



***STRICTLY PRIVATE & CONFIDENTIAL***  
***for internal use only***

**The Chartered Institute of Loss Adjusters**  
**Advanced Diploma Examination 2018 (April)**

**Paper AD2**

**Business Interruption**

**3½ Hours**

**Maximum Marks 200**

**Answer Any Five Questions out of Six**

*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.**

**Notice of Copyright**

This document and any information contained therein remains the confidential and copyright property of the CIL A. Without infringement neither the whole, nor any extract, may be disclosed, loaned, copied or used for manufacturing, the provision of services or any other purpose whatsoever without the express permission and written consent of the CIL A. No liability is accepted for any loss or damages from any cause whatsoever arising out of the use of this document or its contents.

COPYRIGHT © CIL A 2018



## ANSWER ANY 5 QUESTIONS OUT OF 6

### QUESTION 1

- a) Outline the main provisions of the Insurance Act 2015 and explain how these may be relevant to the adjustment of an insurance claim.  
*(20 Marks)*
- b) Explain the following terms and how they would apply to the adjustment of an insurance claim:
- i) Reinstatement Memorandum
  - ii) Public Authorities Clause
  - iii) Escalator Clause
  - iv) Contract Price Clause
  - v) 10% Co-Insurance Clause.

*(20 Marks)*

**40 MARKS**

### QUESTION 2

- a) Explain the difference between Contribution calculated on an Independent Liability basis and the Sums Insured basis.  
*(6 Marks)*
- b) You have been appointed to deal with a claim for flood damage that has occurred at the Insured's property. Your Principals' Policy covers Contents, with the Buildings being covered separately by different Insurers.

Due to the extent of the damage, the Insured and his family require alternative accommodation. It is agreed with the Adjusters representing the Buildings Insurers that their Principals will initially finance these costs and that your Principals will contribute on the basis of each Insurer's independent liability.

Ultimately, the outlay of the Buildings Insurers is quantified at £10,000. The Sum Insured for such costs under that Policy is £25,000 whilst the Sum Insured under your Principals' Policy is £7,500. Additionally, and on first notification of the claim out of hours, your Principals agreed and paid for emergency hotel accommodation at a cost of £500.

Showing all relevant workings, calculate the Contribution now payable by your Principals.

*(10 Marks)*



- c) You are dealing with a claim presented to your Principals for the loss of a gentleman's gold watch. This occurred whilst the Insured was on holiday in France. The Policy includes cover for Unspecified Valuables with a Sum Insured of £5,000 and including a Single Article Limit of £1,500.

Your enquiries establish that the claim is in order and, allowing for Supplier's discount, the replacement cost of the watch is validated at £2,000. Accordingly, settlement is concluded at £1,500 on the basis of the Single Article Limit and this amount is paid to the Insured.

The Insured had disclosed a separate Travel Policy that would cover a loss of this type but with a Single Article Limit of £300. Your Principals request you to contact the Travel Insurers to obtain contribution of that amount towards the outlay they have incurred. What advice do you provide to your Principals on this issue?

*(10 Marks)*

- d) Explain the term "Subrogation" and how this might arise when dealing with an insurance claim.

Briefly discuss how the precedent established in the case of *Mark Rowlands Ltd v Berni Inns Ltd (1986)* impacts upon subrogation.

*(8 Marks)*

- e) Explain briefly the term "Salvage" within the context of an insurance claim and how this would normally be dealt with.

*(6 Marks)*

**40 MARKS**

### QUESTION 3

- a) 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)*

- b) In a typical Business Interruption Policy, explain:

- i) The difference between Increased Costs of Working and Additional Increased Costs of Working. Give one example of each
- ii) The circumstances under which Cover under the Denial of Access Extension would be available



iii) The term “Material Damage Proviso”

iv) Declaration Basis of Cover.

*(16 Marks)*

- c. You are dealing with a claim for fire damage that occurred at a ladies fashion retailer in January 2018. Your Principals’ Policy covers both material damage and business interruption, with a twelve month indemnity period applying to the latter. Due to the damage that has occurred, it is estimated that the shop will be closed for about two months whilst building repairs are completed.

Your enquiries have established that the Sums Insured against the various heads of cover, including business interruption, are all adequate apart from stock, the Value at Risk being confirmed at £100,000 against a Sum Insured of £75,000. You explain to the shop owner the application of average and that effectively she will receive only 75% of the stock claim, initially estimated at £50,000. The position is accepted but the Insured then raises the following issues:

Due to the shortfall in the stock claim, she will not be able to acquire her normal range of stock for the forthcoming summer sales period and this will impact adversely on her turnover during this time.

In addition, and due to the closure of the shop in the aftermath of the fire, she will be left with some undamaged seasonal stock which she may subsequently only be able to sell at a significantly reduced price.

She expects that any losses arising from these issues will be reimbursed within the scope of the Business Interruption Claim. What advice do you provide to her?

*(12 Marks)*

**40 MARKS**



## QUESTION BI1

Insurers have appointed you to deal with the business interruption loss following a fire in a micro-brewery located in a rural location. The brewery manufactures cider which it sells to visitors, wholesalers and public houses in the area. The brewery grows its own apples within a large orchard on site.

The fire destroyed the apple crop, the associated process machinery and the majority of the building occupied by the Policyholder. A small section of the building was saved, from which the policyholder continued to operate.

The incident occurred on 1<sup>st</sup> January 2017.

Liability was accepted by Insurers for the Material Damage aspect.

Estimated Gross Profit (Declaration Linked)	£350,000
Maximum Indemnity Period	12 months

Uninsured Working Expenses are defined as Purchases (net of stock movement), subcontractor charges, carriage, packing and freight.

The cover for Business Interruption has an excess of £25,000.

Turnover for the financial year ending 31<sup>st</sup> December 2016 was £633,675

Turnover for the financial year ending 31<sup>st</sup> December 2015 was £540,289

Turnover for the financial year ending 31<sup>st</sup> December 2014 was £602,105

The directors advise that the harvested apple crop for the financial year ending 31<sup>st</sup> December 2017 was expected to be poorer than in 2016 and was expected to be circa 25,000 kg.

Crop details (rounded) were advised as follows:

2016 26,000 kg

2015 22,000 kg

2014 24,000 kg



Historic turnover is analysed as follows:

Month	2015	2016
January	41,368	56,501
February	41,240	63,637
March	45,868	49,300
April	53,185	57,620
May	47,540	57,366
June	44,771	64,200
July	41,371	60,106
August	41,371	41,371
September	41,371	41,371
October	50,466	50,466
November	50,182	50,182
December	41,556	41,555
Total	<u>£540,289</u>	<u>£633,675</u>

Turnover following the loss was generated from selling cider bought-in from elsewhere, although supply was difficult to source. A third party brewery manufactured and bottled the cider in the policyholder's own packaging.

Turnover achieved during 2017 was recorded as follows:

May	£5,600
Jun	£9,530
Jul	£12,333
Aug	£10,003
Sept	£9,060
Oct	£11,511
Nov	£11,003
Dec	£8,053

The accounts for the financial years ending 31<sup>st</sup> December 2015 and 2016 are as follows:



	31-Dec-15	31-Dec-16
Sales	540,289	633,675
Opening stock	22,500	22,500
Purchases	128,965	144,862
Closing stock	(22,500)	(14,976)
Cost of sales	<u>128,965</u>	<u>152,386</u>
Gross profit	<u>411,324</u>	<u>481,289</u>
Subcontractors	21,085	12,856
Direct orchard costs	74,250	83,215
Carriage	10,005	11,954
Packing	10,806	12,222
Commissions payable	5,540	36,543
Freight	9,568	12,674
Directors' salaries	16,200	16,200
Direct wages	123,849	144,453
Social security	6,148	6,154
Hire of plant and machinery	2,870	7,048
Rates and water	2,134	2,725
Insurance	6,713	4,811
Light, heat and power	17,155	23,535
Computer costs	979	658
Cleaning	18,034	24,327
Telephone	2,531	2,645
Post and stationery	3,116	2,743
Advertising	3,288	2,234
Travelling	1,232	86
Motor expenses	4,500	4,581
Repairs and renewals	16,280	14,073
Sundry expenses	870	2,162
Subscriptions	1,295	984
Accountancy	3,965	7,742
Legal fees	4,125	5,136
Entertainment	1,000	900
Credit card charges	6,624	4,821
Bank interest	63	122
Bank loan interest	2,154	0
Hire purchase	945	1,890
Goodwill	3,500	3,500



Depreciation - orchard equipment	397	389
Depreciation - plant and machinery	2,334	3,406
Depreciation - fixtures and fittings	19,632	14,745
	<hr/>	<hr/>
	403,187	471,534
<hr/>		
Net Profit	£8,137	£9,755

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

Subcontract processing and bottling: £60,000

Based on the above information, calculate:

- a) The Rate of Gross Profit. *(5 Marks)*
- b) 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. *(30 Marks)*
- c) Re-calculate your answer using a Gross Profit Sum Insured policy basis if under-insurance applies. Gross Profit Sum Insured £350,000 with a 12 month Maximum Indemnity Period. Uninsured Working Expenses are the same as noted above. *(5 Marks)*

**40 MARKS**





## QUESTION B12

Insurers have appointed you to deal with the business interruption aspect of a loss following a flood at a charity shop. The entire holding of donated stock for sale was destroyed as were all the policyholder's contents. As a result of the damage, the premises were not capable of occupation for a period of over twelve months. Liability was accepted under the Material Damage cover. The charity shop occupied the building as tenants. The lease was subject to a cessor of rent clause.

The incident occurred on 1<sup>st</sup> April 2016.

Moving to temporary premises was the most appropriate way to attempt to mitigate the loss. The business took occupation of the temporary premises in May 2016 following which there was a brief period of re-fitting and redecorating.

Monthly turnover achieved before and after the incident is as follows.

	<u>2014/15</u>	<u>2015/16</u>	<u>2016/17</u>
Apr	8,002	8,401	0
May	1,999	2,090	0
Jun	5,663	6,581	1,256
Jul	7,999	8,136	2,222
Aug	7,530	7,564	3,019
Sep	7,201	7,336	3,202
Oct	9,201	10,927	6,534
Nov	7,000	7,412	6,300
Dec	8,211	8,353	7,556
Jan	9,400	9,641	7,171
Feb	7,563	7,861	7,002
Mar	8,013	8,468	8,475
	<u>£87,782</u>	<u>£92,770</u>	<u>£52,737</u>



The accounts for the year ending 31<sup>st</sup> March 2016 were presented as follows:

Income	92,770
Purchases	13,365
Gross Profit	<u>79,405</u>
Expenditure	
Advertising	1,700
Payroll costs	29,790
Volunteer expenses	443
Staff parking costs	120
Waste clearance	801
Insurance	1,196
Rent	24,904
Premises cleaning	240
Maintenance and repairs	2,485
Rates	1,639
Water rates	271
Electricity	3,109
Telephone	322
Postage	72
Shop consumables	475
Miscellaneous	217
Legal and professional fees	0
Credit card charges	2,204
Out of till expenses	36
Total - expenditure	<u>70,024</u>
Net Profit	<u>£9,381</u>

Increased Costs of Working were presented as follows:

Purchase of stock for re-opening	£ 2,000
Policyholder's loss adjuster's fees	£10,000
Rent for temporary premises (12 months)	£50,000
Overtime for own staff (decorating and fitting out temporary premises)	£ 1,500
Interest on overdraft	£ 1,500
Decorating materials	£ 1,000
Temporary shop fit-out costs	£12,000
Advertising new premises	£ 5,000
Rates at temporary premises	£ 1,500



No formal claim was presented for loss of Gross Profit.

The policy has a Gross Profit Sum Insured of £75,000 and a Maximum Indemnity Period of 12 months. Uninsured Working Expenses are Purchases.

The policyholder also has Additional Increase in Cost of Working cover with a limit of £50,000.

- a) 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.  
*(20 Marks)*
- b) How would your answer to (1) above vary if the cover was declaration linked (Estimated Gross Profit). Show your answer and calculations.  
*(5 Marks)*
- c) How does an Additional Increase in Cost of Working differ from an Increase in Cost of Working? In what situations would AICOW cover benefit a policyholder? Provide some examples.  
*(5 Marks)*
- d) What factors should be taken into account when considering whether a cost ranks for inclusion as an increased cost of working?  
*(5 Marks)*
- e) Discuss how your answer may be different if the donated stock was subject to a stock claim that was paid for by Insurers.  
*(5 Marks)*

**40 MARKS**



### QUESTION B13

You are requested by insurers to handle the business interruption claim for a manufacturing company involved in producing industrial products. The policyholder's only manufacturing machine was subject to a serious fire which severely damaged a section of the machine. Liability was accepted under the Material Damage cover.

The incident occurred on 1<sup>st</sup> January 2016.

To mitigate the business interruption effects, some temporary repairs were carried out on the damaged machine. The permanent repairs had to be deferred until the policyholder's annual shutdown in August.

To meet orders in the immediate period following the fire, the policyholder sold all their buffer stocks.

The temporary repairs took six weeks to complete, during which time there was no production on the machine. The policyholder was able to bring two mothballed machines back into production as a temporary measure. Unfortunately, the damaged machine that was the subject of temporary repairs was only able to run at half speed following the repairs.

Once the three machines were operational, the company decided to employ overtime and moved to a three shift system on all machines to try to recover as much production as possible.

Policy cover is as follows:

Gross Profit Sum Insured:	£3,000,000
Maximum Indemnity Period:	12 months
Uninsured Working Expenses:	Purchases (net of stock movement), rebates, direct manufacturing costs, freight.



The accounts for the business for the year ending 31<sup>st</sup> December 2015 were presented as follows:

Sales	7,115,732
Less Cost of Sales	
Rebates	58,800
Freight	108,000
Direct wages	960,388
Direct power	213,472
Direct manufacturing costs	340,660
Opening stock	450,000
Purchases	2,616,472
Closing stock	<u>(425,000)</u>
Total Cost of Sales	<u>4,322,792</u>
Gross Profit	2,792,940
Overheads	
Factory costs	777,298
Research and development	214,856
Administration	90,476
Selling	113,489
Distribution costs	55,259
Mortgage interest	18,067
Bank interest	3,600
Finance interest	<u>7,000</u>
Total Overheads	<u>1,280,045</u>
Operating Profit/(Loss)	<u>£1,512,895</u>



Turnover details were supplied as follows:

	2015	2016
Jan	444,709	294,428
Feb	445,808	351,111
Mar	555,240	672,042
Apr	630,122	775,377
May	673,607	621,087
Jun	746,651	690,813
Jul	666,145	600,250
Aug	695,152	152,222
Sep	581,827	455,206
Oct	652,002	650,013
Nov	681,041	700,261
Dec	<u>343,428</u>	<u>402,111</u>
	£7,115,732	£6,364,921

Increased Costs of Working were claimed as follows:

Production overtime	£120,000
Temporary staff	£ 33,000
Additional engineering staff to cover own staff engaged in repairs	£ 46,000
Temporary repairs on main machine	£110,000
Modifications to mothballed machines to bring into production	£182,000
Stock replenishment	£250,000
Directors' time dealing with claim	£ 50,000
Additional manager to cover lost directors' time	£ 45,000
Claim presentation fees	£ 30,000



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, increased cost of working and potential savings.  
*(30 Marks)*
- b) Calculate an appropriate Gross Profit Sum Insured for an 18 month period utilising the data above, detailing any assumptions you have made.  
*(5 Marks)*
- c) Explain the Alternate Trading Clause, quoting any relevant case law?  
*(5 Marks)*

**40 MARKS**