



# The Chartered Institute of Loss Adjusters

**Associateship Examination 2013 (October)**

**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**

1. Define the term “fraud” in legal terms and explain how this might arise in relation to an insurance claim for loss or damage to property.

*(10 Marks)*

2. Specify six potential fraud indicators.

*(6 Marks)*

3. Explain with reasoning what recommendations you would submit to your Principals in the following circumstances:

- a) The Insured has submitted a contractor’s quotation for £2000.00 plus VAT for repairing storm damage to the roof of his property. You have approved this quotation and have requested the Insured to send you the contractor’s VAT invoice on completion so that you can then conclude settlement of the claim.

On receiving the invoice, which is for the full amount including VAT, you notice that it does not appear to be prepared in the correct format and does not include the appropriate serial number required for VAT purposes. You contact the contractor who tells you that they have received no instructions from the Insured to carry out the work and have not issued the invoice that has been presented to you.

You then re-attend the Insured’s property with a view to clarifying the position. On arrival you notice that repairs have been carried out to the roof. During the course of further discussion, the Insured admits that the work was carried out by a friend who is a retired roofer for half the total cost originally quoted. This person was not prepared to provide the Insured with any form of receipt for the cash payment and, without such documentation, the Insured was concerned that his claim may no longer have been admissible. He therefore decided to alter the quotation provided by the original contractor to make it appear that this represented an invoice, but he cannot explain why he attempted to claim more than the actual cost he had incurred.

*(8 Marks)*



- b) Following fire and smoke damage, you approve a quotation for decorative work submitted by the Insured for £1500.00. There is no VAT to consider as the contractor is not VAT registered. You request the appropriate invoice on completion of the work to enable you to conclude settlement of the claim.

On receiving the invoice, you note that it appears to be in the same format as the original quotation but has been crudely altered to make it appear to be an invoice. You investigate further and the Insured explains that the work was completed and the contractor did supply an invoice. Unfortunately, it seems that the invoice was inadvertently discarded with some rubbish before it could be sent on to you. The Insured felt rather foolish in requesting a duplicate from the contractor and therefore amended the quotation into an invoice so that the claim could be settled. Enquiry with the contractor confirms that the work was carried out for the agreed amount and that an original invoice was issued to the Insured.

*(8 Marks)*

- c) You are dealing with a theft claim which involves the loss of several items of jewellery. To assist with validation, you request the Insured to obtain a post-loss valuation from a high street jeweller. On receiving this valuation, you notice that the amount allocated for one of the items is £1500.00. The original figure appears to have been altered and, on enquiry with the jeweller, you find that the item was valued at £500.00 and not £1500.00. The remaining items are all correct and have not been altered.

On discussing matters with the Insured, he admits that he altered the valuation. However, he goes on to state that he believed it was legitimate to do so because “you would have inevitably made downwards adjustments to the overall claim” and he was simply attempting to ensure that he would receive what he considered to be a fair settlement.

*(8 Marks)*

**40 MARKS**



## QUESTION 2

(i) Explain, using case law and statute law, the requirement for a “consumer” policyholder to disclose material facts. Within your answer, explain the effect on a claim where non-disclosure arises.

*(20 Marks)*

(ii) Explain, using the principle of indemnity and insurable interest and case law, the correct procedure in the following circumstances:

- a) The Policyholder has smuggled jewellery into the UK which should have been declared. The Policyholder did so knowing that this was a breach of the law. The item is the subject of an insurance claim.
- b) The same circumstances as in (a) above, but this time the Policyholder was not aware of the need to disclose the importation of the goods.

*(20 Marks)*

**40 MARKS**

## QUESTION 3

(i) In the context of an insurance claim, explain the term “salvage”. Detail what action you should take to ensure that the optimum amount is realised to mitigate the extent of the loss.

Explain briefly how salvage should be dealt with in the following scenarios:

- a) Smoke damage has occurred to rolls of stainless steel coil at the premises of steel stockholders.
- b) Light smoke contamination has occurred to the stock of a retail pharmacist including prescription medicines.

*(12 Marks)*

(ii) Explain the term “subrogation”. What action should be taken to protect your Principals’ position when subrogation is likely to arise?

Give two different legal examples and circumstances that might give rise to subrogation when dealing with a property damage claim.

*(12 Marks)*



(iii) Explain the term “stock reconciliation basis” and discuss the circumstances in which it might be appropriate to quantify the loss on this basis, outlining any specific issues and procedures that might be applicable.

*(12 Marks)*

(iv) Calculate the amount payable by Insurers in the following circumstances. Full details of your workings must be shown.

|   |                                 |
|---|---------------------------------|
| Agreed loss of Gross Profit                                     | £100,000.00                     |
| Loss Assessor’s Fees  | £2,500.00                       |
| Accountant’s Fees for certifying turnover at adjuster’s request | £500.00                         |
| Sum Insured on Gross Profit                                     | £300,000.00 (Declaration Basis) |
| Insurable Amount  | £400,000.00                     |

*(4 Marks)*

**40 MARKS**



**PART 2**  
**ANSWER 2 QUESTIONS ONLY**

**QUESTION BI - 1**

The Insured is a firm of accountants. On 1st January 2012 their premises were subject to serious water damage which rendered the building unusable. A significant quantity of the books and records belonging to the Insured's clients were destroyed including their own records relating to these clients.

The mitigation strategy was two-fold. Firstly, the staff used their own homes as temporary offices whilst alternative premises were sought. The second part of the strategy was to obtain suitable temporary premises whilst their own premises were dried out and repaired.

In June 2012, suitable temporary premises were found and occupied following a period of fitting out. The minimum lease period was 12 months.

The monthly turnover of the business is summarised below. Turnover excludes VAT. The accounts for the business are also detailed below. The Insured owns the building in question and insures Buildings, Contents, Clients' Records and Business Interruption.

Liability was accepted under the Material Damage cover.

Turnover:

|     | <b>2010</b>      | <b>2011</b>      | <b>2012</b>      |
|-----|------------------|------------------|------------------|
| Jan | £ 81,000         | £ 91,000         | £ 1,000          |
| Feb | £ 75,000         | £ 75,000         | £ 10,000         |
| Mar | £ 76,000         | £ 75,000         | £ 12,000         |
| Apr | £ 79,000         | £ 80,000         | £ 12,000         |
| May | £ 72,000         | £ 75,000         | £ 14,000         |
| Jun | £ 70,000         | £ 71,000         | £ 15,000         |
| Jul | £ 85,000         | £ 80,000         | £ 55,000         |
| Aug | £ 76,000         | £ 81,000         | £ 60,000         |
| Sep | £ 79,000         | £ 78,000         | £ 65,000         |
| Oct | £ 81,000         | £ 82,000         | £ 70,000         |
| Nov | £ 70,000         | £ 70,000         | £ 70,000         |
| Dec | £ 94,000         | £ 94,000         | £ 95,000         |
|     | <u>£ 938,000</u> | <u>£ 952,000</u> | <u>£ 479,000</u> |



Business Interruption insurance is provided for thus:

Gross Revenue sum insured £500,000

Maximum Indemnity Period 12 months

Additional Increase in Cost of Working £25,000.

Accounts for the year ending 31 December 2011

|                      |   |                 |
|----------------------|---|-----------------|
| Turnover             |   | £952,000        |
| Overheads:           |   |                 |
| Salaries             | £ | 606,000         |
| National Insurance   | £ | 72,720          |
| Equipment Hire       | £ | 5,600           |
| Rates                | £ | 35,000          |
| Repairs to Property  | £ | 5,070           |
| Office Light & Heat  | £ | 12,899          |
| Telephone            | £ | 4,539           |
| Advertising          | £ | 14,450          |
| Legal & Professional | £ | 6,200           |
| Subscriptions        | £ | 12,000          |
| Bank Charges         | £ | 5,177           |
| Audit & Accountancy  | £ | 10,090          |
| Insurance            | £ | 12,054          |
| Sundries             | £ | 3,775           |
| Bad Debts            | £ | 2,500           |
| Depreciation         | £ | 3,956           |
| Overdraft Interest   | £ | 2,155           |
| Total Costs          |   | <u>£814,185</u> |
| Net Profit/(Loss)    |   | £137,815        |



Costs presented as Increased Costs of Working are summarised below:

|   |          |
|---|----------|
| Costs of setting up employees' homes for remote working | £ 22,000 |
| Rent charges (12 months) for temporary premises         | £120,000 |
| Rates at temporary premises                             | £ 25,000 |
| Electricity, gas and water at temporary premises        | £ 15,000 |
| Fitting out costs for temporary premises                | £ 25,000 |
| Under-insurance on Buildings settlement                 | £ 52,000 |
| Under-insurance on Contents settlement                  | £ 2,000  |
| Under-insurance on Clients' Records settlement          | £ 12,000 |
| Staff time in recovering records and contents           | £ 18,000 |
| Dilapidations on temporary premises at end of lease     | £ 25,000 |
| Legal fees in arranging lease at temporary premises     | £ 2,500  |
| Directors' time dealing with claim                      | £ 19,000 |
| Additional accountants to recreate clients' records     | £ 24,000 |
| Additional accountants to assist existing accountants   | £ 42,000 |

1. Using the information above, calculate the loss to include 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.  
(30 marks)
2. Explain the benefits of Additional Increase in Cost of Working cover.  
(2 marks)
3. How would the settlement differ if the cover was on an Estimated Gross Revenue basis?  
(5 marks)
4. Discuss the difference between cover afforded under a Gross Revenue cover and that under a Gross Profit cover. Discuss the benefits of each and under what circumstances you would choose either of the two covers.  
(3 marks)

**40 MARKS**





## QUESTION BI-2

The Insured operates a recreational paintballing business at three separate locations within a large city. On 1st September 2011, one of the premises was destroyed by fire. In addition to building damage, there was significant damage to contents and a large quantity of consumable stock was destroyed. Mitigation proved difficult as there were no suitable temporary premises available locally, although the other venues opened for longer hours.

At each site, the Insured charges customers for hire of weapons and body armour and paintball ammunition is purchased by customers as needed. A charge is made to customers for hiring the premises. All bookings are on a group basis. In addition, each location has a café and gift shop.

The monthly turnover of all three venues, known as Zone 1, Zone 2 and Zone 3, is summarised below. Zone 1 is the affected location.

Turnover excludes VAT.

The accounts for the business are detailed below.

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

The Business Interruption cover is as follows:

Gross Profit sum insured £600,000

Maximum Indemnity Period 24 months

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

Liability was accepted under the Material Damage cover.

There is a cessation of rent clause within the lease for Zone 1. Rent for each of the three venues is £30,000 per annum.



Increased Costs of Working have been presented as follows:

|                        |         |
|------------------------|---------|
| Overtime at Z2 and Z3  | £22,000 |
| Additional advertising | £10,000 |

Turnover for the years ending 31 August:

|             | Z1       | Z2       | Z3       |
|-------------|----------|----------|----------|
| <b>2010</b> | £190,000 | £230,000 | £165,000 |
| <b>2011</b> | £196,000 | £237,000 | £165,000 |

|        | Z1<br>Turnover  | Z2<br>Turnover  | Z3<br>Turnover  |
|--------|-----------------|-----------------|-----------------|
| Sep-10 | £ 14,000        | Sep-10 £ 12,000 | Sep-10 £ 18,000 |
| Oct-10 | £ 16,000        | Oct-10 £ 29,000 | Oct-10 £ 16,000 |
| Nov-10 | £ 14,000        | Nov-10 £ 12,000 | Nov-10 £ 11,000 |
| Dec-10 | £ 18,000        | Dec-10 £ 24,000 | Dec-10 £ 10,000 |
| Jan-11 | £ 18,000        | Jan-11 £ 20,000 | Jan-11 £ 12,000 |
| Feb-11 | £ 19,000        | Feb-11 £ 22,000 | Feb-11 £ 14,000 |
| Mar-11 | £ 14,000        | Mar-11 £ 24,000 | Mar-11 £ 13,000 |
| Apr-11 | £ 16,000        | Apr-11 £ 23,000 | Apr-11 £ 13,000 |
| May-11 | £ 19,000        | May-11 £ 27,000 | May-11 £ 14,000 |
| Jun-11 | £ 17,000        | Jun-11 £ 15,000 | Jun-11 £ 16,000 |
| Jul-11 | £ 13,000        | Jul-11 £ 14,000 | Jul-11 £ 13,000 |
| Aug-11 | £ 18,000        | Aug-11 £ 15,000 | Aug-11 £ 15,000 |
|        | <b>£196,000</b> | <b>£237,000</b> | <b>£165,000</b> |

|        |            |                 |                 |
|--------|------------|-----------------|-----------------|
| Sep-11 | £ 0        | Sep-11 £ 24,000 | Sep-11 £ 20,000 |
| Oct-11 | £ 0        | Oct-11 £ 32,000 | Oct-11 £ 18,000 |
| Nov-11 | £ 0        | Nov-11 £ 18,000 | Nov-11 £ 13,000 |
| Dec-11 | £ 0        | Dec-11 £ 25,000 | Dec-11 £ 12,000 |
| Jan-12 | £ 0        | Jan-12 £ 22,000 | Jan-12 £ 15,000 |
| Feb-12 | £ 0        | Feb-12 £ 23,000 | Feb-12 £ 17,000 |
| Mar-12 | £ 0        | Mar-12 £ 29,000 | Mar-12 £ 14,000 |
| Apr-12 | £ 0        | Apr-12 £ 24,000 | Apr-12 £ 14,000 |
| May-12 | £ 0        | May-12 £ 28,000 | May-12 £ 17,000 |
| Jun-12 | £ 0        | Jun-12 £ 20,000 | Jun-12 £ 17,000 |
| Jul-12 | £ 0        | Jul-12 £ 18,000 | Jul-12 £ 14,000 |
| Aug-12 | £ 0        | Aug-12 £ 18,000 | Aug-12 £ 17,000 |
|        | <b>£ 0</b> | <b>£281,000</b> | <b>£188,000</b> |



Accounts for the business for the year ending 31 August 2011 are as follows:

|                   |            |            |
|-------------------|------------|------------|
| Sales             |            | £ 598,000  |
| Opening Stock     | £ 13,000   |            |
| Purchases         | £ 256,698  |            |
| Closing Stock     | (£ 10,000) |            |
| Cost of Sales     |            | £ 259,698  |
| Gross Profit      |            | £ 338,302  |
| Wages             | £ 53,500   |            |
| Salaries          | £ 104,767  |            |
| Heat & light      | £ 15,001   |            |
| Maintenance       | £ 5,915    |            |
| Stationery        | £ 500      |            |
| Advertising       | £ 55,000   |            |
| Telephone         | £ 2,041    |            |
| Rates             | £ 30,000   |            |
| Rent              | £ 90,000   |            |
| Insurance         | £ 5,576    |            |
| Postage           | £ 270      |            |
| Bad Debts         | £ 227      |            |
| Depreciation      | £ 1,000    |            |
| Total Costs       |            | £ 363,797  |
| Net Profit/(Loss) |            | (£ 25,495) |

1. Using the information above, calculate the Loss of Gross Profit to include your calculation of Increased Cost of Working and savings. In your answer, discuss the reason for the inclusion of these items. (25 Marks)
2. How would your answer differ if the cover was on an Estimated Gross Profit basis? (5 Marks)
3. Discuss what potential options Insurers could consider to protect themselves from under-declarations of Gross Profit where the cover is Estimated Gross Profit. (5 Marks)
4. What do you understand by the following clauses in a standard Business Interruption policy?
  - i. Alternative Trading clause
  - ii. Departmental clause(5 Marks)

**40 MARKS**



### QUESTION BI-3

Insurers have appointed you to deal with the business interruption loss following a fire at a major shopping centre. The Insured operate a hotel near to the shopping centre. Fortunately, none of the Insured's premises was damaged in the fire. The incident occurred on 1st November 2012.

Due to the extent of the damage to the shopping centre, the police cordoned off the entire area for a period of two weeks and there was no access to the shopping centre or to the hotel. Following the removal of the cordon, the shopping centre re-opened partially to allow the undamaged stores to trade. It was reported that, following re-opening, business in the shopping centre was down on pre-fire levels.

Turnover of the business is shown below and excludes VAT.

|     | <b>2010</b>     | <b>2011</b>     | <b>2012</b>     |
|-----|-----------------|-----------------|-----------------|
| Jan | £ 52,000        | £ 42,000        | £ 45,000        |
| Feb | £ 38,000        | £ 33,000        | £ 35,000        |
| Mar | £ 60,000        | £ 45,000        | £ 50,000        |
| Apr | £ 45,000        | £ 40,000        | £ 42,000        |
| May | £ 59,000        | £ 50,000        | £ 55,000        |
| Jun | £ 49,000        | £ 45,000        | £ 46,000        |
| Jul | £ 45,000        | £ 34,000        | £ 40,000        |
| Aug | £ 40,000        | £ 37,000        | £ 37,000        |
| Sep | £ 51,000        | £ 41,000        | £ 45,000        |
| Oct | £ 53,000        | £ 46,000        | £ 52,000        |
| Nov | £ 65,000        | £ 59,000        | £ 0             |
| Dec | £ 75,000        | £ 70,000        | £ 28,050        |
|     | <u>£632,000</u> | <u>£542,000</u> | <u>£475,050</u> |



Accounts for the year ending 30 December 2011 are as follows:

|                     |            |                 |
|---------------------|------------|-----------------|
| Sales               |            | £542,000        |
| Opening Stock       | £ 27,100   |                 |
| Purchases           | £138,706   |                 |
| Payroll             | £107,580   |                 |
| Laundry             | £ 44,605   |                 |
| Closing Stock       | (£ 28,500) |                 |
| Cost of Sales       |            | <u>£289,491</u> |
| Gross Profit        |            | £252,509        |
| Rates               | £ 34,100   |                 |
| Utility Costs       | £ 74,059   |                 |
| IT Costs            | £ 22,000   |                 |
| Printing/Stationery | £ 2,256    |                 |
| Advertising         | £ 25,500   |                 |
| Telephone Charges   | £ 14,650   |                 |
| Management Charge   | £ 25,000   |                 |
| Insurance           | £ 15,500   |                 |
| Maintenance         | £ 11,001   |                 |
| Bank Charges        | £ 6,175    |                 |
| Bad Debts           | £ 500      |                 |
| General Expenses    | £ 4,195    |                 |
| Depreciation        | £ 10,500   |                 |
| Total Costs         |            | <u>£245,436</u> |
| Net Profit/(Loss)   |            | £ 7,073         |

Additional advertising costs totalling £7,500 were incurred to promote the re-opening of the hotel.

The Business Interruption cover is:

Denial of Access £25,000

Loss of Attraction £50,000

Maximum Indemnity Period 3 months

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



1. Using the information above, calculate the Loss of Gross Profit to include your calculation of Increased Cost of Working and savings. Include an explanation on how Standard Turnover has been calculated and what assumptions have been made regarding the trend of the business.

(25 Marks)

2. In relation to wider area of damage and loss of attraction, detail the recent legal case *Orient Express Hotels Ltd v Assicurazioni Generali SpA (2010)*.

(5 Marks)

3. What factors should be taken into account when considering whether a cost ranks for inclusion as an Increased Cost of Working?

(5 Marks)

4. In relation to misrepresentation explain the Court's findings in the legal case *Synergy Health (UK) Ltd v CGU Insurance Plc (2010)* and its relevance regarding business interruption claims.

(5 Marks)

**40 MARKS**