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The Chartered Institute of Loss Adjusters

Associateship Examination 2014 (October)

Paper C3

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.

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PART 1
ANSWER ALL QUESTIONS

QUESTION 1

1. Define the term “Warranty” when applied to a policy of insurance. (4 Marks)
2. List four warranties that might apply to a typical Commercial Policy and two warranties that might apply to a typical Domestic Policy. (6 Marks)
3. Explain briefly the effect of breach of warranty, both in relation to a claim under a Commercial Policy and a claim under a Domestic Policy. (10 Marks)
4. What advice and recommendations should you provide to your Principals in the following circumstances:

The Insured, Mr A, has a portfolio of ten buy-to-let properties, all of which are terraced houses dating from the 1900s, in different areas of an industrial town. Your Principals provide Buildings Cover for all the properties, each of which is separately specified under the Policy. The Policy stipulates, amongst other things, that only “professional lets” are covered, references should be obtained for prospective tenants, each property should be inspected at least every two months and also damage caused by persons lawfully on the premises is excluded.

Mr A manages the portfolio himself and does not employ agents. He is normally diligent in obtaining references from potential tenants and ensuring they are suitable. However, on this occasion, this particular property had been occupied for three years by Mr T who had always been a good tenant. Since he was leaving the area to work elsewhere, he asked the Insured whether a friend of his, Mrs C, could take over as the new tenant. The Insured had met Mrs C on a number of previous occasions when visiting the property and understood that she was employed as a social worker. She seemed to be a respectable individual and could also take up occupation as soon as Mr T left so Mr A agreed that she could become the new tenant, particularly since she could pay six months’ rent in advance. A tenancy agreement was completed on this basis.

Two months later, Mr A called at the property to carry out the normal routine inspection. He had previously attempted to contact Mrs C by telephone to arrange the necessary appointment but without success. Since he was in the area, he decided to make a speculative visit but Mrs C was not at home and he was unable to gain entry. He then wrote to her to arrange a specific appointment for two weeks later. He did not hear from Mrs C but attended there on the appointed date. He then discovered that the front entrance door was temporarily boarded and, on enquiry with neighbours, was told that the Police had recently forced entry and had discovered that the house had been converted into a cannabis factory. The Insured immediately contacted the Police who confirmed these details and also told the Insured that it was suspected that Mrs C had allowed others to use the premises for the cultivation of cannabis. Neither Mrs C nor the other suspects can be traced. In addition, and although the Insured believed that Mrs C was a social worker, it would now appear, from further enquiries that he has carried out, that she worked in an unlicensed bar. The property has sustained significant structural and other cosmetic damage internally following its conversion into a cannabis factory. (20 Marks)

(40 MARKS)



QUESTION 2

1. Discuss the circumstances under which it might be appropriate to evaluate a stock loss using the stock reconciliation method and also comment upon any potential disadvantages of using this method of validation. Explain how the loss would be calculated on this basis (figures need not be included).

(12 Marks)

2. Explain briefly the term “Subrogation” and give one example of how this might arise when dealing with a claim. What initial action should you take once potential subrogation has been identified?

Discuss how the case of Mark Rowlands Ltd v Berni Inns Ltd (1986) impacts upon subrogation.

(14 Marks)

3. In the context of an insurance claim, what do you understand by the term “Salvage” and how should you deal with this if identified during the course of the claim?

(10 Marks)

4. Briefly outline the main features of the following legislation and how they may be relevant to the adjustment of an insurance claim:

- a) Riot (Damages) Act 1886
- b) Hotel Proprietors Act 1956.

(4 Marks)

(40 MARKS)

QUESTION 3

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

- a) Loss of Attraction
- b) Increased Cost of Working
- c) Departmental Clause
- d) Suppliers Extension.

(12 Marks)

2. In the following scenarios, discuss briefly what action, if any, might be considered to mitigate loss of turnover. Unless otherwise stated, your Principals’ Policy also covers the Buildings and Trade Contents, cover is on the sum insured basis, and the maximum indemnity period is 12 months.



- a) Ladies Fashion Retailer. Estimated period of closure three months.
- b) Gentlemen's Hairdresser. Estimated period of closure five days.
- c) Licensed Betting Office. Privately owned and not part of a national chain. Estimated period of closure five days.
- d) Seaside café. Lock-up detached unit not owned by the Insured and occupied by them as tenants. Unit totally destroyed and interruption period not yet established but could potentially exceed the twelve month maximum indemnity period.

(20 Marks)

3. Explain briefly the following terms found in the Standard Fire Policy and how they would apply to the adjustment of a claim:

- a) Reinstatement Memorandum
- b) Public Authorities Clause.

(8 Marks)

(40 MARKS)



PART 2
ANSWER TWO QUESTIONS ONLY

QUESTION BI1

The Insured own and operate a food manufacturing business. On 1st September 2012, the premises were subject to serious fire which damaged the building, machinery and plant and miscellaneous contents. Raw material, work in progress and finished goods stock were also affected to varying degrees. Following some temporary repairs to the building, the Insured were able to continue trading from the premises.

The monthly turnover (by customer) of the business is summarised below. Turnover excludes VAT. The accounts for the business are also detailed below. The Insured are tenants in the building in question and only insure Machinery, Contents, Stock and Business Interruption under their Policy.

There is a cessation of rent clause within the lease with the landlord.

Liability was accepted under the Material Damage cover.

Business Interruption insurance is provided as follows:

Gross Profit sum insured £1,500,000
Maximum Indemnity Period 12 months

The Policyholder decided to include Uninsured Working Expenses as follows:

Purchases (net of stock movement); carriage, packaging and freight; bad debts.

Accounts for the year ending 31st August 2012:

Turnover	£ 2,817,371
Purchases	<u>£ 1,071,413</u>
Gross Profit	£ 1,745,958

Expenses:

Agency labour	£ 189,600
Direct wages and NI	£ 745,475
Carriage	£ 88,341
Miscellaneous	£ 27,706
Office staff costs	£ 170,272
Packaging	£ 56,347
Rent and rates	£ 23,032
Heat, light and power	£ 58,803
Freight	£ 73,281
Printing	£ 14,520



Professional fees	£	9,961
Equipment hire	£	16,653
Maintenance	£	41,009
Bank charges	£	15,250
Depreciation	£	22,335
Bad debts	£	15,000
General expenses	£	9,702
Insurance	£	25,090
Total expenses	£	<u>1,602,377</u>
Net Profit	£	143,581

Historic turnover:

Month	Cust 1	Cust 2	Cust 3	Cust 4	Cust 5	Total
Sep-10	£ 248,961	£ 85,394	£ 47,597	£ 9,800	£ 9,841	£ 401,593
Oct-10	£ 229,435	£ 38,224	£ 70,832	£ 13,674	£ 19,427	£ 371,592
Nov-10	£ 179,696	£ 86,585	£ 41,501	£ 28,055	£ 12,762	£ 348,599
Dec-10	£ 148,645	£ 27,441	£ 15,875	£ 1,627	£ 5,200	£ 198,788
Jan-11	£ 117,880	£ 39,438	£ 29,322	£ 11,715	£ 11,925	£ 210,280
Feb-11	£ 69,256	£ 63,480	£ 49,113	£ 3,942	£ 8,658	£ 194,449
Mar-11	£ 108,553	£ 40,246	£ 60,879	£ 13,977	£ 20,902	£ 244,557
Apr-11	£ 160,561	£ 46,623	£ 47,908	£ 11,744	£ 3,062	£ 269,898
May-11	£ 63,932	£ 91,054	£ 45,727	£ 2,642	£ 8,312	£ 211,667
Jun-11	£ 151,393	£ 59,792	£ 53,789	£ 2,595	£ 7,282	£ 274,851
Jul-11	£ 123,508	£ 40,203	£ 55,032	£ 13,547	£ 26,242	£ 258,532
Aug-11	£ 219,324	£ 26,990	£ 70,832	£ 3,773	£ 15,111	£ 336,030
	<u>£1,821,144</u>	<u>£ 645,470</u>	<u>£ 588,407</u>	<u>£ 117,091</u>	<u>£ 148,724</u>	<u>£3,320,836</u>
Sep-11	£ 251,092	£ 62,352	£ 58,067	£ 1,931	£ 15,897	£ 389,339
Oct-11	£ 158,742	£ 81,986	£ 23,629	£ 15,900	£ 8,796	£ 289,053
Nov-11	£ 185,097	£ 85,047	£ 41,501	£ 5,876	£ 17,337	£ 334,858
Dec-11	£ 103,544	£ 50,395	£ 15,875	£ 1,627	£ 9,504	£ 180,945
Jan-12	£ 100,785	£ 41,025	£ 30,624	£ 5,583	£ 9,983	£ 188,000
Feb-12	£ 70,114	£ 52,695	£ 44,130	£ 4,067	£ 9,758	£ 180,764
Mar-12	£ 196,351	£ 16,042	£ 35,637	£ 10,300	£ 0	£ 258,330
Apr-12	£ 225,798	£ 30,758	£ 16,687	£ 6,672	£ 0	£ 279,915
May-12	£ 261,240	£ 36,235	£ 31,132	£ 6,100	£ 0	£ 334,707
Jun-12	£ 71,344	£ 57,418	£ 29,716	£ 9,422	£ 0	£ 167,900
Jul-12	£ 54,089	£ 56,035	£ 17,652	£ 1,809	£ 0	£ 129,585
Aug-12	£ 16,597	£ 32,650	£ 33,102	£ 1,627	£ 0	£ 83,976
	<u>£1,694,793</u>	<u>£ 602,638</u>	<u>£ 377,752</u>	<u>£ 70,914</u>	<u>£ 71,275</u>	<u>£2,817,372</u>



Turnover during indemnity period:

Month	Cust 1	Cust 2	Cust 3	Cust 4	Cust 5	Total
Sep-12	£ 0	£ 4,300	£ 0	£ 0	£ 0	£ 4,300
Oct-12	£ 0	£ 7,940	£ 0	£ 0	£ 0	£ 7,940
Nov-12	£ 0	£ 13,584	£ 9,501	£ 0	£ 0	£ 23,085
Dec-12	£ 0	£ 16,000	£ 12,830	£ 0	£ 0	£ 28,830
Jan-13	£ 0	£ 40,902	£ 35,808	£ 0	£ 0	£ 76,710
Feb-13	£ 0	£ 30,333	£ 45,973	£ 0	£ 0	£ 76,306
Mar-13	£ 0	£ 27,105	£ 21,406	£ 0	£ 0	£ 48,511
Apr-13	£ 0	£ 20,333	£ 10,555	£ 0	£ 0	£ 30,888
May-13	£ 0	£ 19,015	£ 9,010	£ 0	£ 0	£ 28,025
Jun-13	£ 0	£ 25,010	£ 6,502	£ 0	£ 0	£ 31,512
Jul-13	£ 0	£ 30,001	£ 0	£ 0	£ 0	£ 30,001
Aug-13	£ 0	£ 19,555	£ 0	£ 0	£ 0	£ 19,555
	£ 0	£ 254,078	£ 151,585	£ 0	£ 0	£ 405,663

Increased Cost of Working claim:

Wages and salaries incurred	£745,475
Machinery and equipment hire	£125,000
Temporary building works	£ 15,000
Loss assessors' fees	£ 10,000
Accountants' fees	£ 3,000

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 justification 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. Discuss what mitigation strategies could be adopted in this case to protect turnover and customer retention.
4. Discuss the recent legal case concerning depreciation. What is the relevance of this in terms of adjusting business interruption losses?

Each Question Carries Equal Marks

(40 Marks)



QUESTION B12

The Insured operate a small retail business. On 1st July 2012, the premises occupied by the Insured were subject to a significant fire. The fire damage was such that the premises were not fit for occupation post fire. Building repairs were undertaken by the landlord and following completion the Insured were able to re-occupy the premises in November 2012.

The accounts for the business are detailed below.

The Insured are tenants in the building and insure Tenants Improvements, Contents, Stock and Business Interruption under their Policy.

The Business Interruption cover for the business is as follows:

Gross Profit sum insured	£50,000
Maximum Indemnity Period	24 months

The business insured is that of a retail premises.

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

Liability was accepted under the Material Damage cover.

The accounts for the year ending 30th June 2012 are as follows:

Sales		£62,169
Cost of sales:		
Opening stock	£ 6,500	
Purchases	£26,221	
Packaging	£ 1,243	
Less closing stock	(£12,814)	
		£21,150
Gross Profit		£41,019
Expenses:		
Rates and water	£ 1,469	
Rent	£12,000	
Wages	£12,000	
Insurance	£ 1,500	
Repairs and renewals	£ 1,956	
Accountancy	£ 500	
Credit card charges	£ 311	
Miscellaneous costs	£ 950	
Depreciation	£ 1,200	
		£31,886
Net Profit		£ 9,133



The breakdown of turnover is as follows:

	2011/12	2012/13	2013/14
Jul	£ 7,274	£ 0	£ 3,567
Aug	£ 5,100	£ 0	£ 5,331
Sep	£ 7,451	£ 0	£ 4,021
Oct	£ 6,067	£ 0	£ 4,205
Nov	£ 4,134	£ 234	£ 3,569
Dec	£ 8,290	£ 2,120	£ 5,012
Jan	£ 2,263	£ 2,101	£ 1,022
Feb	£ 2,249	£ 2,124	£ 1,001
Mar	£ 2,907	£ 2,287	£ 1,423
Apr	£ 4,040	£ 1,990	£ 1,523
May	£ 4,956	£ 2,245	£ 1,750
Jun	£ 7,438	£ 2,935	£ 2,699
	<u>£ 62,169</u>	<u>£ 16,036</u>	<u>£ 35,123</u>

Increased Costs of Working were claimed as follows:

Legal costs for assistance with claim	£ 7,500
Acceleration of building works	£ 5,000
Advertising	£ 1,000
Director's time dealing with landlord	£ 1,000
Airfreight of stock from overseas	£ 500
Overtime for re-stocking store	£ 250
Wages	£12,000
Increased overdraft charges	£ 500
Loss of rental income from flat above shop	£ 1,500

1. Using the information above, calculate the Loss of Gross Profit to include your calculation of Increased Costs of Working and savings. In your answer, discuss the reason for the inclusion of items identified as Increased Costs of Working and savings.
2. How would your answer differ if the cover was on an Estimated Gross Profit basis?
3. What do you understand by the following clauses in a standard Business Interruption policy?
 - i. Uninsured Standing Charges clause
 - ii. Departmental clause
 - iii. Alternate Trading clause.

Each Question Carries Equal Marks

(40 Marks)



QUESTION B13

Insurers have appointed you to deal with business interruption loss following a serious fire. The fire occurred at one of their Insured's supplier's premises. The premises in question were badly damaged and the supplier was unable to trade for a time following the incident. The incident occurred on 1st October 2013.

The supplier in question (XYZ Ltd) had been trading with the Insured (ABC Ltd) for a number of years.

The Business Interruption cover is as follows:

Specified supplier: XYZ Ltd Gross Profit £100,000
Maximum Indemnity Period 6 months

Uninsured Working Expenses are defined as:

Purchases, net of stock movement
Carriage, packaging and freight
Bad debts.

Historic turnover generated from XYZ products is as follows:

Oct-11	£	79,512	Oct-12	£	82,793
Nov-11	£	82,025	Nov-12	£	85,381
Dec-11	£	68,827	Dec-12	£	71,788
Jan-12	£	85,546	Jan-13	£	89,008
Feb-12	£	79,784	Feb-13	£	83,073
Mar-12	£	84,167	Mar-13	£	87,627
Apr-12	£	123,782	Apr-13	£	128,495
May-12	£	59,879	May-13	£	62,675
Jun-12	£	129,351	Jun-13	£	134,231
Jul-12	£	104,245	Jul-13	£	108,372
Aug-12	£	80,428	Aug-13	£	83,841
Sep-12	£	77,230	Sep-13	£	80,549
Total		£1,054,776	Total		£1,097,833

Turnover achieved by ABC selling buffer stocks (previously supplied by XYZ) totalled £15,170 in October 2013. All figures exclude VAT.



The accounts for ABC Ltd are detailed as follows:

Turnover	£7,563,000
Purchases	£5,899,140
Gross Profit	£1,663,860

Expenses:

Wages	£389,500
Carriage	£75,630
Warehousing	£27,706
Directors' salaries	£230,250
Rent and rates	£48,000
Heat, light and power	£5,803
Licences	£60,000
Promotions/PR	£125,000
Printing	£14,520
Professional fees	£9,961
Maintenance	£1,000
Bank charges	£5,250
Depreciation	£12,366
Bad debts	£150
General expenses	£2,202
Insurance	£15,090
Total expenses	£1,022,428

Net Profit £641,432

1. Using the information above, calculate the Loss of Gross Profit to include your calculation of savings. Include a discussion on how Standard Turnover has been calculated and what assumptions have been made regarding the trend of the business. What concerns may you have over the rate of gross profit used in the calculation?
2. The Insured advised that a customer of ABC presented a claim to them for their (ABC's customer) lost gross profit as a result of ABC not being able to supply XYZ originated products as a result of the fire. The claim for this totals £75,000 in gross profit terms. How would you deal with this item?
3. Discuss the recent legal case *Orient-Express Hotels Ltd v Assicurazioni Generali SpA (2010)*. What are the implications for business interruption policies?
4. Discuss the recent legal case *Synergy Health (UK) Ltd v CGU Insurance Plc (2010)* and its relevance regarding business interruption claims.

Each Question Carries Equal Marks

(40 Marks)