



Business Interruption: Case Example and Lessons Learned

by Chris Hamilton, CPA, CFE, CVA, DABFA

It was a spectacular scene. At 5:30 in the morning a large two-story building right next to a southern California freeway was fully engulfed in flames. Within minutes, news organizations had converged and the morning drive-time on the radio was full of the details of a fire that was visible for miles. It was one of those strip mall buildings with restaurants and other retail operations on the ground floor and office space upstairs. Because of the ferocity of the flames and the speed at which the fire spread, the arson investigators were called to the scene right away. Their conclusion led to the arrest of the restaurant owner. The investigation showed that the restaurant had been struggling financially and the owner decided that cashing out his fire insurance policy was a great way to get out of financial trouble. That didn't work so well for him or the many other tenants.

The business immediately upstairs was a highly successful and busy mortgage loan broker that employed nearly 50 people in the affected location. One can imagine the volume of paper in that place of business as well as the importance of the paper. Of course, paper is highly flammable and, consequently, in the aftermath of the fire, less than 50 intact sheets of paper were recovered. None of the hard drives survived. Everything either burned or melted. It was a fire that defined devastation both for the business owner and for clients who were in various stages of purchasing or refinancing a home.

Recovery for the loan business began within hours of the fire. New office space was leased, computers purchased and networked, furniture rented, real estate agents contacted to enlist their assistance in informing the clients and replacing the documentation, and off-site data backups restored. What unfolded was a remarkable example of the indomitable spirit of a small business owner who refused to allow such a significant setback to kill his business. But, he had not yet begun dealing with the insurance company. And that would prove to be a process that almost caused him to close the doors of his business. The business owner often said in the next three years that what the arsonist could not do, the insurance adjuster almost did.

The business owner cooperated in every way with the adjuster from the insurance company. Even in the midst of a hectic recovery operation, time and office space was provided to the adjuster. The initial conclusion by the adjuster shocked the policy owner; the adjuster was claiming that virtually nothing was due for lost business and extraordinary expenses incurred to get the business operational again. Three years after the fire, the business owner realized that an attorney must be hired. Shortly after that a forensic accounting firm was retained to re-create accounting records that had been lost in the fire and to calculate lost earnings and extraordinary expenses as defined by the insurance contract. Two years after retaining the law firm, the insurance company finally settled (without trial) at a sum many times higher than their best offer to the policy owner. While it was a big win for the business owner it came at a very high cost of time, effort, and grief. And the "big win" was simply getting the insurance company to pay what they should have been paid under the contract. However, without the work of the law firm and the forensic accounting firm, the owner would not have received his due from the insurer.

Lessons Learned

While this story is certainly not unique or extreme, it does provide some simple lessons about business interruption and the use of outside experts to achieve a fair settlement.

- Review your business interruption insurance policies now – before a disaster strikes. The review should be done by either an attorney experienced in business interruption insurance or a forensic accountant that has experience reading insurance contracts and calculating damages. Such a review can reveal potential problems should a disaster happen. An ounce of prevention is worth a pound of cure ...



- In the event of a disaster, consider getting legal representation quickly. We all have an idealistic hope that the insurance company is a partner in protecting the business. And they are ... until they are called upon to write checks, in many cases. Then it becomes an arms-length business relationship and treating it other than that rarely produces a good result.
- Depending on the size of the loss, a forensic accounting firm should also be retained to do a calculation of damages under the contract definitions. Of course, in the case of destroyed accounting records, the forensic firm is also valuable in assisting in re-creating records. Most insurance policies will cover the cost of the outside accountants.
- There should be close cooperation between the law firm and the forensic accounting firm. While nobody wants to initiate litigation, a good forensics firm understands that is a possibility and does their work as if it is a strong probability.
- The financial expert that is retained in the damage recovery phase should be smart, sharp, experienced in reading insurance contracts, cooperative with the attorney, and on top of all of that – very personable. An initial attitude of mortal combat by the forensic accountant sets a tone that is very difficult to overcome later on and presents hurdles that are unnecessary. The forensic expert should be experienced in communicating with adjusters (who are often CPAs retained by the insurance company) in a way that is firm, clear, and not provocative.
- Emotional communication is not persuasive communication in the world of insurance settlements. The financial expert should have communication skills that are reflected in rational and reasonable conclusions that are based on the contract and facts. Reports must be done in a way that the readers (insurance company personnel and their counsel) can re-create the results independently of the forensic accountant.
- Finally, the financial expert should be able to think outside the parameters established by the adjusters. Many adjusters have been handed a formula and are simply hired to determine the inputs to the formula. Sometimes, the formula is faulty and does not reflect what the contract actually says. The forensic accountant should be able to identify when that is the case and make their case accordingly.

Business interruption matters are never a pleasant experience. Insurance is a vital element of the recovery from a disaster. The use of experts to facilitate the insurance reimbursement is often necessary to arrive at a fair and reasonable conclusion.

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