the exercise of due diligence and dispatch to rebuild, repair or replace" the damaged property. Some policies provide (or have been interpreted by the courts to provide) extended coverage, allowing a business to recover losses beyond the time it takes to restore the property to its original condition.

Whatever the policy's terms, a financial expert with relevant business experience can help you estimate and document an appropriate loss period.

Assessing the damage

To survive a business interruption, you need to move quickly to estimate the losses and put together a persuasive, well-documented insurance claim. Because this requires you to establish the business's lost income and extra expenses during the interruption period, the assistance of financial experts with experience calculating lost profits damages can be invaluable.

As with everything, doing your research ahead of necessity is key to success. Consult with your professional advisors now.

Your Insurance Protection Program must reduce your insurance costs while providing you piece of mind. A multi-layered protection approach works best:

- 1) Loss control
- 2) Risk Management/Risk Transfer
- 3) Insurance coverage (the ultimate backstop)

Richard Gaynor
CIC, CRM, President

(973) 383- 5525 Ext.220

(973) 383- 9602 Fax

rgaynor@middletonins.com

www.middletonins.com

**"How you make your money is YOUR Business.
How you protect it, is OUR Business!"**