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# **The Chartered Institute of Loss Adjusters**

## **Associateship Examination 2015 (April)**

### **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**

- a) Explain the difference between Contribution calculated on the Independent Liability basis and Contribution calculated on the Sums Insured basis. (8 Marks)
- b) The agreed loss is £15,000. The Sum Insured against Policy A is £20,000 and against Policy B the Sum Insured is £60,000. Calculate the Contribution payable by each Policy on the basis of each Insurer's Independent Liability. (8 Marks)
- c) The agreed loss is £15,000. The Sum Insured against Policy A is £12,000 and against Policy B the Sum Insured is £35,000. Calculate the Contribution payable by each Policy on the basis of each Insurer's Independent Liability. (8 Marks)
- d) Using the same figures as in b) and c) above, calculate the Contribution payable in each case when using the Sums Insured basis. (8 Marks)

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

- e) You are dealing with a claim for fire damage to commercial premises where the Policy is subject to a 10% 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)

**(40 MARKS)**



## QUESTION 2

a) When dealing with a claim under a typical Business Interruption Policy, what do you understand by the following terms:

1. Additional Increased Cost of Working
2. Denial of Access Extension
3. Declaration Linked Policy
4. All Other Circumstances Clause.

(4 Marks each)

b) Malicious Damage has occurred to a number of lock-up commercial units in an arcade of similar units in a busy suburban area. The damage includes smashed glazing and daubing of graffiti. You are instructed by your Principals to deal with claims for both Material Damage and Business Interruption for three of the units. These are:

1. A takeaway sandwich shop
2. A ladies nail bar
3. An antiquarian bookseller.

Pending renewal of the glazing and removal of debris etc, each of the units is closed for three days following the incident, which occurred after trading hours on a Monday night.

In dealing with the Business Interruption claims, explain what considerations will apply to calculating and validating turnover lost by each of these separate businesses as a result of their premises being closed during this three day period.

(18 Marks)

c) Following fire damage, explain briefly how you would deal with any salvage from:

1. A retail furniture store
2. A ladies clothing retailer.

(6 Marks)

**(40 MARKS)**



### QUESTION 3

a) Explain the following terms:

1. Day One Reinstatement Memorandum
2. Contract Price Clause
3. Professional Fees Clause
4. Appreciation in Value Clause (Escalator).

(4 Marks each)

b) Outline the main provisions of the following in the context of an insurance claim:

1. Party Wall etc Act 1996
2. Consumer Insurance (Disclosure and Representations) Act 2012
3. The Construction (Design and Management) Regulations 2007.

(18 Marks)

c) You are handling a claim for an escape of water in a bathroom. The ceiling has a textured covering and you suspect it may have an asbestos content. Explain what steps you should take to protect Insurer's interest and that of the Policyholder.

(6 Marks)

**(40 MARKS)**



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

**QUESTION BI 1**

Insurers have appointed you to deal with the business interruption loss following a fire at a large audio/visual/technology retailer. The entire stock was destroyed in the fire as were the premises. The incident occurred on 1 January 2013.

Liability was accepted under the Material Damage cover.

Under normal circumstances, products are imported in container loads from China with lead times of up to three months. In order to mitigate the loss, smaller temporary premises were sought and some stock was purchased locally at greater unit cost.

Turnover for the financial year ending 31 December 2010 was £4,305,226.  
Turnover for the financial year ending 31 December 2011 was £4,735,749.  
Turnover for the financial year ending 31 December 2012 was £5,209,324.  
The directors advise that the forecasted turnover for the financial year ending 31 December 2013 was £6,250,000.

Historic turnover is analysed thus:

	2012 (actual)	2013 (forecast)	2013 (actual)
Jan	£ 196,115	£ 378,434	£ 0
Feb	£ 229,533	£ 204,372	£ 0
Mar	£ 534,741	£ 526,867	£ 31,123
Apr	£ 352,708	£ 483,941	£ 108,631
May	£ 382,523	£ 527,030	£ 151,966
Jun	£ 374,830	£ 462,179	£ 200,637
Jul	£ 319,144	£ 447,202	£ 250,727
Aug	£ 467,955	£ 510,546	£ 300,011
Sep	£ 393,763	£ 473,841	£ 359,752
Oct	£ 402,790	£ 565,916	£ 507,856
Nov	£ 715,432	£ 799,773	£ 680,914
Dec	<u>£ 839,790</u>	<u>£ 869,899</u>	<u>£ 695,040</u>
Total	<b>£5,209,324</b>	<b>£6,250,000</b>	<b>£3,286,657</b>



The accounts for the financial year ending 31 December 2012 are as follows:

<b>Turnover</b>	£5,209,324
<b>Cost of Sales:</b>	
Opening stock	£ 456,911
Purchases	£3,216,506
Shop wages	£ 360,530
Agency labour	£ 53,000
Depreciation	£ 35,000
Closing stock	(£ 500,104)
<b>Total Cost of Sales</b>	<hr/> £3,621,843
<b>Gross Profit</b>	£1,587,481
<b>Expenses:</b>	
Staff salaries	£ 100,035
Directors' salaries	£ 200,516
Carriage	£ 468,717
Packaging	£ 90,743
IT costs	£ 50,000
Advertising	£ 195,290
Repairs and renewals	£ 26,225
Telephone costs	£ 2,400
Energy costs	£ 23,609
Stationery/postage	£ 17,045
Sundry	£ 1,000
Audit fees	£ 25,000
Legal fees	£ 15,000
Credit card charges	£ 104,186
Bad debts	£ 3,410
Bank charges	£ 19,008
	<hr/> £1,342,184
<b>Net Profit</b>	£ 245,297

The policy is declaration linked with an Estimated Gross Profit of £1,000,000 and a Maximum Indemnity Period of 12 months. Uninsured Working Expenses are purchases (including stock movement), carriage, packing and freight, and bad debts.



The Increased Cost of Working claim was presented thus:

Shop fitting works at temporary premises	£105,000
Dilapidations on temporary premises	£ 25,000
Rent for temporary premises	£135,000
Temporary warehousing	£150,000
Purchase of a van	£ 14,000
Additional advertising	£ 50,000
Premiums paid for stock purchases locally	£450,000
Overtime	£ 25,000
Director's time handling claim etc	£ 20,000
Wages whilst unable to trade	£ 80,000

- a) Based on the above information, calculate:
- The Rate of Gross Profit.
  - A proposal for settlement of the Gross Profit loss to include a discussion surrounding any trend that is incorporated.
  - A proposal for settlement of the Increased Cost of Working claim with an explanation of the reasons for their inclusion or exclusion.
  - A proposal for what categories of cost could constitute savings and your explanations as to the reasoning behind their inclusion as a savings item.
- b) If the stock loss was settled under a Contract Price Clause, how would this affect your consideration of the Gross Profit loss?
- c) Comment on the adequacy of the Declared Gross Profit and what remedies insurers have in relation to Gross Profit that has been under-declared.

**(40 MARKS)**



## QUESTION BI 2

You are requested by Insurers to handle the business interruption claim for a city centre cafe. The cafe was one of two opened recently by the insured business and was subject to a heavy promotional campaign prior to opening.

On 31 March, there was a riot in the city centre. During the riot, extensive damage was caused to the first cafe that was opened and it was closed subsequently for a number of months. During this time, repairs were conducted and contents items were replaced.

The directors of the business had provided business plans to the bank to secure funding and have presented these to you in support of the claim. Turnover expectations were high given the extent of the promotional campaign, a high profile launch and considerable local media coverage.

Additional amounts were claimed for promoting the re-opening of the business following the repairs (£10,000) and in directors' time dealing with the claim (£14,000).

Some casual staff were laid off, with savings totalling £11,000.  
Rent payments to the landlord were withheld, totalling £20,000.

	Cafe 1			Cafe 2	
	Plan	Actual		Plan	Actual
Jan	£ 45,000	£ 13,849	Jan	£ 35,000	£ 23,109
Feb	£ 90,000	£ 35,000	Feb	£ 50,000	£ 24,123
Mar	£ 95,000	£ 44,500	Mar	£ 55,000	£ 26,150
Apr	£ 90,000	£ 0	Apr	£ 50,000	£ 42,750
May	£ 90,000	£ 0	May	£ 50,000	£ 43,016
Jun	£ 95,000	£ 0	Jun	£ 55,000	£ 43,450
Jul	£ 95,000	£ 0	Jul	£ 55,000	£ 45,875
Aug	£ 95,000	£ 3,358	Aug	£ 55,000	£ 41,619
Sep	£ 90,000	£ 19,151	Sep	£ 50,000	£ 26,735
Oct	£ 90,000	£ 18,793	Oct	£ 50,000	£ 26,835
Nov	£ 90,000	£ 24,751	Nov	£ 50,000	£ 25,500
Dec	£ 100,000	£ 30,000	Dec	£ 60,000	£ 30,491
Total	£1,065,000	£189,402	Total	£615,000	£399,653





Policy cover is as follows:

Gross Profit Sum Insured: £900,000

Maximum Indemnity Period: 24 months

Given that the business is relatively new, no accounts have been prepared yet. The accountants for the Insured have prepared a set of accounts at your request which demonstrates a rate of gross profit of 65%. This exercise cost the business £4,500.

- a) Based on this information, you are requested by insurers to:
  - i) Calculate a settlement figure detailing your assumptions as appropriate.
  - ii) Discuss the problems you think you would encounter in trying to achieve a settlement and how these issues could be addressed.
  - iii) Calculate an appropriate Gross Profit Sum Insured for a 12 month period utilising the budget (plan) data above, detailing any other assumptions you have made.
- b) Assessor's fees and accountants' fees were presented in the sum of £20,000 and £4,500 respectively. Explain how the Business Interruption Policy responds to these costs.
- c) Explain the difference between a Gross Profit Sum Insured basis and a Declaration Linked basis policy. What do you understand by the term 'flexible limit of loss'?
- d) To what extent are Gross Profit losses recoverable following a riot?

**(40 MARKS)**



### QUESTION BI 3

Insurers have appointed you to deal with the business interruption aspect of a loss following a fire at a manufacturing business. All the production machinery was destroyed. Liability was accepted under the Material Damage cover. The incident occurred on 1 October 2013.

It was agreed that subcontracting the manufacturing operation would be the most appropriate way to mitigate the loss. A temporary machine was purchased to assist with some production on site, which the Insured decided they would keep at the end of the Indemnity Period. The machinery that was destroyed has very long lead times.

Turnover for the financial year ending 30 September 2012 totalled £3,200,000. Historic turnover and turnover achieved following the incident are noted below.

	Turnover 2012/13	Turnover 2013/14
Oct	£ 257,550	£ 0
Nov	£ 290,951	£ 41,500
Dec	£ 317,422	£ 82,850
Jan	£ 271,934	£ 75,000
Feb	£ 262,027	£ 65,100
Mar	£ 309,538	£ 85,450
Apr	£ 347,783	£ 88,750
May	£ 295,580	£ 77,550
Jun	£ 196,951	£ 46,500
Jul	£ 235,904	£ 63,100
Aug	£ 251,905	£ 62,950
Sep	£ 296,970	£ 72,300
Total	£3,334,515	£ 761,050

The Insured appointed their own Chartered Loss Adjusters to present their claim, which is as follows:

Policyholder's Loss Adjuster's fees	£20,000
Temporary office accommodation	£15,000
Cost of subcontracting	£650,000
Penalty on late order	£10,000
Manufacturing overtime	£30,000
Capital amount of short-term loan	£200,000
Liquidated damages on late order	£45,000



Interest on short-term loan	£30,000
Accountants' charges	£5,000
Additional transport	£18,000
Directors' costs	£82,000
Temporary machine	£35,000

Subcontract costs were claimed after the Insured's own costs had been deducted.  
No formal claim was presented for loss of Gross Profit.

The accounts to 30 September 2013 show the following:

	£	£
<b>Turnover</b>		3,334,515
<b>Cost of Sales:</b>		
Opening stock	456,000	
Purchases	1,560,975	
Carriage	166,500	
Wages and salaries	825,905	
Repairs	85,000	
Closing stock	(300,000)	
		<hr/>
		2,794,380
<b>Gross Profit</b>		540,135
<b>Expenses:</b>		
Directors' remuneration		10,000
Vehicle lease		10,900
Packing		31,000
Staff salaries		100,120
Travel expenses		3,100
Freight charges		52,500
Advertising		25,000
Depreciation		90,115
Rates		35,000
HLP		90,000
Insurance		20,500
Telephone		7,500
Stationery		5,800
Sundry		1,900
Audit fees		10,000
Legal fees		15,000



Bad debts	15,705
Bank charges	9,950
	<hr/>
	534,090
<b>Net profit</b>	<b>6,045</b>

The policy has a Gross Profit Sum Insured of £700,000 and a Maximum Indemnity Period of 12 months. Uninsured Working Expenses are purchases (including stock movement), carriage, packing and freight, and bad debts.

- a) Calculate settlement of the loss to include loss of Gross Profit, Increased Cost of Working and savings.
- b) What is the relevance of liability being accepted under the Material Damage cover?
- c) How does an Additional Increase in Cost of Working differ from an Increase in Cost of Working?
- d) What factors should be taken into account when considering whether a cost ranks for inclusion as an increased cost of working?
- e) What is the difference between an Accumulated Stocks clause and a Contract Price clause?
- f) Severe cash flow difficulties were experienced by the business following the damage. How can the Policy assist with cash flow following damage?

**(40 MARKS)**