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The Chartered Institute of Loss Adjusters
Advanced Diploma Examination 2017 (October)

Paper C3 - Business Interruption

3½ Hours

Maximum Marks 200

Answer Any Five out of Six Questions

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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ANSWER ANY FIVE QUESTIONS FROM SIX

QUESTION 1

You are instructed to deal with a claim for water damage at Home Farm Cottage, Darrington. Darrington is a village situated on the flood plain of the River Am. The risk address is of brick construction under a pitched tiled roof. The building has solid walls and, being built in 1823, has no damp-proof membrane.

The Policyholder, Sid Perks, advises that his family has owned the building for at least 130 years and he believes that his great-great-grandfather may well have had the house built. Sid is 93 years of age, partially sighted and, due to the onset of arthritis, is unable to climb up or down stairs. As a result, he sleeps on the ground floor in a small room that was previously used as an office. Adjacent to the room is a bathroom.

Sid has no relatives nearby, his partner having died fifteen years before. He has a carer, Phoebe, who is employed by a local agency, Care4You.

Phoebe is present when you visit and is asked by Sid to explain the problem to you. From your conversation, you ascertain that there is a leaking radiator on the first floor. Water has been dripping into the living room and the lath and plaster ceiling has bowed and is likely to collapse. The bathroom used by Sid has also been affected. Sid warns you that the wall panelling in that room is dangerous - he believes that his late brother installed a partition in the room in the 1960s and “foolishly” used asbestos in the construction.

It is apparent from your inspection that the pipe leading to the radiator has been leaking for several months. When asked, Phoebe says that she first told Sid about the leak around seven months ago, but he told her that there was no need to worry. When the large crack in the ceiling appeared four weeks ago, he became more interested and last week he finally agreed to allow Phoebe to contact the Insurers.

You ascertain quickly that the bathroom is not fit to be used due to the extent of water damage to the asbestos partition. You are concerned that the asbestos has been significantly disturbed. Sid has no other facilities accessible to him.

Further, you identify that there is evidence of dry and wet rot in the building.

- a) Explain, providing your rationale, the issues you would take into account to consider the matter of late notification to enable the Insurers to make a reasonable decision on Policy liability on late notification.

(15 Marks)

- b) Irrespective of the decision concerning the late notification, you are asked to provide guidance to the Insurers on the matter of Alternative Accommodation. Provide, with an explanation as to why, what information you would obtain and provide to Insurers to decide on liability for Alternative Accommodation.

(15 Marks)

- c) Stating assumptions as relevant, explain what your recommendations to Insurers would include in terms of how they might base their decisions on Policy liability with regard to the Late Notification and Alternative Accommodation.

(10 Marks)

40 MARKS

QUESTION 2

- a) Explain what is meant by the following terms under a Business Interruption Policy:

- 1) Gross Profit
- 2) Rate of Gross Profit
- 3) Savings
- 4) Declaration Linked.

(20 Marks)

- b) You are handling a claim for Impact to the front of a shop by a motor vehicle. The owner of the shop is claiming that her business has been interrupted as a result and that a claim will be made under the Business Interruption Policy.

During the Period of Indemnity, a famous cycle race, which draws crowds from across the world, takes place. The cycle race passes the front of the shop. Taking advantage of the situation, the shop owner opens for extended hours and takings on that day are approximately 10 times greater than would be expected on any other day. Seeing this, you realise this has almost made up for the entire loss suffered by the Policyholder for Business Interruption. The Insurers therefore suggest to you that there ought to be no payment to the Policyholder for loss of profit. Explain, with your rationale, how this would normally be dealt with under a Business Interruption Policy.

(20 Marks)

40 MARKS

QUESTION 3

Having been appointed to handle a claim for the theft of a Rolex watch under a typical All Risk Policy, you have ascertained a number of facts around the circumstances that warrant greater consideration.

The circumstances of the event are that Mark Hepdon had been accompanying his 25-year-old brother on a weekend trip to a European city. By his own admission, Mark advises that the weekend was quite a big occasion and involved considerable consumption of alcohol, river rafting and a visit to a casino.

Mark tells you that he is not in the habit of drinking alcohol and in fact this was the first time in 2 years that he had done so.



He remembers wearing the watch on the Saturday evening. He recalls this because Matt Crawford, a former colleague, asked him for the time and, seeing the Rolex, he made continuous reference to the obvious wealth of Mark until Eddie Grundy, his brother's best friend, asked Matt to stop talking about Mark in that way.

Mark tells you that he had mixed fortunes at the casino. He remembers at one stage he lost a considerable amount of money, but by the end of the night he thinks he was about even.

The following afternoon, Mark woke in a hotel room - not his own room or indeed his own hotel. There was another man in the room, David Archer, who had been part of the party but had chosen to stay elsewhere as he preferred privacy and some quiet time. David advised Mark that he had found Mark strolling outside the casino at 3 a.m. and had taken him back to his hotel to ensure he came to no harm. David is sure that the watch was not present when he found Mark because Mark kept showing him the watch on his wrist but the watch was missing. David could not get any real sense from Mark and took no action other than to take him back to his hotel.

- a) With particular reference to the Policyholder's duty to exercise reasonable care, provide your recommendation to Insurers, stating your rationale and evidence to support your rationale. You should include relevant case law and other authoritative decisions (you are NOT required to prepare this as a report or letter).
(20 Marks)
- b) Provide, with relevant statutes and case law to support your answers, the definition of **TWO** of the following Perils:
 - a) Storm
 - b) Fire
 - c) Theft
 - d) Riot.

Your answers should include an explanation of how you would determine whether a particular peril has operated.

(20 Marks)

40 MARKS

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 1st January 2016.

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 31st December 2013 was £4,305,226.

Turnover for the financial year ending 31st December 2014 was £4,735,749.

Turnover for the financial year ending 31st December 2015 was £5,209,324.

The directors advise that the forecasted turnover for the financial year ending 31st December 2016 was £6,250,000.

Historic turnover is analysed thus:

	2015 (actual)	2016 (forecast)	2016 (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	£5,209,324	£6,250,000	£3,286,657

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

Turnover	£5,209,324
Cost of Sales:	
Opening stock	£ 456,911
Purchases	£3,216,506
Shop wages	£ 360,530
Agency labour	£ 53,000
Depreciation	£ 35,000
Closing stock	(£ 500,104)
Total Cost of Sales	<hr/> £3,621,843
Gross Profit	£1,587,481
Expenses:	
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
Net Profit	£ 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. Your answer should explain your rationale for the trend you propose, and any assumptions you make.
 - A proposal for settlement of the Increased Cost of Working claim with an explanation of the reasons for the inclusion or exclusion of additional costs.
 - A proposal for what categories of cost could constitute savings and your rationale as to the reasoning behind their inclusion as a savings item.
- b) If the stock loss was settled under a Contract Price Clause, explain how this would affect your consideration of the Gross Profit loss.
- c) Discuss the adequacy or otherwise of the Estimated Gross Profit declared. Assuming that the Insurance Act 2015 was in force at the time of Policy inception, comment on the remedies insurers may have in relation to Gross Profit that has been under-declared.

(40 MARKS)

QUESTION BI 2

You are the Business Interruption Adjuster appointed to deal with the Business Interruption loss resulting from damage to a wholesale and retail nursery following a serious fire at the premises.

The incident occurred on 1st April 2016. The Insured attempted to mitigate the loss by obtaining temporary premises from which to trade. The temporary premises required adaptations to enable them to be used. The damage was such that the nursery was completely destroyed. Liability was accepted under the Material Damage cover.

Cover is provided on an Estimated Gross Profit basis in the sum of £175,000 with a Maximum Indemnity Period of 12 months.

Uninsured Working Expenses are defined as Purchases (including stock movement) and Equipment Hire.

Profit and Loss Account for the financial year ending 31 March 2016:

Turnover	£ 570,411
Cost of Sales:	
Opening stock	£ 220,000
Purchases	£ 383,262
Equipment hire	£ 6,451
Closing Stock	(£ 205,000)
Total Cost of Sales	£ 404,713
Gross Profit	£ 165,698
Expenses:	
Wages and salaries	£ 57,624
Rates and water	£ 19,871
Light and heat	£ 14,368
Insurance	£ 12,986
Cleaning and waste removal	£ 2,543
Repairs and maintenance	£ 3,473
Telephone costs	£ 1,469
Motor expenses	£ 2,555
Stationery	£ 2,937
Sundry	£ 1,432
Accountancy	£ 3,700
Credit card charges	£ 3,024
Depreciation	£ 11,431
HP interest	£ 2,101
Loan interest	£ 8,059
Bad debts	£ 110
Bank charges	£ 398
	£ 148,081
Net profit	£ 17,617

Turnover has been provided from VAT returns as follows:

Quarter ending 30/06/15	£273,392	(previous year £260,373)
Quarter ending 30/09/15	£128,895	(previous year £123,937)
Quarter ending 31/12/15	£ 89,666	(previous year £ 86,217)
Quarter ending 31/03/16	£ 78,458	(previous year £ 76,173)

The extra costs incurred in relation to the setting up of temporary premises have been presented as follows:

Rental cost of alternative premises	£100,000
Rental cost of car park for customers	£ 4,000
Professional fees in relation to alternative premises	£ 15,000
Redecoration costs of alternative premises	£ 10,000
Overtime	£ 500
Hire of forklift truck	£ 5,000
Promotional costs	£ 5,000
Accountant's charges for presenting post-loss financial data	£ 3,500
Purchase of racking for temporary premises	£ 49,000
Electricity and water charges	£ 19,000
Rates at alternative premises	£ 19,000
Lost revenue from cancelled contract with local authority	£ 50,000
Additional overdraft charges	£ 3,000

The Insured's accountant presented monthly turnover following the incident as follows:

	Turnover 2016/17
April	£ 0
May	£ 758
June	£ 7,923
July	£ 25,636
August	£ 32,027
September	£ 39,834
October	£ 27,282
November	£ 29,185
December	£ 16,657
January	£ 15,403
February	£ 22,503
March	£ 24,071
Total	<u>£241,279</u>

- a) Calculate settlement of the loss given the above information to include Gross Profit, Increase in Cost of Working and potential savings. Provide an explanation as to the inclusion or otherwise of the Increase in Cost of Working expenses claimed.
- b) If the Insured had a contract to supply flowers, trees and plants to a local landscaping firm deferred as a result of the loss, how might you deal with this in the settlement of the claim? What enquiries would you make?
- c) Explain (i) the Professional Accountants Clause, (ii) the Contract Price Clause, (iii) the Accumulated Stocks Clause and (iv) the other circumstances clause.
- d) Briefly discuss the cover, and for each give an example of circumstances that might trigger a valid claim, under the following common extensions to core BI cover:
 - i) Denial of access
 - ii) Action of competent authority
 - iii) Loss of licence
 - iv) Supplier's extension.

(40 MARKS)

QUESTION BI 3

You are instructed by insurers to handle the Business Interruption claim for a car retailer following a major fire at their sole location which occurred on 1st February 2016. The fire was so severe that all vehicles located in the main showroom were destroyed. The showroom and office facilities required substantial repair and the site reopened on 1st October 2016.

In an attempt to mitigate the business interruption loss, the Insured acquired a short-term lease for a 350 m² plot of land for 9 months commencing on 1st March 2016 at a cost of £18,000. Some sales of newly sourced vehicles were achieved from the temporary site, but due to restricted access the business performance was disappointing.

The Insured hired a portakabin office and generator for the same period (£24,000) and erected a security fence around the plot (£5,500). Further, an improved road surface was laid at the entrance to the site at a cost of £3,500.

The Business Interruption Policy is subject to an underinsurance clause and provides cover for Gross Profit at £450,000 for a 12 month maximum indemnity period.

Utilising the accounting information below, calculate and set out your proposals for settlement of the claim under the Policy, explaining your rationale and any assumptions made.

Your answer should also include an explanation of the advice you would provide to the Policyholder with regard to how some of the loss could be mitigated. As the Policyholder does not understand what fees/costs might be recoverable under the Policy, this too should be explained.

You can assume that Policy liability is engaged, but you should comment on the requirements of the Material Damage Policy you would expect to see in a typical Business Interruption Policy.

SALES	<u>2014/15</u>	<u>2015/16</u>	<u>2016/17</u>
	<u>£</u>	<u>£</u>	<u>£</u>
February	128,950	134,265	NIL
March	134,876	137,564	35,687
April	163,489	166,890	46,588
May	143,687	153,428	58,733
June	137,673	139,895	64,532
July	98,782	102,659	77,643
August	87,720	90,674	88,675
September	146,890	154,398	133,476
October	134,897	137,850	121,545
November	126,576	128,967	105,534
December	83,986	85,978	72,549
January	<u>97,372</u>	<u>99,445</u>	<u>82,465</u>
	1,484,898	1,532,013	887,427

DETAILED PROFIT & LOSS ACCOUNT FOR YEAR ENDED 31st JANUARY 2016

	<u>£</u>	<u>£</u>
Turnover		1,532,013
Opening Stock	142,500	
Purchases	1,040,288	
Closing Stock	<u>-135,786</u>	
		<u>1,047,002</u>
Gross Profit		485,011
Rent & Rates	102,300	
Light & Power	13,547	
Salaries	124,588	
Pensions	12,500	
Credit Card Charges	5,342	
Motor Expenses	7,386	
Advertising	10,687	
Cleaning	3,450	
Telephone	8,644	
Legal & Accountancy	3,750	
Depreciation	24,000	
		<u>316,194</u>
Net Profit		168,817

(40 MARKS)