



# **The Chartered Institute of Loss Adjusters**

## **Associateship Examination 2013 (April)**

### **Paper C3**

### **Adjustment of Claims - Business Interruption**

**3½ Hours**

**Maximum Marks 200**

**Answer ALL questions in Part 1 and 2 questions from Part 2.**

*Where appropriate, answers should make reference to relevant case law or statute.*

**PLEASE ENSURE THAT QUESTION NUMBERS ARE ENTERED CLEARLY AND IN FULL ON THE COVER OF YOUR ANSWER BOOK AND IN YOUR ANSWER BOOK.**



**PART 1**  
**ANSWER ALL QUESTIONS**

**QUESTION 1**

a) Explain the difference between Contribution calculated on the Independent Liability basis and Contribution calculated on the Sums Insured basis.

b) The agreed loss is £10,000. The Sum Insured against Policy A is £20,000 and for Policy B the Sum Insured is £50,000. Calculate the Contribution payable by each Policy on the basis of each Insurer's Independent Liability.

c) The agreed loss is £15,000. The Sum Insured against Policy A is £10,000 and for Policy B the Sum Insured is £35,000. Calculate the Contribution payable by each Policy on the basis of each Insurer's Independent Liability.

d) Using the same figures as in b) and c) above, calculate the Contribution payable in each case when using the Sums Insured basis.

**NB IN THE ABOVE EXAMPLES, ALL WORKINGS USED TO CALCULATE THE APPROPRIATE CONTRIBUTIONS MUST BE SHOWN.**

e) You are instructed to deal with a claim for fire damage to commercial premises where the Policy is subject to a 20% Co-Insurance Clause. Explain how this clause would operate when adjusting the claim and why a clause of this type would normally be applied to the Policy.

*(8 Marks for each)*

**40 MARKS**



## QUESTION 2

1. Outline the main provisions of the following legislation and how these would apply to the adjustment of a claim:

- a) Riot (Damages) Act 1886
- b) Rehabilitation of Offenders Act 1974
- c) Water Industry Act 1991
- d) Fires Prevention (Metropolis) Act 1774.

*(20 Marks)*

2. a) Define the term “Fraud”.

*(2 Marks)*

b) You are instructed to deal with a claim for fire damage which has occurred at a retail furniture store. As a result of your initial investigations, you suspect that the claim may possibly be fraudulent. Explain what action you would then take and what recommendations you would make to your Principals.

*(8 Marks)*

3. a) Define the term “Warranty” when applied to an insurance policy.

*(2 Marks)*

b) Explain the effect of breach of Warranty and, in the event of any breach, whether and how different considerations apply to domestic and commercial claims.

*(8 Marks)*

**40 MARKS**



### QUESTION 3

1. In a typical Business Interruption Policy, explain briefly the following terms:

- a) Gross Profit
- b) Suppliers Extension
- c) Additional Increased Costs of Working
- d) Material Damage Proviso.

(12 Marks)

2. When dealing with a claim under a typical Business Interruption Policy, explain briefly what action you would take to mitigate loss of turnover and any possible savings that might be identified in the following scenarios. *Unless otherwise specified, assume that all Sums Insured are adequate. The Maximum Indemnity Period in each case is twelve months.*

a) Fire damage has occurred to a Convenience Store where the stock includes the usual range of fresh products, groceries and confectionery together with alcohol, cigarettes and tobacco. The fire originated in and was restricted to the stock room at the rear of the premises, but the main sales area and stock there was affected by light smoke contamination. Your Principals' Policy also covers all Trade Contents and the Building. The potential interruption period is initially estimated at approximately thirty days.

b) A burst water supply pipe has caused extensive damage to a ladies hairdressing salon located on the ground floor of a three storey building in multiple occupation. The burst pipe was located on the top floor of the building and the escape of water occurred overnight whilst the whole building was unoccupied. Initial estimates suggest that the period of disruption whilst damaged equipment and contents are replaced/repared and the building damage is reinstated will be at least three months. Apart from the Business Interruption element, your Principals' Policy covers all Trade Contents. The Buildings cover is arranged separately by the Landlords.

c) A seaside café accommodated in a detached single storey building is totally destroyed as a result of a gas explosion. The café normally trades between March and November and closes for the winter period from December until the end of February. The explosion occurred in January 2013 whilst the café was closed. Apart from Business Interruption, your Principals' Policy covers all Trade Contents and the Building. Sums Insured are adequate apart from the Building, where the Sum Insured represents only 50% of the Value at Risk on a Reinstatement basis.

(24 Marks)

3. Give two examples only of "consequential losses" that would not normally fall for consideration under a typical Business Interruption Policy.

(4 Marks)

**40 MARKS**



## PART 2

### ANSWER 2 QUESTIONS ONLY

#### QUESTION BI1

The Insured own and operate a manufacturing business. On 1st January 2012, the premises were subject to a serious fire which destroyed the building, stock and machinery. Mitigation involved obtaining and occupying alternative premises on a temporary basis. In May 2012, suitable temporary premises were occupied. The minimum lease period was 24 months. The monthly turnover of the business is summarised below. Turnover excludes VAT. The accounts for the business are also detailed below. In January 2013, the business returned to its original premises which had been fully reinstated. The Insured are tenants in the building in question and only insure Machinery, Stock and Business Interruption under their policy.

Liability was accepted under the Material Damage cover.

Turnover:

	2010	2011	2012
Jan	£ 120,641	£ 152,074	£ 0
Feb	£ 120,702	£ 156,839	£ 0
Mar	£ 115,465	£ 149,311	£ 0
Apr	£ 115,715	£ 144,979	£ 0
May	£ 115,462	£ 142,728	£ 14,523
Jun	£ 118,532	£ 143,573	£ 35,605
Jul	£ 107,691	£ 152,395	£ 100,505
Aug	£ 111,131	£ 152,082	£ 132,003
Sep	£ 114,210	£ 163,971	£ 148,000
Oct	£ 122,312	£ 158,217	£ 159,259
Nov	£ 118,980	£ 166,151	£ 215,181
Dec	<u>£ 125,876</u>	<u>£ 157,043</u>	<u>£ 204,100</u>
	<u>£1,406,717</u>	<u>£1,839,363</u>	<u>£1,009,176</u>

Business Interruption insurance is provided for thus:

Estimated Gross Profit £550,000.

Maximum Indemnity Period 12 months.

Uninsured Working Expenses are defined as Purchases, net of stock movement, Bad Debts.



Accounts for the year ending 31 December 2011

Sales		£1,839,363
Opening Stock	£ 82,500	
Purchases	£1,081,055	
Closing Stock	(£ 78,515)	
Cost of Sales		<u>£1,085,040</u>
Gross Profit		£ 754,323
Payroll & Pension	£ 366,457	
Carriage Costs	£ 37,589	
Other Staff Costs	£ 2,476	
Equipment Hire	£ 8,632	
Equipment Repairs	£ 6,125	
Rent	£ 43,446	
Rates	£ 13,321	
Repairs to Property	£ 4,770	
Office Light & Heat	£ 10,899	
Telephone	£ 2,239	
Security	£ 2,996	
Electricity & Gas	£ 56,051	
Advertising	£ 4,451	
Legal & Professional	£ 2,217	
Bank Charges	£ 9,117	
Audit & Accountancy	£ 1,010	
General Insurance	£ 3,554	
Sundries	£ 9,272	
Bad Debts	£ 4,500	
Depreciation	£ 21,856	
Overdraft Interest	£ 1,115	
Total Costs		<u>£ 612,093</u>
Net Profit/(Loss)		£ 142,230



Costs presented as Increased Costs of Working are summarised below:

Rental charges (24 months) for temporary premises	£100,000
Rates at temporary premises	£ 15,000
Electricity, gas and water at temporary premises	£ 45,000
Fitting out costs for temporary premises	£ 25,000
Under-insurance on Machinery settlement	£ 32,000
Overtime	£ 8,000
Dilapidations on temporary premises at end of lease	£ 18,000
Legal fees in arranging lease at temporary premises	£ 2,500
Loss assessor's fees	£ 19,000
Accountant's fees	£ 3,000
Acceleration of machinery delivery and installation	£ 10,000
Additional transport costs	£ 4,000

1. Using the information above, calculate the Loss of Gross Profit, including your calculation of Increased Cost of Working and savings. In your answer, discuss the reason for the inclusion of the costs within those identified as Increased Cost of Working and savings.
2. What is the relevance of liability being accepted under the Material Damage cover?
3. Delays in resolving settlement can cause cash flow problems for the Insured, especially with their banks reluctant to provide funding in the current environment. Explain how this issue can be addressed, quoting any relevant case law.

**40 MARKS**



## QUESTION B12

The Insured operate a retail business in a rural location. On 1st November 2011, the premises were subject to a flood which rendered the building incapable of occupation whilst it was dried and repaired. In addition to building damage, there was significant damage to contents, including racking, display material and so on. A large quantity of stock was destroyed. Mitigation proved difficult as there were no suitable temporary premises available locally.

Whilst there is competition locally, the Insured also operate two further stores, one to the east and one to the west, approximately 10 miles and 12 miles away respectively. All three stores sell the same product lines.

The monthly turnover of all three businesses, known as X, Y and Z, is summarised below. X is the affected store.

Turnover excludes VAT.

The accounts for the affected business (X) are also detailed below.

The Insured are tenants in the building in question and only insure Contents, Stock and Business Interruption under their policy.

Each store has separate sums insured under the same policy.

The Business Interruption cover for store X is:

Estimated Gross Profit £350,000

Maximum Indemnity Period 12 months

Uninsured Working Expenses are defined as Purchases, net of stock movement, Carriage, Packaging, Bad Debts.

Liability was accepted under the Material Damage cover.





X Turnover		Y Turnover		Z Turnover	
Nov-09	£ 154,000	Nov-09	£ 192,000	Nov-09	£ 108,000
Dec-09	£ 166,000	Dec-09	£ 209,000	Dec-09	£ 116,000
Jan-10	£ 144,000	Jan-10	£ 172,000	Jan-10	£ 101,000
Feb-10	£ 148,000	Feb-10	£ 204,000	Feb-10	£ 100,000
Mar-10	£ 198,000	Mar-10	£ 250,000	Mar-10	£ 122,000
Apr-10	£ 189,000	Apr-10	£ 242,000	Apr-10	£ 124,000
May-10	£ 164,000	May-10	£ 224,000	May-10	£ 113,000
Jun-10	£ 176,000	Jun-10	£ 233,000	Jun-10	£ 113,000
Jul-10	£ 159,000	Jul-10	£ 227,000	Jul-10	£ 104,000
Aug-10	£ 137,000	Aug-10	£ 195,000	Aug-10	£ 106,000
Sep-10	£ 153,000	Sep-10	£ 164,000	Sep-10	£ 103,000
Oct-10	£ 128,000	Oct-10	£ 195,000	Oct-10	£ 115,000
	<u>£1,916,000</u>		<u>£2,507,000</u>		<u>£1,325,000</u>
Nov-10	£ 170,000	Nov-10	£ 167,000	Nov-10	£ 101,000
Dec-10	£ 158,000	Dec-10	£ 185,000	Dec-10	£ 114,000
Jan-11	£ 160,000	Jan-11	£ 176,000	Jan-11	£ 111,000
Feb-11	£ 155,000	Feb-11	£ 208,000	Feb-11	£ 108,000
Mar-11	£ 212,000	Mar-11	£ 258,000	Mar-11	£ 130,000
Apr-11	£ 210,000	Apr-11	£ 191,000	Apr-11	£ 120,000
May-11	£ 200,000	May-11	£ 290,000	May-11	£ 131,000
Jun-11	£ 169,000	Jun-11	£ 217,000	Jun-11	£ 117,000
Jul-11	£ 182,000	Jul-11	£ 216,000	Jul-11	£ 109,000
Aug-11	£ 169,000	Aug-11	£ 218,000	Aug-11	£ 106,000
Sep-11	£ 157,000	Sep-11	£ 177,000	Sep-11	£ 107,000
Oct-11	£ 166,000	Oct-11	£ 230,000	Oct-11	£ 120,000
	<u>£2,108,000</u>		<u>£2,533,000</u>		<u>£1,374,000</u>
Nov-11	£ 0	Nov-11	£ 170,000	Nov-11	£ 111,000
Dec-11	£ 0	Dec-11	£ 190,000	Dec-11	£ 122,000
Jan-12	£ 0	Jan-12	£ 180,000	Jan-12	£ 120,000
Feb-12	£ 0	Feb-12	£ 212,000	Feb-12	£ 116,000
Mar-12	£ 0	Mar-12	£ 265,000	Mar-12	£ 145,000
Apr-12	£ 150,000	Apr-12	£ 192,000	Apr-12	£ 125,000
May-12	£ 185,000	May-12	£ 291,000	May-12	£ 136,000
Jun-12	£ 165,000	Jun-12	£ 219,000	Jun-12	£ 122,000
Jul-12	£ 170,000	Jul-12	£ 216,000	Jul-12	£ 113,000
Aug-12	£ 160,000	Aug-12	£ 218,000	Aug-12	£ 110,000
Sep-12	£ 150,000	Sep-12	£ 185,000	Sep-12	£ 111,000
Oct-12	£ 159,000	Oct-12	£ 235,000	Oct-12	£ 125,000
	<u>£1,139,000</u>		<u>£2,573,000</u>		<u>£1,456,000</u>



Accounts for X for the year ending 31 October 2010

Sales		£1,916,000
Opening Stock	£ 253,000	
Purchases	£ 1,464,308	
Closing Stock	(£ 260,000)	
Cost of Sales		£1,457,308
Gross Profit		£ 458,692
Packaging	£ 3,500	
Carriage	£ 44,167	
Trade Subscriptions	£ 312	
Heat & Light	£ 10,015	
Maintenance	£ 3,314	
Stationery	£ 256	
Travel	£ 281	
Advertising	£ 110	
Motor Vehicle Costs	£ 7,832	
Telephone	£ 2,041	
Rates	£ 20,653	
Rent	£ 62,000	
Insurance	£ 5,576	
Postage	£ 270	
Sundry	£ 75	
Training	£ 165	
Wages	£ 120,200	
Pension	£ 4,054	
Bad Debts	£ 826	
Depreciation	£ 11,581	
Packaging	£ 5,917	
Head Office Costs	£ 50,097	
Total Costs		£ 353,242
Net Profit/(Loss)		£ 105,450

(1) Using the information above, calculate the Loss of Gross Profit, including your calculation of savings. In your answer, discuss the reason for the inclusion of items identified as savings.

(2) How should your answer differ if the cover was on a Gross Profit Sum Insured Basis?

(3) What do you understand by the following clauses in a standard Business Interruption policy?

- i. Other Circumstances clause
- ii. Alternative Trading clause
- iii. Departmental clause

**40 MARKS**



### QUESTION B13

Insurers have appointed you to deal with the business interruption loss following a fire at a furniture manufacturing business. The entire stock of furniture and work in progress was destroyed in the fire as was the Insured's main production machine. Liability was accepted under the Material Damage cover. The incident occurred on 1st June 2011.

The business had only recently been incorporated (in December 2009). Turnover since commencement of the business is shown below. Turnover excludes VAT.

	2009/10	2010/11	2011/12
Jun	£ 0	£ 20,054	£ 0
Jul	£ 0	£ 33,060	£ 0
Aug	£ 0	£ 37,521	£ 0
Sep	£ 0	£ 30,697	£ 12,950
Oct	£ 0	£ 30,399	£ 15,001
Nov	£ 0	£ 15,847	£ 21,999
Dec	£ 22,164	£ 34,350	£ 24,356
Jan	£ 28,345	£ 37,785	£ 27,503
Feb	£ 15,346	£ 22,672	£ 19,555
Mar	£ 16,237	£ 26,746	£ 22,342
Apr	£ 51,197	£ 35,995	£ 26,895
May	£ 14,211	£ 29,997	£ 28,050
	<hr/> <b>£147,500</b>	<hr/> <b>£355,123</b>	<hr/> <b>£198,651</b>



Accounts for the year ending 30 November 2010 are as follows:

Sales		£315,078
Opening Stock	£ 7,111	
Purchases	£158,756	
Wages	£ 77,576	
Carriage	£ 14,506	
Freight	£ 17,001	
Closing Stock	(£ 8,166)	
Cost of Sales		£266,784
Gross Profit		£ 48,294
Packaging		£ 8,500
Rent & Rates		£ 14,106
Utility Costs		£ 24,059
Travelling & Entertaining		£ 823
Printing and Stationery		£ 256
Maintenance		£ 5,451
Bank Charges		£ 172
Bad Debts		£ 2,000
General Expenses		£ 4,591
Depreciation		£ 5,686
Total Costs		£ 65,644
Net Profit/(Loss)		(£17,350)

The Business Interruption cover is:

Gross Profit Sum Insured £100,000

Maximum Indemnity Period 24 months

Uninsured Working Expenses are defined as Purchases, net of stock movement, Carriage Packaging and Freight, Bad Debts.

Costs incurred in accelerating delivery of the replacement machinery were incurred in the sum of £25,000. This brought delivery forward one month over that originally quoted by the supplier.



1. Using the information above, calculate the Loss of Gross Profit including your calculation of Increased Cost of Working and savings. Include a discussion on how Standard Turnover has been calculated and what assumptions have been made regarding the trend of the business.
2. Discuss the economics or otherwise of accelerating delivery of the replacement machinery.
3. The Insured advised that they lost a customer during the interruption and presented a claim for this totalling £75,000 in revenue terms. How should you adjust this item and what steps should you take to establish the legitimacy of this claim?
4. In the claim presentation, the Insured also claimed a higher Rate of Gross Profit (using the policy definition) than that calculated from the only set of accounts available (effectively increasing the Rate of Gross Profit by 5%). What steps should you take to verify the claimed Rate of Gross Profit? What part of the policy allows us to be able to consider this?
5. How would the developments in (3) and (4) above affect the settlement if they were found to be accurate?
6. If the policy was on an Estimated Gross Profit basis, what should your recommendations to Insurers be, to include the settlement calculated in (1) above and taking account of the developments in (3) and (4) above?

**40 MARKS**