Business interruption insurance and the Coronavirus Job Retention Scheme (furloughing)

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On 5 March 2020, COVID-19 was designated as a 'notifiable disease' in England.[1] On 20 March 2020, the Government required pubs, restaurants, cinemas and gyms to close. Three days later it ordered all but certain essential shops to close, with the public being ordered to stay at home other than for limited purposes.

At the time of writing the 'lockdown' remains in force and seems likely to continue for some time. It is clear that the result of these measures will be huge losses to (or at least substantially reduced profits for) many businesses which have been forced to close entirely or substantially reduce or change their usual commercial activities.

Many of these businesses will have Business Interruption ("BI") Insurance and will expect that insurance to respond. Most will be disappointed. But a fortunate few (at least) are likely to have cover in principle. This is *not* an article about which wordings fall into which camp (much of this has been written and said elsewhere).

Rather, this article considers some of the issues an insured who otherwise has (or thinks it may have) cover should be thinking about in relation to its insurance. In particular, it looks at how a business' decision to furlough or not furlough staff pursuant to the Government's proposed Coronavirus Job Retention Scheme ("CJRS") might impact on recovery under BI Insurance.

The first step, however, for any insured which thinks it may be entitled to claim is to notify the insurer as soon as it thinks it has, or may have, such a claim. That is because it is common for policies to require that notice be given forthwith after any circumstances which may give rise to a claim, within a specified period of time of those circumstances or 'as soon as reasonably practicable' after those circumstances. Moreover, a failure to give such notice may constitute a failure to comply with a condition precedent to the claim and give the insurer a right to reject it. By contrast, there is generally little to be lost by promptly notifying insurers.

Once notice has been given, the insured is very often expressly required to take reasonable, or even all practicable, steps to minimise / avert its loss.[2] That term may, under some policies, even be a condition precedent to liability, so it is critical for the insured to comply with it.

Some steps that an insured would have to take pursuant to such a clause are obvious. To take an extreme case, a restaurant that choses to carry on ordering ingredients (only to throw them away in the absence of any kitchen staff or diners) is unlikely to be able to bring the wasted cost of the ingredients into the calculation of its losses. More generally, an insured should obviously do what it can to keep its business going as best it can. This could include providing its services or goods remotely where possible.

However, the Government's CJRS raises much more difficult issues. By way of reminder of the basics of the proposed scheme:[3]

1. The scheme is due to go live at the end of April 2020 and is intended to apply from 1 March 2020 until 30 June 2020 (although may be extended).[4]

2. The scheme will be designed to assist businesses whose workforce cannot be maintained because their operations have been "*severely affected*" by COVID-19. What "*severely affected*" means is not defined.

3. The scheme enables an employer who furloughs an employee to recoup from the Government 80% of their wages up to £2,500 per month plus the associated Employer National Insurance contributions and pension contributions (the employer can 'top up' up the employee's salary to 100% but will only recover 80%).

4. During the period of furlough, the employee cannot undertake work for, or on behalf of, the employer or any linked or associated organisation.

5. If an employer has recently made an employee redundant, they may re-hire them and furlough.

The current guidance is light on detail. As a result, businesses are having to

1. See https://www.gov.uk/government/news/coronavirus-COVID-19-listed-as-a-notifiable-disease

2. Whether the insured has such a duty absent an express term to that effect is open to debate but an insured would be safest to assume that there may be such a duty.

3. See https://www.gov.uk/guidance/claim-for-wage-costs-through-the-coronavirus-job-retention-scheme.

4. The Government extended the scheme until 30 June 2020 on 17 April 2020, see https://www.gov.uk/government/news/chancellor-extends-furlough-scheme-to-end-of-june

take decisions now about whether to furlough staff, make them redundant or continue to employ them normally without being sure whether, if they opt for the first option, they will in fact recoup 80% of the employee's salary etc.

These are difficult enough decisions without adding potential insurance-related complications. Unfortunately, such complications may exist as a result of any obligation on the insured to take steps to minimise its losses and the related (but different) principle that only losses caused by the insured peril are covered. For example:[5]

1. Take the case of an employee who could work from home, but the employer takes the view that the benefit to the business of the employee doing so is less than the cost of continuing to employ him as usual. If the employer therefore furloughs the employee on 80% of their wages, expecting all of that to be recouped from the Government, but for some reason it turns out not to be entitled to recoup anything,[6] the decision to furlough may actually increase the employer's loss:

   i. First, they have had to pay the employee for the entire period when they could have made them redundant, potentially at less cost. Unattractive as it might appear, insurers might seek to argue that by failing to make the employee redundant the employer has failed to minimise its losses.

   ii. Secondly, in the alternative, insurers might argue that if (as has turned out) the employer was going to have to pay the employee 80% of their wages to do nothing, it would have been better off financially to pay them 100% to do something productive. The decision to furlough has therefore actually increased the losses.

   iii. One potential answer to any argument by insurers to the effect that they were in either scenario released from liability, or not liable for the 'extra' loss, would be that the insured took a reasonable decision at the time it took it. But any such answer is obviously fact-sensitive and may in any event not be an answer on the relevant policy wording. Insurers might also argue that reasonable or not, the resulting additional losses are not caused by the relevant peril but by the insured's decision to furlough. By contrast, if there is a provision in the policy that permits the insured to recover additional losses incurred in trying to minimise its losses, the insured is likely to be on safer ground.

2. A different problem faces an employer who takes the view that the government scheme is intended to be a last resort and that it is wrong in principle to burden the taxpayer by using the scheme where it has BI insurance under which its losses (including from continuing to pay its employees as usual) are in principle covered.[7] However, might insurers not contend that the employer was obliged to furlough and claim recoupment under the scheme in order to minimise its losses? Any such argument would, we think, be desperately unattractive from a broad merits point of view. However, given the risk of such an argument, an employer may be effectively forced to put his scruples to one side and use the scheme, to the potential benefit of insurers and detriment of taxpayers[8], in order to play it safe. This is an area where one can imagine the Government may choose to intervene.

3. Another readily foreseeable scenario is that of an employer who furloughs an employee under the scheme but tops up the employee's salary to 100%: can insurers argue that the insured employer has thereby failed to minimise its losses such that the contribution of the extra 20% to the employer's losses is irrecoverable? Such an argument seems destined to fail if the employer had no real choice because it could not obtain the employee's consent to the necessary variation to the terms of employment. But what if the employee would readily have agreed to take just 80% if the alternative was redundancy? Again, it would seem somewhat surprising for the financial burden of an employer 'doing the right thing' to fall on it rather than insurers in this scenario and we think a tribunal is likely to look unfavourably on the contrary argument. However, as even a cursory look at insurance cases over the years will reveal, insurance is not always 'fair'.

4. Finally, as indicated above, it currently appears that under the CJRS a business which made an employee redundant may be permitted to re-hire them specifically to furlough them. At first sight that seems to be a recipe for

5. The following examples assume that the employee is willing to be furloughed and does not consider the employment law position where they refuse to do so.

6. Possible (non-exhaustive) reasons for failing to recover under the scheme could be that (i) they furloughed for less than three weeks, (ii) an employee answered an email during furlough period which constituted 'work', and/or (iii) HMRC takes the view that the employer's business was not "*severely affected*".

7. The opprobrium that has fallen on certain wealthy football clubs for indicating an intention to use the scheme and their about-turns in the face of such shows that these are difficult waters.

8. The term 'potential benefit' is used because there may be arguments that the benefit of the government scheme should not inure to the benefit of insurers.

potential abuse, and it is possible that the eventual rules relating to re-hiring and then furloughing will be made very tight. But if an employer makes the decision (in good faith) to re-hire and furlough someone now and then is not in fact permitted to recoup 80% of the employee's wages, will insurers again be able to say that by re-hiring the person the insured has not minimised its losses and/or the additional resulting loss is not covered? Here we think insurers may be getting onto stronger territory.

When considering these issues, it is important for the insured to check whether a specific limit of liability has been agreed for the insured peril (e.g. 'notifiable disease' or 'actions of a competent authority'). It is common for insurers to only cover a small percentage of the gross profit limit agreed for business interruption generally for such perils and, if so, this may have an impact on the extent to which the insured directs its behaviour by reference to its ability to claim.

One final practical point to mention is that the insured should be astute to keep evidence to support its future claim for loss caused by the relevant peril, not overlooking the fact that the relevant evidence may well include documents relating to the period prior to closure (since many policies calculate the sum recoverable by reference to a comparison of profits during the period of business interruption compared to those for a prior period). Contemporaneous records of the reasons for decisions taken may also assist. It will be readily apparent that even an insured who manages to persuade insurers or the relevant tribunal that it has BI Insurance in principle, may well face a number of challenges in recovering its losses under the policy. There will be no substitute for careful consideration of the policy terms and the relevant facts in that event.

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Philip is a specialist lead advocate whose practice focuses on commercial disputes in areas including insurance, fraud, banking, commodities, energy and shipping. He has considerable experience in relation to freezing injunctions. Philip is also particularly noted for his cross-examination skills.

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Read his online bio ›

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Andrew has extensive international commercial litigation and arbitration experience. He has recently advised numerous businesses on their business interruption coverage for COVID-19 under Combined 'All Risks' Policies.

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