

FOXBORO CONSULTING GROUP, INC.

Valuation and Business Advisors

Business Interruption & Economic Damages Claims for Litigation

Over this past week, we have witnessed severe economic damaging events including hurricane Florence, which struck Wilmington, North Carolina, and the natural gas fire catastrophe which destroyed numerous homes and businesses located in Andover, North Andover, and Lawrence, Massachusetts, all located in the Merrimack Valley of Northeastern, Massachusetts.

We all watched, and were aghast, when Massachusetts Governor Charlie Baker appeared on television at 3:00pm on Friday, September 14, 2018, and do the best he could do, and outline a “recovery game plan” to deal with the circumstances at hand, and we watched the totally hapless response provided by Steve Bryant, the “**so called**” President of Columbia Gas of Massachusetts. **If that individual keeps his job after this complete debacle, one has to call into question the intellectual competence of the Board of Directors of Columbia Gas of Massachusetts.**

If Columbia Gas of MA survives the economic damages lawsuits that are certain to follow, and the Company’s potential for bankruptcy, it will be a miracle. I’m sure heads will roll throughout the Company’s management ranks, for their hapless, inept response to the catastrophe.

When a company is deluged with lawsuits, bankruptcy is one defense strategy typically employed. You may remember that Johns Manville Company (the purveyor of asbestos products) filed for bankruptcy protection in 1982, as an alternative to endless years of fighting costly litigation battles.

When an unfortunate occurrence such as these cause economic and property damages that result in a disruption to a business, some of the loss – usually around 80% - may be covered by Business Interruption insurance. (Coverage for a higher percentage of the loss is available, but is prohibitively expensive.)

It’s a Multi- Stage Process

If you are hit by a business interruption event, of course Job One is to get the business back on track; but as you go through the process, keep in mind that you will need to complete two (2) tasks in order to file your business interruption insurance claim.

1. Document Your Losses and Additional Costs Due to the Interruption

First, you will need to document your casualty losses and your additional costs incurred due to the disruptive event, such as a storm or fire. These losses include uninsured (by other coverage) damage to facilities, equipment, inventories, materials and any other assets; possibly the cost of a

temporary location and associated moving costs (both ways), and a detailed account of all actual and projected expenses, paying special attention to extraordinary expense items that were solely incurred as a result of the business interruption event.

2. Establish Your Lost Income Attributable to the Interruption

And second, you will need to provide a reasonable and credible estimate of what your profit losses were due to the interruption. For this, you should engage an experienced expert witness consultant, such as **Foxboro Consulting Group, Inc.**, who can prepare a reasonable and credible projection, and who can provide testimony at deposition and trial if necessary.

And do not overlook the importance of the possibility of the **expert witness testifying** since many professionals can perform the bean-counting aspect of the job but lack the experience to withstand cross-examination at deposition or in court. It is not as easy as it may seem, and I have seen many competent professionals fall flat on their face testifying due to their lack of experience.

Overview of the Process for Establishing Economic Damages in the Form of Profit Losses

Most business interruption insurance covers losses during the first twelve months after the interruption. Recognizing, establishing and effectively demonstrating reasonable and credible profit losses when filing a Business Interruption Insurance Claim or for litigation, if necessary, requires a holistic comparative view of the damaged business's situation prior to and after the business interruption event, a realistic and reasonable projection of how the damages will affect the damaged business in the twelve-month period, and depending on the terms of the insurance coverage, possibly a net present-value calculation to provide a current damages estimate figure for the twelve-month period.

Let's break it down into its comprehensible components:

Step 1. Establishing the Economic Situation Before the Business Interruption Event.

Step 2. Demonstrating the Most Likely Future Economic Situation Without the business Interruption Event.

Step 3. Defining the Business Interruption Event and Tying it to the Damages It Caused.

Step 4. Establishing the Most Likely Future Economic Situation After the Business Interruption Event.

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Step 5. Demonstrating the Difference Between the Most Likely Future Situation Without the Business Interruption Event and the Most Likely Future Situation After the Business Interruption Event.

Step 6. Calculating the Net Present-Value of the Difference in the Two Projections.

Now, let's take them one at a time:

Step 1. Establishing the Economic Situation Before the Business Interruption Event.

The best way to do this is to establish a financial “snapshot” of the business’s financial situation as it was immediately prior to the business interruption event. This should be easy enough to accomplish by using past financial statements and tax returns.

Trends need to be established so as to reflect how the financial condition has changed year over year to arrive at the present “snapshot,” and that can be accomplished by looking at historical financial statements and tax returns for the three to five previous years before the business interruption event.

Step 2. Demonstrating the Most Likely Future Economic Situation Without the Business Interruption Event.

Having established the past trend that brought the business to the position that it was in immediately prior to the business interruption event, you should then project that same trend into the future so as to establish a realistic and reliable estimate of future financial performance for the twelve month period covered by the business interruption insurance.

The projection only needs to be carried out for the one year period covered by the business interruption insurance unless the coverage covers a longer period.

In addition, if there was any known unusual factor, or factors, present that could positively or negatively impact future financial performance, then that factor, or factors, should be included in the analysis.

Note that the factors had to be known before the business interruption event because the damages calculation will be as of the date of the business interruption event. Otherwise, the factors should be thrown out.

Step 3. Defining the Business Interruption Event and Tying it to the Damages It Caused.

What May Be Covered by Business Interruption Insurance

The business interruption event must be caused by something that is covered by your business interruption insurance policy as a legitimate covered cause. This article is not for the purpose of defining what is and what is not considered a legitimate cause and what is not considered a legitimate cause that is covered by a business interruption insurance policy since there are great variations in coverage from policy to policy; but here are some general guidelines as to factors that result in losses that may be covered:

- One fairly generally found requirement is that the cause of the business interruption must inflict some physical damage to the business that prevents it from operating.
- Or there must be physical damage to other property that would be covered under the company's insurance policy that results in a temporary or permanent impediment or impairment to the physical access to the place of business.
- Or if the government orders an evacuation or possibly a curfew for an area that prevents employees or customers from gaining access to the premises.

It is not uncommon for a business interruption policy to require a waiting period of several days before the business interruption coverage becomes active. Accordingly, the coverage may not be retroactive to the beginning of the loss.

What Typically May Not Be Covered

As stated above, one factor that is fairly common in my experience with business interruption insurance claims is that there must be direct physical damage to the business's facilities in order for business interruption insurance to cover anything. Accordingly, if a business sustained no physical damage but had to close for a period of time due to a lack of electrical power or because of a governmental evacuation order, then its losses may not be covered.

Likewise, business interruption due to flood waters usually are not covered by business interruption insurance but may be covered by flood insurance.

Step 4. Establishing the Most Likely Future Economic Situation After the Business Interruption Event.

This is the same process as described above in Step 2 except that it includes the negative influence of the business interruption event. The number of years projected into the future – typically one year, but check your policy - should be the same as used in Step 2 above. In some

cases, you will have financial statements that clearly reflect the impaired financial performance of the business. In other cases, the business's ability to generate income may go away completely, for example, if a business is forced into bankruptcy or otherwise fails. In those cases, the loss is the present value of the entire income stream projected in Step 2 above.

Step 5. Demonstrating the Difference Between the Most Likely Future Situation Without the Business Interruption Event and the Most Likely Future Situation After the Business Interruption Event.

Once you have established the most likely future income projections before (Step 2) and after the business interruption event (Step 4), the difference in these two projections is the gross amount of the loss for the projection period, not taking time into consideration. That is your base number that you carry forward into the next step.

Step 6. Calculating the Net Present-Value of the Difference in the Two Projections.

This is a mathematical exercise that involves net present-valuing the difference in the two projections (Steps 2 and 4) in order to arrive at an Economic Damages value as of the date of the business interruption event.

Range of Values

It is acceptable to produce an Economic Damages value that is a range of values. Due to the level of judgment and speculation that is involved in estimating Economic Damages, it is sometimes necessary to recognize that a particular factor could just as easily be one figure as another figure. In a case like this, it is acceptable to calculate the future financial performance using both factors, and then state the Economic Damages estimate as a range.

Expert Strategy

If you are involved in litigation that involves Economic Damages due to a business interruption event, then hire a professional that is familiar with business finance, business valuation, and Economic Damages calculation techniques, and that is highly experienced in providing supporting testimony at deposition and at trial. You can be assured that the expert will be questioned thoroughly regarding every step and factor of his methodology.

This methodology of calculating an estimation of Economic Damages is Daubert compliant since it is a nationwide industry standard policy, practice and procedure, assists the trier of fact to understand the evidence or to determine a fact in issue, is widely published and peer reviewed, is generally accepted as an accurate procedure, and is capable of being replicated by another competent professional.

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It is extremely valuable for both sides to engage an Economic Damages expert since usually the Plaintiff's expert will provide an Economic Damages opinion and the Defendant's expert will either provide an alternate Economic Damages estimate or a critical review of the estimate provided by the Plaintiff's expert.

IF YOU FEEL THAT YOU HAVE INCURRED ECONOMIC DAMAGE BEGIN TO ASSEMBLE THE FOLLOWING INFORMATION & DATA:

Business Interruption Documents Request List

"" - Items already received, NA - Not Applicable

Key Information Required

- Production records, sales records, inventory records and payroll records for 3- 5 years before the loss, the period during the loss, and the period after the loss.
- Tax returns for 3-5 years before the loss, and the period after the loss.
- Sales tax returns for 3-5 years before the loss, and the period after the loss.
- Financial statements for 3-5 years before the loss, and the period after the loss.
- General ledgers for 3-5 years before the loss, and the period after the loss.
- Bank statements for 3-5 years before the loss, and the period after the loss.
- Business interruption insurance policies.
- Records of expenses that are necessarily incurred for the purpose of reducing the loss. (Premium portion of overtime, price premiums and extra shipping charges to expedite delivery of replacement machinery, extra shipping charges for inventory, difference between the cost of buying the end product

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from a competitor and the insured's normal variable cost to manufacture)

- Records of incremental costs for alternative production. (Temporary facilities, higher costs of production using alternative methods or facilities, extra freight, premium paid for higher cost of material on subcontracted work)
- Records of expenses needed to continue business operation so that the business will not lose customers during a shutdown. (Relocation costs, overtime pay, added freight charges for quicker delivery of emergency supplies, advertising costs in notifying customers of the relocation)

My CV (please click this link below):

<http://www.foxboro-consulting.com/ronald-j-adams-c-p-a-a-b-v-c-v-a-c-b-a-c-f-f-f-v-s-c-g-m-a/>

About Foxboro Consulting Group, Inc. (click this link below):

<http://www.foxboro-consulting.com/>

Litigation Support Services (please click here below):

<http://www.foxboro-consulting.com/clients/litigation-support-valuation/>

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