

**Guidance for administrators considering furloughing employees**

***Re Carluccio’s Limited (in administration), Re the Insolvency Act 1986* [2020] EWHC 886 (Ch)**

**Introduction**

1. On 13 April 2020 Snowden J handed down judgment giving directions to the administrators of Carluccio’s Limited (the “**Administrators**”, the “**Company**”). The Administrators sought guidance and directions on whether, and how, they could place employees of the Company onto the Government’s furloughing scheme announced on 20 March 2020 in response to the Covid-19 pandemic (the “**Scheme**”).

**Background**

1. The Administrators’ current strategy is to ‘mothball’ the Company’s business during the Covid-19 lockdown and to seek a sale of the business in order to achieve a better result for creditors than on winding up. The Administrators stated that they had received several expressions of interest regarding a potential sale. However, the evidence of the Administrators was that the Company has no money with which to pay its employees in the meantime.
2. The Administrators had sent letters to all of the Company’s employees who were not immediately required to assist the Administrators, offering to employ them on varied terms (the “**Variation Letter**”). The Variation Letter set out the Administrators’ intention to place the employee on furlough leave, to claim under the scheme in respect of that employee, and stated that the employee would only be paid if and when the Company received a grant from the Government under the Scheme in respect of that employee.
3. As of 10am on 7 April 2020, 1,707 of the 1,788 employees sent the Variation Letter had consented to its terms (the “**Consenting Employees**”), 4 had rejected it (the “**Objecting Employees**”) and stated that they wished to be made redundant, and the remaining 77 had not responded (the “**Non-Responding Employees**”).
4. The urgency of the Administrators’ application was due to the 14-day grace period under paragraph 99(5) of Schedule B1 of the Insolvency Act 1986, under which their actions for that period were not to be taken as adopting any contracts of employment with the Company’s employees. The end of that period was on 13 April 2020 and the Administrators sought confirmation that (i) they had successfully varied the contracts of employment of the Consenting Employees, (ii) that they had not by their actions adopted the contracts of the Objecting Employees, and (iii) they would not have to dismiss the Non-Responding Employees prior to the end of the 14-day period in order to avoid adoption of their contracts of employment.
5. The problem facing the Administrators and their legal representatives, and the reason for seeking directions, was as follows:
   1. As yet no draft legislation or regulations have been published for the Scheme, which has effect from 1 March 2020. The only indications of the scope of and criteria for the Scheme are those set out in the speech of the Chancellor, the Rt. Hon. Rishi Sunak, in his speech on 20 March 2020, and in the online guidance provided at <https://www.gov.uk/guidance/claim-for-wage-costs-through-the-coronavirus-job-retention-scheme> (the “**Scheme Guidance**”).
   2. As such, although it is clear from the Scheme Guidance that the Scheme is intended to be available to companies in administration where there is a “*reasonable likelihood of rehiring the workers*”, it is not clear how the Scheme is intended to work in the insolvency process.
   3. The Scheme Guidance states that the furlough payments are to be paid to the employer rather than the employee. As Snowden J noted, that creates a potential problem: “*[u]nder the insolvency legislation, administrators are not free to dispose of the assets of the company in administration as they see fit, but must do so in accordance with the insolvency legislation and, in particular, by making payments in the order of priorities prescribed in that legislation*”.[[1]](#footnote-2)
   4. While there are means to ensure that monies payable to a company in financial difficulties are to be held on trust to make specific payments, nothing in the Scheme Guidance indicates that such techniques should be employed in this case, bar (possibly) the statement that “*[y]ou must pay the employee all of the grant you receive for their gross pay in the form of money*”.[[2]](#footnote-3)
   5. Accordingly, the question is whether there is a mechanism under the existing insolvency legislation by which the Administrators can make payments to furloughed employees in priority to other claims against the Company.
   6. The only “*realistic*” candidates for such a mechanism are those under paragraphs 99 and 66 of Schedule B1 of the Insolvency Act 1986. Snowden J’sanalysis commenced with (and ultimately only required) paragraph 99 as it is specifically concerned with administrators’ ability to pay wages or salary to employees in an administration.
   7. Under paragraph 99 the adoption of a contract of employment by the Administrators makes the payment of wages and salary due under the contract a ‘super-priority’, ranking ahead of many other claims in the administration. Without adoption the employees of the Company rank as unsecured creditors.

**Decision**

1. Snowden J considered whether it was appropriate to give directions to the Administrators at all:
   1. Due to the urgency of the application and the difficulty of liaising with employees it had not proved possible to join any representative employees or interested parties to the application.[[3]](#footnote-4) As a consequence, the judge stated that he could not see how his decisions and directions on the law would bind any of the affected employees or the Government.
   2. Snowden J also noted the lack of information about how the Scheme was intended to operate as a matter of law in insolvency.
   3. However, the judge concluded that “*the court should do what it could to give a view of the legal issues to assist the Administrators…wherever possible, the courts should work constructively together with the insolvency profession to implement the Government’s unprecedented response to the crisis in a similarly innovative manner*”.[[4]](#footnote-5)
2. The first question is whether the Variation Letter served to validly amend the contracts of employment of the employees to whom it was sent. Snowden J found that:[[5]](#footnote-6)
   1. The Variation Letter had that effect for Consenting Employees and those of the Non-Responding Employees who subsequently agreed.
   2. The Objecting Employees would be made redundant and their contracts of employment terminated.
   3. The other Non-Responding Employees cannot be taken to have consented to vary their contract of employment.
3. The second question was whether (or what) actions of the Administrators constituted adoption of the employment contracts in view of paragraph 99(5) of Schedule B1. Snowden J concluded that:[[6]](#footnote-7)
   1. The Variation Letter was sent out within the 14-day grace period so did not constitute adoption.
   2. When the Administrators made an application under the Scheme in respect of a given Consenting Employee, or made a payment to an employee, that constituted adoption of that employee’s contract.
   3. The contracts of the Objecting Employees were not varied or adopted.
   4. If the Non-Responding Employees agreed within the 14-day period they would be in the same position as the Consenting Employees.
   5. After the 14-day period and given the business was ‘mothballed’ there was nothing that could be done or said by the Administrators that would constitute adoption – so there was no risk of adopting the original contract of the remaining Non-Responding Employees. Mere failure to terminate the contracts of employment did not constitute adoption.[[7]](#footnote-8)
   6. If and when the Non-Responding Employees consented or objected after the end of the 14-day period, they would be in the same position as the Consenting or Objecting Employees.
   7. If any Non-Responding Employees continued not to respond then their contracts would not be varied or adopted and they would be an unsecured creditor in the administration.
4. Snowden J also noted that the Administrators could continue to ensure that the Variation Letter had reached the Non-Responding Employees (and assist them in making a decision on it)without risking adoption of the original employment contract: “*[a] reiteration by the Administrators after 14 days of the offer of a varied contract is the antithesis of an act of adoption of the contract in its original form*”.[[8]](#footnote-9)

**Conclusion**

1. This decision provides welcome guidance for insolvency practitioners at a time of great uncertainty. However, and as Snowden J noted, it is not clear how the Government or the employees of the Company will be bound by the decision given they were not represented, and it may be that the conclusions that the judge reached turn out to be wrong, or are overtaken by events and/or the legislation for the Scheme.
2. In the meantime, it would appear advisable for administrators to follow the model adopted by the Administrators and seek directions from the court if they intend to take advantage of the Scheme, while joining as many interested parties as possible in the limited 14-day window provided by paragraph 99(5) so that they are bound by the decision.
3. It is difficult to see what else administrators might do in these circumstances, and any challenge by employees or other creditors that seeks to defeat the logic of this decision is likely to be unattractive to any tribunal.

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**15 April 2020**

1. Paragraph 32 of the judgment [↑](#footnote-ref-2)
2. Paragraph 33 [↑](#footnote-ref-3)
3. Paragraph 7. Snowden J did however receive written submissions from Mr Brittenden and heard submissions from Mr Segal QC on behalf of Unite the Union: paragraph 11. Unite did not have any time to consult its members, several of whom are among the employees of the Company, but sought to protect their interests. [↑](#footnote-ref-4)
4. Paragraph 9. [↑](#footnote-ref-5)
5. Paragraphs 44 to 54. [↑](#footnote-ref-6)
6. Paragraphs 90 to 102. [↑](#footnote-ref-7)
7. Paragraph 99 [↑](#footnote-ref-8)
8. Paragraph 110. [↑](#footnote-ref-9)