



The Chartered Institute of Loss Adjusters

Advanced Diploma Examination 2017 (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 how the Insurance Act 2015 deals with the following issues:

- i) Breach of Warranty
- ii) Fraudulent Claims.

(25 Marks)

B. Outline the main provisions of the Consumer Insurance (Disclosure and Representations) Act 2012 and explain how these might apply to the adjustment of an Insurance Claim.

(15 Marks)

40 MARKS

QUESTION 2

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 £25,000. The Sum Insured against Policy A is £20,000 and for Policy B the Sum Insured is £50,000. Showing the method of calculation, advise the Contribution payable by each Policy towards the agreed loss.

(8 Marks)

c) Using the same figures as above, and again showing the method of calculation, advise the Contribution payable by each Policy on the Sums Insured basis.

(8 Marks)

d) The insured own a holiday apartment in Spain where they stay on a regular basis. On one occasion, a theft occurs and they submit a claim to your Principals. The Policy covers unspecified Personal Effects with a Sum Insured of £3,000. The claim is in order and is validated at £4,000. Your Principals therefore conclude settlement at £3,000 on the basis of the Sum Insured.

You had previously asked the Insured to provide you with details of any separate Travel Insurance that they may have arranged. Following settlement of the claim, they confirm that a separate Travel Policy is in place and you find that similarly this provides cover for unspecified Personal Effects and with a Sum Insured of £750.

(Continued)



Your Principals wish to know whether any Contribution may be available from the Travel Insurers. What advice do you provide to them?

(8 Marks)

- e) Discuss briefly the potential for Subrogation that may be available in the following circumstances, citing relevant case law and statute as appropriate:

Fire damage has occurred to the Insured's property including both Building and Contents. The fire originated within and spread from the adjoining property. It is known that the occupier of that property is a smoker and the Fire Service have recorded the supposed cause as a carelessly discarded cigarette. At the time of the fire, various family members, some of whom are also smokers, were visiting the neighbour.

(8 Marks)

40 Marks

QUESTION 3

1. In a typical Commercial Policy covering Material Damage and Business Interruption, explain the following terms:

- a) Material Damage Proviso
- b) Increased Costs of Working
- c) Contract Price Clause
- d) 15% Co-Insurance Clause.

(15 Marks)

2. The Insured are suppliers of CCTV and other electronic equipment to trade and commercial users. The stock is packaged in cardboard cartons and stored on shelving in a warehouse owned by the Insured. A burst pipe occurs which saturates the cardboard cartons directly below. You are appointed by Insurers and, following your enquiries, Policy Liability is confirmed. It is accepted that the equipment within the packaging that has been saturated has been rendered a total loss and quantum is evaluated at £7,500.

However, the Insured, with the support of their Brokers, maintain that other packaged equipment adjacent to the area directly affected should also be declared a total loss since there is the risk of malfunction due to ingress of moisture and potential danger to end users.

(Continued)



In such event, the supply of potentially defective equipment might impact significantly upon their commercial reputation and to this end, and even if Insurers concede that this additional equipment can be included within the claim, the Insured would not allow any salvage disposal by way of mitigation. There is no immediate evidence that this additional stock has been damaged, its external packaging exhibiting no signs of water staining or dampness. If the claim for this equipment is admitted, the additional claim costs are estimated at £15,000.

In discussions with the Insured and their Brokers, you have suggested, as a possible solution, specialist random sampling to ascertain whether there is evidence of moisture-related damage. This proposed procedure is, however, not acceptable to them and they would require all the equipment to be checked, which would clearly be uneconomic.

In view of the impasse that has been reached, what recommendations do you submit to your Principals?

(20 Marks)

3. Calculate the amount payable by Insurers in the following circumstances. All workings must be shown.

Agreed Loss of Gross Profit	£50,000.00
Fees of Claimant's Loss Adjusters	£2,000.00
Accountant's Fee for certifying turnover (at Insurers' request)	£500.00
Sum Insured on Gross Profit	£200,000.00 (Declaration Basis)
Insurable Amount	£300,000.00

(5 Marks)

40 Marks



PART 2
ANSWER TWO QUESTIONS ONLY

QUESTION BI1

Insurers have appointed you to deal with the business interruption loss following a fire at a manufacturing plant. Most of the key production equipment was destroyed. The building was relatively unharmed. The incident occurred on 1 January 2016.

Liability was accepted under the Material Damage cover. The sums insured for Machinery were adequate, but all replacement equipment has a lead time of 18 months.

Under normal circumstances, products are manufactured with lead times of up to one month. In order to mitigate the loss, some items of mothballed production equipment were refurbished and brought back into production. Whilst this exercise was completed within a few months, the capacity of the refurbished equipment was much less than that pre-fire. All stocks of finished goods were sold during the month of the fire.

Turnover for the financial year ending 31 December 2015 was £16,222,000.
Turnover for the financial year ending 31 December 2014 was £16,097,000.
Turnover for the financial year ending 31 December 2013 was £14,708,000.

The directors advise that the forecasted turnover for the financial year ending 31 December 2016 was £17,000,000.

Historic turnover is analysed thus:

	2013	2014	2015	2016
	£000	£000	£000	£000
Jan	1,393	1,065	1,448	1,250
Feb	1,438	1,615	1,692	132
Mar	1,373	1,508	1,076	0
Apr	1,066	914	1,019	0
May	738	1,533	1,198	0
Jun	1,659	1,465	1,384	0
Jul	1,189	1,827	1,179	350
Aug	1,463	1,238	1,456	302
Sep	1,181	1,034	1,126	299
Oct	1,089	1,582	1,399	401
Nov	1,092	1,098	1,304	326
Dec	1,027	1,218	1,941	275
	14,708	16,097	16,222	3,335



The accounts for the financial year ending 31 December 2015 are as follows:

	£000
Sales	16,222
Cost of Sales	
Raw Material Purchases	7,233
Stock and WIP Adjustment	263
Direct Labour Costs	2,393
Moulds for Production	612
Total Cost of Sales	<u>10,501</u>
Gross Profit	5,721
Production Overheads	
Indirect Labour Costs	299
Repairs and Maintenance	156
Depreciation	205
Packaging	811
Electricity	358
Gas	505
Water	199
Total Production Overheads	<u>2,533</u>
Distribution Costs	
Carriage and Freight	1,000
Import Duty on Raw Materials	160
Total Distribution Costs	<u>1,160</u>
Administration Costs	
Rent	360
Rates	95
Insurance	125
Motor expenses	25
Telephones	15
Printing, postage and stationery	22
Bank charges	28
Accountancy/professional fees	40
Director's remuneration	200
Depreciation	26
Total Administration Costs	<u>936</u>
Total Overheads	4,629
Operating Profit/(Loss)	1,092
Interest Payable	153
Profit/(loss) Before Tax	<u>939</u>



The policy is as follows:

Gross Profit Sum Insured £4,000,000 with a Maximum Indemnity Period of 12 months.

Uninsured Working Expenses are Purchases (including stock movement); carriage, packing and freight.

The Increased Costs of Working are presented to you as follows:

Parts and materials used in refurbishing mothballed plant	£905,000
Cost of own engineer refurbishing mothballed plant	£72,000
Engineer's overtime refurbishing mothballed plant	£35,000
Director's time handling claim and meeting with loss assessor	£50,000
Wages whilst unable to trade	£900,000
Loss assessor fees	£75,000
Loss of profit based on lost factory hours	£2,500,000

Based on the above information calculate:

1. The Rate of Gross Profit. (10 Marks)
 2. A proposal for settlement of the loss to include the loss of Gross Profit, Increased Costs of Working and savings in overheads and costs. Include within your answer explanations as to the reasoning behind the inclusion of any trend, Increased Costs of Working and savings. (15 Marks)
 3. Recalculate your answer using a declaration linked (Estimated Gross Profit) policy basis. Estimated Gross Profit £4,000,000 with a 12 month Maximum Indemnity Period. (15 Marks)
- 40 Marks**

(Continued)



QUESTION B12

Insurers have appointed you to deal with the business interruption aspect of a loss following a flood at a furniture retail business. The entire stock of furniture for sale was destroyed as were the policyholder's contents. As a result of the damage, the premises were not capable of occupation for a period of fifteen months. Liability was accepted under the Material Damage cover. The incident occurred on 1 April 2015.

It was agreed that moving to temporary premises would be the most appropriate way to mitigate the loss. A suitable, but smaller, building was found and leased. This was the only available building in the locality. Unfortunately, the landlord in question would only let the building for two years from 1 June 2015. The business took occupation of the temporary premises in June 2015 and promptly commenced redecorating, fitting out and restocking.

Historic turnover and turnover achieved following the incident are noted below.

	2013/14	2014/15	2015/16
	£	£	£
Apr	42,940	52,959	0
May	68,764	42,733	0
Jun	65,225	74,991	0
Jul	33,374	60,242	15,265
Aug	38,208	45,386	20,362
Sep	36,515	51,589	25,986
Oct	24,705	80,180	30,265
Nov	41,646	56,460	27,699
Dec	37,880	82,486	37,542
Jan	70,274	55,992	42,000
Feb	45,742	64,578	55,603
Mar	62,548	68,829	72,001
	<u>567,821</u>	<u>736,425</u>	<u>326,723</u>

The Insured appointed their own Chartered Loss Adjusters to present their claim.

(Continued)



Increased Costs of Working were presented as follows:

Policyholder's loss adjuster's fees	£20,000
Rent for temporary premises (24 months)	£90,000
Overtime for own staff (decorating and fitting out temporary premises)	£6,000
Interest on short-term loan	£1,500
Decorating materials	£1,000
Temporary shop fit-out costs	£25,000
Freight costs premium to expedite stock from overseas	£12,000
Advertising new premises	£5,000

No formal claim was presented for loss of Gross Profit.

The accounts to 31 March 2014 and 2015 have been presented as follows:

	2015	2014
	£	£
Sales	736,425	567,821
Cost of goods bought for resale	486,185	343,073
Delivery charges	36,821	28,391
Wages	105,321	100,265
Gross Profit	<u>108,098</u>	<u>96,092</u>
Overheads		
Car, van and travel expenses	4,775	5,701
Rent and rates	20,000	20,000
Light and heat	9,745	11,838
Insurance	1,000	1,000
Repairs and renewals of property	1,075	509
Phone, stationery and office costs	4,069	3,426
Credit card charges	2,042	144
Accountancy, legal and other professional fees	10,355	4,128
Depreciation	1,200	1,051
Total Overheads	<u>54,261</u>	<u>47,797</u>
Net Profit	<u>53,837</u>	<u>48,295</u>

The policy has a Gross Profit Sum Insured of £200,000 and a Maximum Indemnity Period of 12 months. Uninsured Working Expenses are Purchases.

1. Calculate settlement of the loss to include loss of Gross Profit, Increased Cost of Working and savings. Include within your answer the reasoning for the inclusion or otherwise of any trends, Increased Costs of Working and/or savings.

(15 Marks) (Continued)



2. What is the relevance of liability being accepted under the Material Damage cover?
(5 Marks)
 3. How does an Additional Increase in Cost of Working differ from an Increase in Cost of Working?
(5 Marks)
 4. What factors should be taken into account when considering whether a costs rank for inclusion as an increased cost of working?
(10 Marks)
 5. What is the difference between an Accumulated Stocks clause and a Contract Price clause?
(5 Marks)
- 40 Marks**

(Continued)



BI QUESTION 3

You are requested by insurers to handle the business interruption claim for a restaurant business. The business has two restaurants within a city centre within a mile of each other. One of the restaurants was subject to a serious fire which destroyed the building entirely along with all contents and stock within the building.

The incident occurred on 1 May 2014.

The policyholder is a tenant in both premises and pays rent of £45,000 per annum for each building. There is a suspension of rent clause within the lease with the landlord.

The affected premises was known as Restaurant 1. Restaurant 2 was not damaged.

Unfortunately, there were no suitable premises in the locality that the business could obtain on a short-term temporary lease basis. The repaired premises became available to Restaurant 1 again in June 2015.

The turnover of each restaurant is shown as follows:

	Restaurant 1		
	2013/14	2014/15	2015/16
	£	£	£
May	40,076	0	0
Jun	40,451	0	5,000
Jul	40,329	0	10,500
Aug	35,471	0	26,543
Sep	45,874	0	42,333
Oct	69,285	0	62,789
Nov	73,561	0	
Dec	78,258	0	
Jan	67,682	0	
Feb	53,682	0	
Mar	55,463	0	
Apr	54,949	0	
	655,081	0	147,165

(Continued)



Restaurant 2			
	2013/14	2014/15	2015/16
	£	£	£
May	20,038	30,005	30,005
Jun	20,225	31,225	27,500
Jul	20,165	30,000	25,321
Aug	17,736	27,500	20,111
Sep	22,937	34,001	25,666
Oct	34,643	45,632	35,663
Nov	36,780	46,708	
Dec	39,129	59,129	
Jan	33,841	44,004	
Feb	26,841	37,853	
Mar	27,731	38,005	
Apr	27,474	39,121	
	327,540	463,183	164,266

The accounts for the combined business for the year ending 30 April 2014 read as follows:

	£
Sales	982,621
Purchases	393,048
Gross Profit	<u>589,573</u>
Operational Costs	
Restaurant wages	176,805
Management salaries	112,951
Rent	90,000
Rates	30,000
Energy costs	45,000
Delivery charges	22,099
Packaging	29,031
Telephone	2,715
Credit card charges	24,566
Bank interest	2,561
Bad debts	6,984
	<u>542,712</u>
Head Office costs	265,321
Net Profit/(Loss)	<u>(218,460)</u>

(Continued)



Policy cover is as follows:

Gross Profit Sum Insured: £600,000

Maximum Indemnity Period: 18 months

Uninsured Working Expenses: Purchases

1. Based on this information, you are requested by Insurers to:
 - a) Calculate a settlement figure, detailing in your answer your assumptions as appropriate regarding turnover, trends and savings. (20 Marks)
 - b) Calculate an appropriate Gross Profit Sum Insured for a 18 month period, detailing any assumptions you have made. (10 Marks)
 2. 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'? (5 Marks)
 3. What is the Alternate Trading Clause, quote any relevant case law? (5 Marks)
- 40 Marks**