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Furlough and Insolvency – Carluccio's in the High Court

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Furlough and Administration

- Government Coronavirus Job Retention Scheme
- Paragraph 3(1)(b) of Schedule B1 of the Insolvency Act 1986
- Rescuing the company as a going concern, or
- Achieve a better result for the Company's creditors than would be achieved in a winding-up order, or
- Realising property in order to make a distribution to one or more secured or preferential creditors.

Furlough and Administration

- British Chamber of Commerce Survey
 - More than 70% of private firms have furloughed staff
 - 59% of firms have at most 3 months of funds in reserve
 - 30% of firms have furloughed 75-100% of employees

What happened in Carluccio's?



The Carluccio's Case

- **In the matter of Carluccio's Ltd (in administration) [2020] EWHC 886 (Ch), Snowden J**
- Application by the Administrators
- For a declaration
- Under paragraph 63 of Schedule B1 of the Insolvency Act 1986

The Carluccio's Case

- Why was this done?
- All 70 branches closed 16 March 2020
- c.1,800 staff
- Administration order made 30 March 2020
- Government's stated intention CJRS would enable employers, including those in administration, to furlough employees whose services cannot be used due to the current COVID-19 pandemic
- Urgency: Needed decision before 14 day "safe" period when actions of administrators not lead to adoption of employment contracts

The Carluccio's Case

- Why was this done?
- Had no money to pay wages
- Unless could use CJRS
- **AND** limit liability for wages
 - 80%
 - Payment by CJRS
- Redundancies would have to be made
 - Against the spirit of the CJRS?
- Bad for employees/Bad for business sale value

The Carluccio's Case

- Scheme Guidance - Who Can Claim?
- *“Where a company is being taken under the management of an administrator, the administrator will be able to access the Job Retention Scheme. However, we would expect an administrator would only access the scheme if there is a reasonable likelihood of rehiring the workers. For instance, this could be as a result of an administration and pursuit of a sale of the business.”*

The Carluccio's Case

- Plan of Administration
- “Mothball” strategy
- Sell business
- Want to retain e/ees for this
- Focus on best result for creditors
- So not retain e/ees if liability for wages falls to insolvent Carluccio's, not Government

The Carluccio's Case

- Actions of the Administrators
- Within first 14 days
- Administrators made offer to employees to place them on furlough
 - Still early in CJRS - limited guidance
 - Para 4 recognises limits of Govt guidance
- Overwhelming majority e/ees accepted
 - 4 rejected, sought redundancy
 - Others non-responding (but short time period)

The Carluccio's Case

- Variation Letter
 - Within first 14 days - so not action leading to adoption
 - Found to vary the contract where accepted
 - Not implied acceptance for non-responding e/ees (para 46-54)
 - Could have implied acceptance in other circumstances (para 54)
 - **Abrahall v Nottingham CC [2018] ICR 1425, CA**, applied
 - If accept later, not action by admin, so not cause adoption
 - Not liable for wages/salary in excess of CJRS 80% and until CJRS funds received
 - Warned if not accept, be considered for redundancy, not impliedly accept furlough

The Carluccio's Case

- Issues
 - Claim by/payment of 'income' to employer
 - Payment to e/er bank account, not separate
 - Monies paid = asset of company in administration
 - Order of priorities for administrators to dispose of assets of company in administration
 - CJRS Guidance no provision for holding money on trust

The Carluccio's Case

- Issues
 - How to justify payment of such wages and salary in priority to other claims against the Company?
 - Paragraphs 99 and 66 of Schedule B1 IA 1986.
 - Adoption of a contract of employment
 - Super-priority of wages - para 99
 - Payable before admin's fees/expenses

The Carluccio's Case

- 'Wages'?
 - Includes holiday pay and contribution to occupational pension schemes
 - Does not include redundancy payments, unfair dismissal payments, PILON and protective awards.
- If not adopted in first 14 days, merely unsecured provable debts

The Carluccio's Case

- Issues/Details
 - Paragraph 66 of Schedule B1 IA 1986:
 - *“The administrator of a company may make a payment otherwise than in accordance with paragraph 65 or paragraph 13 of Schedule 1 if he thinks it likely to assist achievement of the purpose of administration.”*
 - Plug gaps?

Adoption of the Contract

- Leading case on the meaning of “adoption” in the context of Paragraph 99(5) **Powdrill v Watson & Anor (Paramount Airways Ltd)** [1995] 2 A.C. 394, HL, applied
 - Para 57 - 68 (66-68)
 - Appointment of an administrator itself does not terminate employment
 - “... *the mere continuation of the employment by the company does not lead inexorably to the conclusion that the contract has been adopted by the administrator or receiver.*”
 - Adoption an all or nothing concept - cannot pick and choose liabilities/apply conditions to adoption

Adoption of the Contract

- *“It is common ground that adoption does not mean an assumption of personal liability by the administrator ... the issue is not whether the company is liable on the continued contract but whether the liability on the contract is to have a higher priority....adoption in sections 19 and 44 can only connote some conduct by the administrator or receiver which amounts to an election to treat the continued contract of employment with the company as giving rise to a separate liability in the administration or receivership.”*

Adoption of the Contract

- Normal situation, that conduct on the part of the administrator is likely to occur when the administrator communicates to the employee that the business remains open, and that the employee should attend for work in the usual way.
 - Avoid mischief of administrator signifying willingness that the funds of the company should be used to pay wages or salary for the work done in priority to unsecured claims then failing to pay

Key Conclusions in Carluccio's

- Conclusions
- Para 91 - adoption for consenting e/ees when:
 - Apply under CJRS
 - Or unexpected money becoming available to pay
 - *"Administrators would be doing an act which could only be explicable on the basis that they were electing to treat the varied contract as giving rise to liabilities which qualify for super-priority."*
- Not duty on admin to apply to scheme

Key Conclusions in Carluccio's

- Conclusions
- Para 93-96 re attempt to exclude adoption by wording in the variation letter - not determinative but a mistake
- Objecting employees
 - Not varied
 - Not adopted
 - Unsecured
- Non-responding
 - Not varied, unless accept prior to termination
 - Unsecured

The Carluccio's Case

- Commentary/Future Potential Steps
- Para 35:
 - *“It might be that when the detail of the legislation and regulations giving effect to the Scheme are drafted and published, the Government will propose a regime that imposes a trust mechanism, or that modifies or entirely bypasses the normal insolvency legislation in some, as yet unidentified, way.”*
- Para 62 re **Paramount** recognising the “quite inadequate” initial 14 day period

The Carluccio's Case

- Limits:
 - Parties - no representative employees/other interested parties - only Unite (no consultation)
 - Therefore, not binding (para 7)

What happened in Debenhams?

Debenhams Retail Limited

[2020] EWHC 921 (Ch)

- Background
 - Suffered significant financial difficulties for a period of time.
 - Forced to shut 142 stores, with only online business continuing to trade.
 - 25th March 2020 Company wrote to c. 13,000 employees informing them of the decision to furlough them and pay only 80% of salaries.
 - Entered administration on 9th April, by which time most of the 15,500 employees had been furloughed.

Debenhams Retail Limited

[2020] EWHC 921 (Ch)

- Administrator's plan
 - “Light touch administration”.
 - Intended to rescue the Company as a going concern.
 - Mothball the business and retain the employees.
 - 10th April 2020 Administrators sought employees' express consent to being furloughed and associated pay cut. 12,700 consented, 4 objected, 359 failed to respond.
 - Proposed to pay out of cash reserves and then be reimbursed by the JRS.

Debenhams Retail Limited

[2020] EWHC 921 (Ch)

- Administrator's concerns
 - If, by continuing to furlough employees, contracts of employment were adopted, concerned that all of the employees' wages and salary entitlements would obtain "super-priority" under para. 99(5) Sch B1.
 - Exposure of c. £3 million per month.
 - Also concerned about the lack of clarity of the treatment of sick pay and holiday pay, which would attract "super-priority".
 - Adoption would have significant negative consequences for the Company and its employees, and an adverse impact on the wider rescue culture underlying the administration regime.

Debenhams Retail Limited

[2020] EWHC 921 (Ch)

- The Issue
 - Would simply continuing the furloughing amount to an adoption of the employment contracts?
 - Administrators sought a declaration that it would not.
 - Argued Snowden J had erred in invoking para. 99 Sch B1. He should and could have relied on para. 66 which would not invoke super-priority.

Debenhams Retail Limited

[2020] EWHC 921 (Ch)

- The Decision
 - Agreed with Snowden J’s analysis of para. 99.
 - Absence of actual services being rendered did not prevent adoption of the contracts.
 - The Administrator’s criticism of Snowden J re. para. 66 “missed the point”. Contracts would be adopted by participation in the JRS. Adoption meant that para. 99 required the Administrators to make the payments which participation in the JRS require Carluccio to pay.

Debenhams Retail Limited

[2020] EWHC 921 (Ch)

- The Decision (contd)
 - Causing a company to treat a person as an employee after the 14-day post-administration period means the contract of employment will have been adopted for the purposes of para. 99.
 - “Mere continuation” is not enough, there must be positive conduct by the Administrators.
 - Participation in the JRS amounted to the requisite positive conduct.
 - The fact that services weren’t being supplied by the employees was irrelevant on these facts.
 - Administrators’ subjective intention as to ranking was not the issue.

The Implications

- Where Administrators cannot obtain the consent of enough employees to vary their contracts to accept only the 80% under the JRS, the inevitable adoption by use of the JRS could lead to Administrators declining to use it and making more employees redundant so as to avoid super-priority.
- Care should be taken to explain the likely consequences to employees, though take care not to stray into the realms of duress/undue influence.

What is the impact of these cases?



Collective Consultation

- Numbers proposed in 90 days?
 - 20+/100+
- Length of consultation
 - 30 days/45 days
- Potential for protective award
 - Up to 90 days' pay per employee
 - Special circumstances 'defence'?
 - Rendering consultation impractical

Conclusions

- Whilst the decisions are not binding, they do tell us:
 1. The JRS applies to companies in administration.
 2. Administrators will be taken to have adopted employment contracts, whether they cause the employee to be furloughed or not, if they apply under the JRS.
 3. Having utilised the JRS, the company's liabilities to furloughed employees obtain super-priority.
 4. Contracts can be properly varied before applying under the scheme to limit liabilities to the equivalent of the sums received under the JRS.
 5. Where a company has cashflow issues, unlawful deductions claims can be avoided by varying the contract to reflect the timing of receipt of the government grant.

Any Questions?

