serle court

CASE COMMENT

Furlough and Administration: *In the matter of Carluccio's Limited* [2020] EWHC 886 (Ch)

As the Government's '*Corona Virus Job Retention Scheme*' – or furlough programme – kicks into action, the decision of Snowden J *In the matter of Carluccio's Limited* provides welcome guidance for administrators on the interaction between furlough and Schedule B1 of the Insolvency Act 1986. At present the legislative underpinnings of the furlough programme are yet to be announced and IPs are limited to the Government's online guidance to understand its operation. The *Carluccio's* judgment offers welcome relief that administrators, in appropriate cases, can furlough staff to retain them as a valuable asset for distressed businesses.

Background

The troubles of the Italian restaurant chain Carluccio's have been well documented in the press and it was perhaps one of the first casualties of the Corona virus and the UK lockdown. It entered administration on 30 March 2020, its venues had all been closed since 16 March 2020, and 13 April 2020 (Easter Monday) was the last day of the initial "safe" period the administrators enjoyed during which their actions could not amount to an adoption of contracts of employment. The administrators' strategy was to "mothball" the chain with a view to selling the business pursuant to the aim under paragraph 3(1)(b) of the Schedule B1; however, this crucially relied upon the administrators retaining the business's employees rather than making them redundant. The administrators were only willing to do so if the employees' salaries would be met from the Government's furlough scheme thereby avoiding any further liabilities for the business.

The relevant terms of the furlough scheme are that the Government will cover 80% of retained workers' salaries up to £2500 per month, payments to businesses to cover such salaries are to be treated as income and the employer must pay all the grant to the furloughed employee as gross pay. The scheme guidance confirms that it applies to companies in administration but the Government '*would expect an administrator would only access the scheme if there is a reasonable prospect of rehiring the workers*'. Snowden J considered that the word "rehired" clearly envisaged a circumstance in which the business was sold, the employees transferred, and they would resume working (and come off furlough) at the restaurants after lockdown.

Shortly after the administration, the administrators had written to the employees informing them that the company intended to place them on furlough but invited them to agree to a variation of their terms of employment so that their salaries were capped at the furlough amount. Over 95% of the 1788 employees accepted the offer, 4 had rejected it and 77 had not responded.

Issue for the Court

The real issue for administrators is that the furlough scheme clearly states that payments under it are to be accounted for as income and, as such, constitute

assets of the company in administration which have to be dealt with in accordance with the order of priorities in the insolvency legislation. There is no suggestion that these sums are being advanced by the Government to distressed companies on a form of Quistclose trust. The administrators therefore sought directions from the Court as to whether they could rely on the "super-priority" provisions related to employees in paragraph 99(5) of Schedule B1. That provides that the payment of salary or wages due under a contract of employment 'adopted' by the administrators shall be paid in priority to the administrators' own expenses, claims of floating charge creditors and unsecured creditors.

Decision

First, Snowden J held that the letters sent by the administrators had validly amended the contracts of employment of those employees who had accepted their offer.This was crucial to the administrators' plans because it meant the company could only be liable for the maximum amount payable under the furlough scheme. The contracts of the rejecting employees and, at least at present, those of the non-responsive employees had not been varied.

Secondly, Snowden J concluded that the varied contracts would be adopted by the administrators within the meaning of paragraph 99(5) as and when the administrators made an application under the furlough scheme or made any payments pursuant to the varied contracts. His Lordship referred to the dictum of Lord Browne-Wilkinson in *Powdrill v Watson* (*Paramount Airways Ltd*) [1995] 2 AC 394 who held that this concept '*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*'. A mere failure to terminate employment contracts will not amount to adoption. Once the application for furlough grants were made that would only be explicable on the basis that the administrators were electing to treat the varied contract as giving rise to liabilities which qualify for super-priority.

Thirdly, the consequence of this analysis was that making such an application for furlough grants under the Government scheme would enable super-priority payments to be made outside the ordinary waterfall via paragraph 99(5) by either using the grant funds as and when received, or making payments from other company funds which would be reimbursed once the grants were received.

Analysis

Carluccio's is clearly a welcome decision in providing clear guidance to IPs and in adopting a rescue-centred approach to the application of the Government's Covid-19 response measures. For example, Snowden J was unconvinced by the view that paragraph 99(5) should not apply to furloughed workers because the section was designed to remedy the mischief of employees rendering services in an insolvency for no reward. His Lordship noted that parliament could have imposed such an express limitation had it wished to and, in any event, there could be very good commercial reasons to keep an employee retained whilst there was no work for her to do (e.g. she had valuable know-how that if obtained by a competitor would devalue the business the administrator was seeking to sell). Rather the Court ought to strive for a construction of the insolvency legislation that gave effect to the furlough scheme and the Government's efforts to support the economy. It is to be hoped that this is the approach adopted by the courts generally.

The decision does also highlight the risks of the Government enacting programmes without detailed legislation and guidance. Indeed, Snowden J paused to consider whether he ought to give directions at all when it was not possible to convene any representative employees to the proceedings. It would be unfortunate if administrators – or indeed companies generally – felt the need to seek regular guidance from the courts in relation to the Covid-19 measures introduced by the Government.

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Yeah of Call: 2016