NEWS

Business, Interrupted – how should losses be assessed?

13 December 2010 Commercial Disputes

In this article, Michael Axe looks at some of the arguments on quantum that can be put forward by both Claimants and Defendants in Business Interruption claims.

Business interruption claims can arise in a wide variety of situations, sometimes indirectly, such as where a defendant's actions damage the claimant's business reputation and popularity resulting in a loss of customers, and other times more directly, such as when a defendant's actions disrupt the claimant's business by, for example, causing the loss of vital equipment. Whatever the cause of the interruption to the claimant's business, it is likely that the issues to be considered when the parties are attempting to quantify the business interruption claim will be very similar.

The Claimant's Perspective

In a business interruption case the claimant will be trying to make sure that the claim includes all of the losses that have been suffered as a result of the interruption. In very simple terms, the claimant will be trying to assess what its "lost net profits" are, i.e. its lost gross profits less the savings it has made in relation to overheads etc.

The first factor the claimant should consider is any evidence of direct losses, such as lost customers and cancelled orders. These will, of course, be one of the easier losses to prove.

Once these have been considered, the claimant may want to look at the historic performance of the business and any relevant trends, such as steady year-on-year percentage increases in sales. The claimant must, however, always make sure that any claims in this regard are reasonable and realistic – for example, if the business could not have possibly handled the volume of work which the claimant is alleging was lost, then the claim will be doomed to fail to this extent.

The Defendant's Perspective

The defendant will, of course, be looking to challenge the credibility of the losses claimed by the claimant Sometimes the easiest way to do this is to compare the performance of the business prior to the interruption with the level of profits which the claimant alleges were lost during the period of interruption.

Indications that the quantum of a business interruption claim has been inflated/exaggerated include:

a) unexplained decreases in the gross profit percentage (i.e. gross profit divided by sales), as this figure should remain fairly consistent from one year to the next

b) unexplained increases in the total costs as a percentage of sales, as this can be used to deflate net profits

c) as an extension of b) above, unexplained increases the specific expenses (such as salaries, entertainment, leases, and bad debts) as a percentage of sales, as these increases may not be commercially justifiable.

A defendant may also want to challenge whether or not a claimant has made a reasonable effort to "mitigate its loss", for example, by at least making some sales at a lower value rather than no sales at all.

The Wider Context

It is also likely that there are several issues which both the claimant and the defendant will want to look at more closely when assessing whether the business performance forecasts are reasonable. These could include asking the following questions:

- Is the claimant's "marketplace" already saturated, or is there room for the claimant's business to grow?
- How have the claimant's competitors fared during the same period?
- What are the historic/current business trends in the claimant's industry?
- What was the national/local economy like during the period of interruption?
- Were there any factors which were unrelated to the interruption that would have been likely to have affected the business' performance, such as the loss of key personnel, relocations/ refurbishments or increases in external costs?

Ultimately, it will never be as easy to quantify a business interruption claim as it would be to quantify, for example, a claim for repair costs or unpaid invoices, and in many cases, expert assistance from a forensic accountant may be required. However, by considering the issues summarised above, parties may at least be able to form a general view on the likely level of loss arising from a business interruption claim, which could potentially then assist the parties in attempting to reach an early resolution to the dispute without the need for court proceedings or expert witnesses.

For further information on this or any other issue on business interruption, please contact Michael Axe by emailing Michael or by calling him on 08450 990045, or speak to your usual contact in the Commercial Disputes Team.

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