



Planning and Conducting a Management Interview

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Relating to a Business Interruption Claim (Part II of II)

It remains unclear whether business interruptions caused by the current novel Coronavirus pandemic will be covered under business interruption insurance policies because insureds and insurance companies are still arguing whether the pandemic and/or related state and/or local government shutdown orders qualify as “physical damage.” While litigation on the issue has begun, at the time of authoring this article, no courts have made a final decision on that question. The purpose of this two-part article is to consider the nature, timing, and extent of the information and/or documentation that logically should be gathered by a client with a potential claim in preparation for a detailed working meeting with the practitioner engaged to prepare that loss. Part I focused on the documents that should be gathered by the client. In Part II, the author considers the range of likely questions that the practitioner will ask of the client during that management interview.



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companies are still arguing whether the pandemic and/or related state and/or local government (civil authority) shutdown orders qualify as “physical damage.” While litigation on the issue has begun, at the time of authoring this article, no courts have made a final decision on that question.

The purpose of this two-part article is to consider the nature, timing, and extent of the information and/or documentation (documents) that logically should be gathered by a client (the client) with a potential claim in preparation for a detailed working meeting with the practitioner engaged to prepare that loss claim (the management interview). Part I, previously published, focused on the documents that should be gathered by the client. Part II will consider the range of likely questions that the practitioner will ask of the client during that management interview.

The practitioner should ask if the claim might arise solely from events covered by the client’s business interruption policy. The practitioner may collaborate with the client’s legal counsel to obtain an understanding of all the client’s commercial property insurance policies. The claims might relate to general liability, workers compensation, event cancellation, directors and officer’s liability, and/or errors and omissions insurance, besides business interruption insurance. The practitioner should inquire as to any “*force majeure*” defenses the client may raise regarding any breaches of contract (which defenses contemplate a justification for unforeseeable circumstances outside the client’s control that may have prevented the client from fulfilling a certain contract). Perhaps the client received a reduction or deferment of a portion of their lease?

The practitioner should obtain an understanding of the duration of the claim—what triggered coverage, when was it triggered, what is the beginning and ending point of the claim? What if the ending point has not yet been reached? What was/is the expected period of restoration? Assuming coverage, most business interruption policies pay for the actual loss of business income that the client sustained due to the necessary suspension of its operations during the period of restoration —terms defined by the business interruption policy.

Was the suspension of operations caused by direct physical loss of or damage to the property—at what premises? Was there a “waiting period”? Does the business interruption loss end when the insured’s business operations resume, whether at the same or a functionally equivalent location? Could the client resume full or partial business operations at another location? Has the business not reopened, reopened only partially, or reopened but doing a reduced amount of business? Is that current reduced amount of business due to ongoing civil authority regulations or due to a general level of reduced business activity?

Business interruption insurance policies generally require the interruption of business operations to be the result of a direct physical loss of or direct physical damage to property. The crucial issue that business owners will face when making a pandemic-related claim will hinge on whether the novel Coronavirus constituted a direct physical loss or direct physical damage to property. It is anticipated that carriers may deny coverage based on the argument that the novel Coronavirus has not caused any physical loss or damage to the client’s property. However, there might be possible theories of recovery for businesses who are making claims. Practitioners should obtain an understanding of the theory of the claim (some theories discussed below), discuss these during the management interview, and tailor the claim accordingly.

One possible claim theory is that actual physical damage to property can be made by things such as gases, odors, and substances that are not visible to the human eye. Other claim theories could be based on the

assertion that actual physical damage does not necessarily have to be physical damage to the property but can be damages from loss of use of property. Another potential claim theory is that the business has lost its ability to function. The client might be pursuing a broad scope covered by an all risk policy generally that might cover situations where a civil authority prohibits access to the insured premises. This was the purpose of asking the client to gather all stay-at-home orders that might have resulted in its temporary closing.

Business interruption coverage operates to compensate the insured both for losses during the period of actual business interruption and lost profits, loss of earnings, and continuing expenses during the period of restoration of the property. Practitioners should, therefore, discuss with management how long it might take the client to have the business restored; a tough ask in the current pandemic environment. Ordinarily, the claim ends after the period of restoration—but possibly, in the current pandemic—which might mean when the civil authorities allowed use of the property.

That still may leave the client with a far lower level of revenues due to overall reductions in the growth of the economy as a whole or a loss of client/customers due to business closures. That may not be part of the claim. Therefore, unlike other forms of lost profits calculations, additional lost income coverage is unavailable for losses occurring after the restoration period even if revenues and/or profits are not restored.

Another difference between lost profits calculations and claim calculations is the possibility that the insurance carrier has a maximum limit of insurance coverage. During the management interview, the practitioner should inquire as to these limits (including for the obvious reason that the calculated claim should not exceed such maximum limit of insurance coverage). The typical commercial policy might set the maximum amount that the insurance carrier may be obligated to pay. The practitioner should inquire if that maximum amount is per event, per claim, per period, or lifetime. It is possible that the business interruption insurance policy limits the number of lost days that could be claimed and that, in turn, would set the maximum dollar amount of the claim.

An important part of the management interview revolves around the lost revenues. The practitioner should review the revenue trends of the business and inquire as to the business' historical level of revenues to determine the projected revenues that would have been earned during the interrupted periods. Sales performance records should be discussed, as well as seasonality in revenues. Data regarding revenues in the trailing 12 months preceding the business interruption may be more relevant than data regarding revenues for the last full calendar year or average sales per month. The practitioner should inquire if the client is a new business without a history of revenues. The practitioner should inquire if there is sufficient economic and financial data, market surveys, financial analysis, and business records to estimate lost revenues but for the pandemic's interruption of revenues.

During the management interview, the practitioner may wish to explain to the client (and/or legal counsel) that there are four commonly accepted methods used to gather evidence to support and estimate lost revenues (the "before-and-after" method; the "yardstick" method; the "sales projection" method; and the "market model" method) and that discussion, in turn, may enable the practitioner to identify the most relevant and reliable method for the claim (the practitioner may end up using one of these methods or a combination thereof). The practitioner may have difficulty comparing the client's loss experience to internal and/or external benchmarks if those too are impacted by the pandemic.

An important part of the management interview revolves around multiple issues relating to saved/avoided and/or extra expenses. Do the expenses of the business include the business owner's non-business expenses? Did the owner(s) reduce/eliminate salaries during the period of the business interruption? Did the client continue to pay its workers even though there were little or no revenues? Did the client participate in the Paycheck Protection Program (PPP)? (If the client anticipates that the PPP repayment will be forgiven—having been used to pay payroll, all other criteria being met—an argument could be made that is other income/reduced payroll costs within the claim period.)

Did extra expenses include more than the normal costs associated with the normal conduct of business? Were these extra expenses incurred to minimize or mitigate the covered business interruption loss? Were any extra expenses incurred after the period of recovery? Were any extra expenses for costs that would have been incurred to conduct the business had no loss occurred. Is there a difference between avoided costs and incremental costs?

The management interview should cover the issue of mitigation. Generally, the client has a duty to minimize its losses, meaning taking all reasonable steps to limit a loss. The practitioner may wish to obtain an understanding why the client failed to take measures to protect the business from all its losses—if that is what happened. It is possible, especially in the earliest days of the pandemic, that the client did not have knowledge of the full extent of the dangers of and/or responses to the novel coronavirus—or civil authorities prohibited entering the premises.

Post-pandemic, some client businesses will simply never reopen and, therefore, the pandemic has caused the destruction of that business. Trade associations in New York City are estimating that significant numbers of New York City restaurants have closed permanently due to the pandemic. Clearly, there will be no “period of restoration” for those types of claims.

In claims where the business has been interrupted so significantly that it ceases to exist (and/or where its value has changed significantly due to the pandemic), the appropriate claim measure might be ascertained by performing a business valuation (based on say one day prior to the impact of the pandemic). Again, this is an area where business valuation practitioners can bring a significant amount of value to determining the amount of a claim.

A business valuation involves assigning a value to a financial asset for which there is either no market or a limited market available to value it. Some courts have provided guidance when such business valuation is the appropriate measure for the destruction of a business; as opposed to lost profits approach. The practitioner will need to establish during the management interview the valuation date and whether the practitioner is determining fair market value (willing buyer, willing seller, each being fully informed of the relevant facts, and neither under a compulsion to pursue the transaction) or fair value (a legal standard applicable to certain types of valuations more commonly used in state statute).

The insurance company is not simply going to take the client's (and/or the practitioner's) word for the value of the business interruption loss and may not rely solely on spreadsheets of the claim provided. More likely than not, the insurance company (and/or the practitioner it hires to evaluate the claim) will drill down on the claim and seek all the explanations, details, and documents concerning the loss as a condition to paying the claim. These will likely be some of the same questions that should have been contemplated and discussed during the management interview.

Generally, the client has a duty to cooperate by producing documents relevant to the claim. In turn, that may well mean that the practitioner's work, analyses, and files may be scrutinized in detail; including but not limited to the discussions that took place during the management interview(s). Accordingly, the practitioner should be mindful to memorialize such management interview in a manner that withstands later valid detailed scrutiny.

Preparing the claim could be time consuming and the client's existing internal and/or external accountants may not have the time and/or depth of experience to prepare these claims. Clients filing claims will need help from both their legal counsel and talented and experienced practitioners to assess the applicability of the provisions and/or exclusions in one or more insurance policies and file claims. The practitioner will be performing detailed financial analyses while legal counsel performs detailed legal analyses. Even if ultimate coverage remains an issue, claims submitted will need to include solid support for the claimed impacts of the business interruption.

The client's claim will need to be supported by solid documentation both as to financial and legal issues. Both the financial and legal analyses may need to distinguish between the financial impacts of a client's voluntary actions versus any involuntary closings mandated by civil authorities. Clients need to prepare claims that carefully follow the insurance policy coverage language and the applicable legal theories. Insurance carriers will be vigorously defending claims both on coverage and claim modeling considerations. Practitioners are uniquely placed to assist clients with these claims and the management interview is a central and vital part of substantiating the reasonableness of the claim.

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