ombudsman

essential reading for people in the financial services and consumer advice sectors

confidence building



The former United States' Defence Secretary, Donald Rumsfeld, will go down in history for – among other things – reminding us to distinguish between the '*knowns, the known unknowns, and the unknown unknowns – the ones we don't know we don't know*'. At the Financial Ombudsman Service we have a good idea about the people who contact us and make complaints. We also know about the people who contact us but don't need to refer a complaint. And beyond them, there are all those who might think about contacting us about a complaint, but don't.

settling financial disputes, without taking sides

Financial Omb<u>udsman</u>

Service

issue 58

in this issue

home insurance case studies: problems with leaking or blocked pipes **3**

ombudsman focus – our recent specialist seminars on travel insurance and disputed card and cheque transactions 8

mortgage endowments: complaints about post-'A Day' sales **11**

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ombudsman news issue 58

Out there, among the unknowns (the ones we'll never know), we can feel reasonably sure there are plenty of people who - glancing at their insurance policy, bank leaflet or investment details - see a mention of the Financial Ombudsman Service. As a result – it flashes through their minds that, in the unlikely event of something going wrong, there's somewhere they can go to get it put right.

In the season of goodwill, that's a positive thought to end the year on.

Cent

Walter Merricks chief ombudsman

did you know...



our website gives you free access to over 1,000 pages of up-to-date information?

You can browse through case studies in earlier editions of ombudsman news, refer to technical briefing notes on a specific subject, or check out our expected workload for the year ahead.

And our new section – *information for businesses covered by the ombudsman service* – provides the answers to nearly 80 of the questions we're most frequently asked by businesses.

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home insurance case studies: problems with leaking or blocked pipes

The onset of winter inevitably brings an increased risk of burst pipes. And particular problems can sometimes arise if homes are left empty and unheated for any length of time during spells of cold weather.

Many people go away for a week or so over Christmas and the New Year. And – increasingly – those who can afford it are taking the opportunity for an extended break abroad to escape the worst of the British weather. So the following case studies provide some seasonal cautionary tales, as well as illustrating our approach to a variety of insurance disputes involving leaking or blocked pipes.

58/1

whether policyholders are covered for '*trace and access*' work and/or pipe repairs

When a maturing investment produced a larger sum than expected, Mr G decided to spend part of the money on a cruise. He had recently taken early retirement on ill-health grounds and his wife thought a trip to the Caribbean over Christmas and New Year would boost his spirits.

Before the couple left home, they turned off their central heating. They were anxious to save on their gas bill while they were away. Three weeks later, Mr and Mrs G returned home to find their kitchen flooded with water from the bathroom above. The weather had been particularly cold while they were away and the water in the pipes had frozen, expanding and cracking the metal. As the temperature rose, the ice melted and water flooded out of the pipes, causing extensive damage to the kitchen ceiling, walls and carpet.

The insurer accepted the claim and arranged to put right the damage caused by the flooding. But it would not reimburse Mr G for the cost of calling out the emergency plumber to find the source of the leak and fix it. After complaining to the insurer about this without success, Mr G came to us.

complaint rejected

Details of the cover were set out very clearly in the policy. Mr and Mrs G were covered for loss or damage caused by *'escape of water'*. But they were not covered for *'trace and access'* – the cost of finding and repairing the source of the damage.

This restriction on the scope of the cover was neither unusual nor significant. So it was not something the insurer needed to have highlighted in its policy summary, given to customers at the point of sale.

As with most home insurance policies, the '*trace and access*' cost and the plumber's fees for replacing the damaged pipe were uninsured losses, which had to be borne by the policyholder. We rejected the complaint.

58/2

whether there is cover for '*escape of water*' when insured premises are left unoccupied

After a major lottery win, Mr and Mrs W decided to spend some of the money on a three-month cruise. Before they set off on their trip early in the New Year, they switched off their heating and hot water.

The couple returned home at the beginning of April to find that burst internal water pipes had caused a significant amount of damage to their home. As well as the initial problems caused by the flood, the resulting damp had caused the wooden floor to start rotting.

... it had never occurred to them that they might not be covered for the situation they now faced.

Understandably, Mr and Mrs W were very distressed by what had happened. But they were even more upset when their insurer rejected their claim. The insurer said an exclusion clause in the policy meant there was no cover for 'escape of water' if the insured property had been left unoccupied for 60 or more consecutive days.

It had never occurred to the couple that they might not be covered for the situation they now faced. And after complaining unsuccessfully to their insurer, Mr and Mrs W came to us.

complaint substantially upheld

Technically, there *had* been a breach of the policy conditions, since the couple had left their property unoccupied for more than 60 days. However, the insurer's own evidence had established that the area where Mr and Mrs W lived suffered particularly cold weather during the first 10 days of January. So the flood had almost certainly occurred well within the period during which the property was covered, even if it was unoccupied.

That meant that the 'circumstances of the claim' (the burst pipes) were not connected with the breached policy condition. We explained to the insurer our long-established approach to such cases, as set out in issue 34 of ombudsman news (January 2004): 'We do not consider it good practice for insurers to decline to pay out where the policyholder's breach of a policy condition has been only a technical breach, that has not prejudiced the firm's position in any way ...'

We also pointed out that the *Insurance: Conduct of Business Rules* (which came into force on 14 January 2005) state: 'An insurer must not...except where there is evidence of fraud, refuse to meet a claim by a retail customer on the grounds ... of breach of warranty or condition, unless the circumstances of the claim are connected with the breach.' (Rule 7.3.6).

We said the insurer should accept the claim. However, we accepted the insurer's argument that it should pay only part of the cost of replacing the wooden floor. If Mr and Mrs W had not left their home unoccupied for so long, the water damage could have been dealt with more quickly, and the floor would probably not have started to rot.

... this was simply a matter of maintenance, for which no insurance cover was available

58/3

whether a blocked oil-pipe is covered

Miss J woke one morning in early February to find her cottage was unusually cold. The central heating had failed to come on. She was unable to get it to work, so she called out an emergency plumber.

It took the plumber some time to discover the cause of the problem. The outlet pipe from the oil storage tank to the boiler had become blocked with the sludge and oil deposits that had built up over the years. The plumber eventually managed to unblock the system and get it up and running. But Miss J was left with a bill for almost £1,000.

When she submitted a claim to her insurer for damage to the oil tank and pipes, the insurer refused to pay out. It told her this was because there been no physical damage to the tank or pipes and no '*contamination of the surrounding site*'. The unblocking of the system was simply a matter of maintenance, for which no insurance cover was available.

After arguing unsuccessfully against the insurer's decision, Miss J brought her complaint to us.

complaint rejected

We sympathised with Miss J's predicament. However, it was clear that her policy did not cover loss or damage caused by *blocked* pipes; it only covered loss or damage caused by escape of oil. Fortunately, there had not been any escape of oil. In principle (and in certain circumstances) '*damage*' can be interpreted to include loss of function. However, this was not the case here since the '*insured peril*' (escape of oil) had not occurred in the first place.

In any event, damage resulting from *'wear and tear'* or lack of maintenance was specifically excluded from the scope of cover. We therefore rejected the complaint.

58/4

whether insurers should pay for replacing a new bathroom suite and wall tiles, removed when plumber traced the source of a leak

Mr C's sitting room was badly damaged when water leaked through the ceiling from his bathroom. He called a plumber, who located the source of the leak and fixed it. In so doing, the plumber apparently had to rip out the entire bathroom suite, including the wall and floor tiles.

The insurer accepted Mr C's claim for 'escape of water' and it paid the cost of repairing the water damage to the sitting room and replacing the bathroom floor tiles. But it would not cover the cost of replacing the bathroom suite and the wall tiles. It told Mr C it did not think it had been necessary for the plumber to remove these items in order to 'trace and access' the burst pipe.

Unhappy with the insurer's response, Mr C brought his complaint to us.

... repair would not be a reasonable solution in this case.

complaint rejected

We were satisfied that the insurer's offer had been fair and reasonable in the circumstances. It was a clearlystated condition of the policy that policyholders should:

- notify the insurer immediately of any situation that was likely to give rise to a claim and
- preserve relevant information and evidence.

Mr C had not contacted his insurer to report the damage until after the plumber had ripped out and disposed of the bathroom suite and wall tiles.

We accepted the evidence provided by the insurer that it had not been necessary to remove the entire bathroom suite and all the wall tiles in order to locate a pipe beneath the floor. In the circumstances, we thought the insurer's offer to pay for Mr C's actual, proven, losses was fair and reasonable. We rejected the complaint.

58/5

whether insurers should pay for new kitchen units, following flood damage

When a mains pipe burst underneath Ms K's kitchen sink, water flooded everywhere. There was a great deal of damage, particularly to the kitchen units.

Ms K's insurer accepted the claim, but offered her only 50% of the cost of replacing the kitchen units. It pointed out that the units were quite old and had probably already suffered a fair degree of wear and tear before the flood damage occurred.

Ms K said this was unfair, as she could not afford to replace her kitchen units for the amount the insurer had offered.

complaint upheld

When we looked into Ms K's complaint, we felt the insurer had not handled the claim fairly and reasonably. Like most home policies, this provided '*new for old*' cover. The policy did not contain any exclusion for items that had already suffered some degree of '*wear and tear*'. And there was no doubt that Ms K's kitchen units had been damaged as a result of a genuine incident.

... we felt the insurer had not handled the claim fairly and reasonably. *'Indemnity'* policies simply require the insurer to put the policyholder back to their pre-incident position (so far as reasonably possible). But as this was a *'new for old'* policy, the insurer was required to replace the damaged items with new ones, or to give the policyholder enough money to cover the cost of buying new items.

The insurer pointed out that the terms of the policy gave it the discretion to arrange repair rather than replacement in certain circumstances. However, expert evidence, together with photographs of the units, convinced us that repair would not be a reasonable solution in this case.

Regardless of their previous condition, all but one of the units had been severely damaged by the escape of water. So we said it was fair and reasonable for the insurer to meet the cost of a complete set of new units.

ombudsman focus on

our recent specialist seminars on **travel insurance** and **disputed card and cheque transactions**

Readers of *ombudsman news* will know that the Financial Ombudsman Service regularly organises and takes part in conferences and meetings with the financial services industry and the professional consumer-advice network.

It is perhaps *not* such common knowledge that we also organise smaller, more informal events, which focus closely on particular topics of interest. These events allow more detailed discussions to take place between senior ombudsman service staff and industry specialists, with the aim of increasing mutual understanding.



Seminars we organised recently focused on two areas of financial services where we have noticed a slow but steady increase in complaints: travel insurance and disputed card and cheque transactions.

Representatives from a wide range of banks, building societies, travel insurance providers and brokers, together with officials from various trade bodies, such as the *Association* of British Insurers and the Building Societies Association, took part in the seminars at our offices in London's Docklands on 14 September and 31 October.

The informal nature of the meetings helped generate lively and detailed discussion. Ahead of the events we invited participants to suggest topics of particular interest. These suggestions formed much of the agenda and helped ensure the discussions focused on areas of common concern. Feedback from participants has been positive, with the consensus being that businesses find events like this help them better understand the ombudsman's approach – and means they are better able to resolve complaints at an early stage, without the need for our direct involvement.

We are always keen to receive suggestions from businesses or consumer advisers of any particular topics they would like us to cover in events such as these. Just call our technical advice desk on 020 7964 1400 or email <u>technical.advice@financial-</u>

<u>ombudsman.org.uk</u>.



ombudsman news issue 58

seminar on disputed transactions 14 September 2006

This event covered a broad range of situations that may give rise to disputed transactions – from problems with personal identification numbers (PINs) to the cheque clearing process.

The following questions and answers summarise some of the issues touched on at the seminar.

what approach does the Financial Ombudsman Service take in cases involving disputed plastic card transactions?

A significant number of the banking complaints we see involve disputed card transactions. Typically, the customer denies having made a certain transaction – saying that someone must have discovered their PIN, or that the card must have been used without their permission or 'cloned'.

Meanwhile the banking or credit card firm insists the transaction is the customer's responsibility and that the problem may result from lack of sufficient care on the customer's part.

We decide such cases on the balance of probabilities. Is it more likely – considering all the details of the case – that the customer carried out the transaction but then forgot about it, or that their card was used fraudulently? *if a customer gets caught out by a cheque clearing scam are they* automatically *liable for their loss?*

When unresolved disputes like this are referred to us, we have to decide what the customer probably asked and what the bank or building society probably said. This type of scam is well known within the industry. In all good faith, a customer releases goods to a third party on the understanding that the cheque they received for those goods has been paid, when in fact it has not.

We generally expect the bank or building society – as professionals – to have been more aware than the customer of any potential underlying issues, including the possible subtext to any queries or concerns the customer may have raised at the time they paid the cheque in.





seminar on travel insurance 31 October 2006

This event focused on pre-existing medical conditions and the ongoing '*duty of disclosure*' under single trip and annual multi-trip policies. The following questions and answers summarise some of the issues touched on at the seminar.

> how does the ombudsman assess disputes involving non-disclosure or partial disclosure of medical conditions?

Many of the cases we see involve a dispute over pre-existing medical conditions – an issue which only tends to come to light once a claim is made. Much will depend on the details of the individual case, but we will generally take into account the following factors:

- did the customer know they had a particular condition?
- did the customer fully understand the term 'pre-existing condition'?
- was the customer asked clearly if they had such a condition? and
- if the customer withheld information, why may they have done so?



at what point should it become necessary to declare a medical condition?

Disclosure is generally required at the time a relevant question is asked. If an insurer requires disclosure at any other time, it will need to take specific steps to ensure the consumer understands this.

what is the ombudsman's opinion when an insurer cancels an annual policy following the customer's declaration of a serious medical condition?

We would normally consider this unfair, especially where a trip has already been booked. If an insurer agrees to provide cover for a year, it has agreed to take the risk of medical conditions developing during this time and must accept this. Exclusions will only apply if the customer chooses to travel against medical advice.

mortgage endowments: complaints about post-'A Day' sales

We recently published on our website (www.financial-ombudsman.org.uk) a briefing note on post-'A Day' mortgage endowment complaints. A post-'A Day' sale is one that took place after 29 April 1988 – when the provision of investment advice became regulated under the *Financial Services Act 1986*.

There is nothing new in the approach set out in the briefing note; the principles were established many years ago. But we hope the note will prove useful in drawing together some of the available information on the way in which we handle these complaints.

Here, we provide a short extract from the briefing note, together with some recent case studies.

'In general terms, since 'A Day', firms should:

- obtain sufficient personal and financial information relevant to the service to be performed for the customer to 'know the customer' and
- (based on that information) give recommendations that are suitable to the customer's circumstances.

We consider the regulatory requirements that applied to the firm at the time of the sale when deciding whether a recommendation was suitable for the particular customer.

There may have been something about the customer's circumstances, or about the policy itself, which meant that the firm should not have recommended the policy to that customer – irrespective of the customer's understanding of the risks involved. Examples could include situations where it was clear that the customer required a level of flexibility that was inconsistent with a long-term commitment or where affordability over the full term was likely to be an issue.

But in the vast majority of cases the underlying issue, when considering whether or not a policy is '*suitable*', is whether the policy exposed the customer to a risk (or level of risk) that they were unwilling, or unable, to take with the repayment of their mortgage.

One of the main differences with post-'A Day' (as opposed to *pre*-'A Day') cases is that there is likely to be more documentary evidence available from the time of the sale. With post-'A Day' complaints there may be a 'fact find', illustration, brochure or 'key features' document and (after 1995) a 'reason why' letter. Where these are available, we consider them carefully, along with the customer's circumstances, to help us decide whether the policy was suitable.'

case studies

mortgage endowments: complaints about post-'A Day' sales

58/6

In 1997, on the firm's recommendation, Mr and Mrs V took out a £30,000 interestonly mortgage and an endowment policy. The policy – invested in the firm's managed fund – had a 25-year term.

The 'fact find' which Mr and Mrs V signed records that, at the time:

- Mr V was 20 and employed as a factory worker, earning £13,000 a year
- Mrs V was 19 and employed as a cleaner, earning £6,000 a year and
- they had a young child and were expecting another baby in five months' time.

There was a question on the 'fact find' about '*attitude to risk in regards to using an investment vehicle to repay your mortgage*'. Customers answered this by selecting a number on a scale from 1 (signifying '*cautious*') to 10 (signifying '*speculative*'). The couple had answered with a '3'.

The firm told us it believed Mr and Mrs V had knowingly accepted the risk associated with the policy. It said the couple's answer to the question about attitude to risk suggested they had a '*balanced*' attitude, consistent with the policy it had recommended. The firm said it had given the couple:

- (at the time of the sale) an illustration which stated: 'These figures are only examples and are not guaranteed – they are not minimum or maximum amounts. What you will get back depends on how your investments grow'
- (after the sale) a 'key features' document and
- a 'reason why' letter, which summarised why it had sold the endowment policy.

Mr and Mrs V told us:

- they remembered the 'attitude to risk' question – they had ticked '3' because the adviser said '3 was average and normal' and
- they didn't understand the illustrations but had trusted the adviser, who said their mortgage would be repaid in full and they would receive 'at least £10,000 on top'.

complaint upheld

Mr and Mrs V took out the policy in 1997, so the regulatory requirements and standards introduced by the *Financial Services Act 1986* applied to the sale. We considered whether the policy sold to Mr and Mrs V had been suitable for them.

Mr and Mrs V's jobs at the time of the sale do not suggest there was scope for significant salary increases. They were struggling financially and found it difficult to save. It seemed likely to us, from their circumstances, that they would expect it to be difficult to cope with a shortfall on their mortgage. It was unlikely they would knowingly have risked having to do this. Mr and Mrs V's explanation of why they had answered the question about attitude to risk with a '3' appeared to us to be plausible. And we didn't think the record necessarily reflected their actual attitude to risk.

We thought the illustration and 'key features' document were likely to have been of secondary importance in the sales process to the information provided by the firm's representative. Mr and Mrs V's occupations did not suggest they would have been familiar with documents of this type, and we thought the couple would have relied heavily on the representative's advice.

The 'reason why' letter referred to the fact that the policy would be reviewed to ensure it remained on track to repay the mortgage. However, we were not persuaded that this would have alerted Mr and Mrs V to the extent of the risk presented by the policy, bearing in mind that the representative had already advised them that the policy was suitable for them.

After considering the detail of Mr and Mrs V's testimony, we were satisfied that they had not appreciated the risk posed by the managed fund policy. We did not consider the policy to have been a suitable recommendation and we upheld the complaint.

58/7

In 1993, acting on the firm's recommendation, Dr D took out a £63,360 interest-only mortgage and a with-profits endowment policy.

The mortgage application form that he signed stated that he:

- was working as a hospital doctor earning £40,000 a year
- was aged 30 and divorced with no dependants
- held approximately £20,000 on deposit in bank and building society accounts
- was looking to move house and
- already had a £30,000 interest-only mortgage supported by a with-profits endowment policy.

The firm's records showed that it had prepared an illustration the day before Dr D met the firm's adviser. The firm was not able to produce any other point-of-sale documentation.

The firm said:

- it had advised Dr D on his general finances in 1990 and, as a result, he had taken a Personal Equity Plan (PEP) and a unit trust
- with-profit funds are considered a low area of investment risk and were 'within the attitude to investment risk' demonstrated by Dr D's existing equity investments
- the illustration it provided had clearly shown that a shortfall was possible and
- Dr D had understood and accepted the risk that the endowment might not produce enough to pay off his mortgage.

Dr D told us:

- the adviser had said the endowment policy would cover his mortgage, provide surplus cash and work out cheaper than a repayment mortgage
- he had not received the firm's illustration – possibly because the firm sometimes sent documents to his work address and they didn't always reach him and
- his attitude to risk is extremely cautious; he would have taken a repayment mortgage if he had known the endowment policy carried any element of risk.

complaint rejected

Dr D took out the policy in 1993, so the regulatory requirements and standards introduced by the *Financial Services Act 1986* applied to the sale. We considered whether the endowment policy was suitable for him.

At the time of the sale, Dr D had savings in a building society account. Every month he paid £70 into a personal equity plan (PEP) invested in a UK fund and £80 into a unit trust invested in a family of funds.

We acknowledged that Dr D's attitude to risk might differ when it came to his mortgage rather than his savings. However, it seemed possible to us that Dr D had some knowledge of financial matters and might have been prepared to take some risk. He could expect a rising income from his occupation and the endowment policy was due to mature ten years before he reached retirement age. We thought it plausible that, in his circumstances, Dr D might have decided to accept a risk in return for the prospect of receiving a surplus over and above the amount needed to repay his mortgage.

The illustrations the firm had provided were clear. And since they had been prepared in advance of the meeting with Dr D, it seemed likely to us that they had formed part of the sales process. Of course, we couldn't be sure Dr D had seen the illustrations. However, we thought it likely that if he had done so, he would have understood them.

After considering the detail of Dr D's representations, we decided it was more likely than not that he had understood and accepted the risk of an endowment policy. We rejected the complaint.

58/8

In 1998, on the firm's recommendation, Mr and Mrs T took out a £40,000 interestonly mortgage and endowment policy. The policy was invested in a with-profits fund and had a 25-year term.

At the time of the sale, the adviser noted down his recommendations in a *'Customer Needs Analysis'* form which Mr and Mrs T had both signed. This form records that:

- Mr T was 38, working as a taxi driver, earning £10,000 a year and expecting to retire when he was 65
- Mrs T was 35, working as manager of a car rental shop earning £11,000 a year and expecting to retire when she was 60

- the couple had no savings or investments apart from the £3,000 they were using as a deposit for the house
- they did not expect to be in a position to save or invest in the future and
- they were buying their first home together and required a mortgage for £40,000.

The adviser's notes from the point-of-sale documents show that he recommended a with-profits endowment mortgage because it has a 'secure build-up of funds which matches clients' low tolerance to risk concerning the repayment of their mortgage' and because the couple 'anticipated moving home in the future'.

The adviser also noted that Mr and Mrs T were aware that '...although the idea of an endowment is to repay the mortgage sum at the end of its term, there is the potential to accumulate an additional lump sum, however this is not guaranteed.'

The firm told us:

- the adviser obtained sufficient information from Mr and Mrs T to make a suitable recommendation and he carefully documented their attitude to risk
- Mr and Mrs T had a low tolerance to risk, which matched the fund recommended.

Mr and Mrs T told us:

- the adviser assured them the policy was risk-free and would pay out a cash surplus at the end of the term, but a repayment mortgage would cost more and be less flexible
- they relied on what the adviser told them – but if they had known about the risk they would not have taken an endowment mortgage

- they told the adviser they didn't expect to be able to save in the future and
- if the adviser had discussed a shortfall, they would have expected him also to document how he expected them to fund it.

complaint upheld

Mr and Mrs T took out the policy in 1998, so the regulatory requirements and standards introduced by the *Financial Services Act 1986* applied to the sale. We considered whether the policy was suitable for the couple.

The adviser's notes stated that Mr and Mrs T had a '*low tolerance to risk concerning the repayment of their mortgage*'. We thought about this statement carefully. It seemed to us that it could mean more than one thing. A consumer – unused to the terminology of the investment industry – might think that having a '*low tolerance to risk*' meant they would not want to take a risk, not that they would be happy to accept a low risk.

And it was not clear from the adviser's notes whether the couple appreciated that it was the repayment of the mortgage that was '*not guaranteed*', or just the additional lump sum.

We thought it likely that there had been at least some sort of discussion about Mr and Mrs T's attitude to risk. But the notes and 'fact find' from the time of sale were not decisive in this case.

After considering the couple's circumstances and their detailed submissions, we decided that, on balance, the firm's recommendation had been unsuitable. It exposed the couple to a level of risk they were not prepared to take with the repayment of their mortgage. We upheld the complaint.

where? how? how? what?

⁶⁶ is it true that some cases are free?⁹⁹

⁶⁶where are the complaints-handling rules published?⁹⁹

⁶⁶who does the ombudsman service answer to?⁹⁹

look at the new section on our website

information for businesses covered by the ombudsman service

> for the answers to your questions

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