KIRKLAND & ELLIS

Kirkland Alert

Treatment of Furloughed Employees in Administration Proceedings — the First English High Court Judgment

14 April 2020

At a Glance

In the first ruling of its kind, the English court ruled on 13 April that the UK's Coronavirus Job Retention Scheme in respect of furloughed employees ("the Scheme") is available to a company in administration, and provided related directions as to the variation and adoption of affected employment contracts.

The case followed a letter ("the Variation Letter") from the administrators of Carluccio's Limited ("the Company"), which:

- placed employees on "furlough leave", requiring them not to undertake any work for the Company;
- announced an intention to apply under the Scheme for grants equal to 80% of the employee's regular wages, up to the applicable cap of £2,500 per month, per employee; and
- provided that the varied contractual pay would be the portion of the employee's regular wages that the grant would cover: the Company would only pay if and when it received the grant; the Company would not be liable for wages/salary above amounts actually received.

The court directed that the administrators could act upon the basis summarised in the following table (and explained further below).

Category	Consenting Employees	Objecting Employees	Non-Responding Employees
Definition	Employees who expressly agreed to the Variation Letter	Employees who expressly objected to the Variation Letter	Employees who did not respond to the Variation Letter
Were employment contracts varied by the Variation Letter?	Yes	No	No (unless the employee accepts the Variation Letter prior to the termination of their contract)
Were employment contracts adopted by the administrators?	Yes — when the adminstrators pay them or make an application in respect of them under the Scheme	No	No (unless the employee accepts the Variation Letter prior to termination of their contract — in which case, adoption will occur as per other Consenting Employees)

Crucially, the judgment is simply that the administrators may act on the above basis — without prejudice to any employee's argument as to the true legal position. Owing to the urgency of the matter, and absent adversarial argument or any draft legislation in respect of the Scheme, Snowden J concluded that his decision could not actually bind any of the affected employees or the government.

The ruling effectively buys the administrators additional time, in a divergence from the usual approach in which administrators take steps to terminate the contracts of

employees they do not wish to adopt within the first 14 days following their appointment.

The judgment provides welcome, timely clarification as to the variation and adoption of employment contracts for companies in administration seeking grants under the Scheme. Its practical impact may be somewhat limited by the fact that it was the administrators who sought to furlough employees; the position may differ where employees are already furloughed when the company enters administration, or employees' consent is not expressly sought.

The judgment also includes a welcome statement that “wherever possible, the courts should work constructively together with the insolvency profession to implement the government’s unprecedented response to the crisis in [an] innovative manner”.

Background — the Company and its Furlough Arrangements

All branches of the Company’s Italian casual dining chain have been closed since 16 March, 2020, owing to UK COVID-19 social distancing requirements. The Company entered into administration on 30 March as a consequence. Evidence showed that the Company had no money with which to pay the continuing wages of its employees. Accordingly, unless it could take advantage of the Scheme (and limit its liability for wages to the amount it could claim under the Scheme), the administrators would have been forced to make the workforce redundant. That would not only have a prejudicial effect on the employees, but also on the value of the business, which the administrators hope to sell.

The administrators offered to place employees on furlough via the Variation Letter. The overwhelming majority of employees accepted that offer; a handful indicated they would prefer to be made redundant and retire; a relatively small but significant number had not yet responded.

Counsel for the administrators adopted a neutral position on the outcome of this case.

Background — the Scheme

No draft legislation or regulations have yet been published in respect of the Scheme. Online guidance for employers provides that "[i]f you cannot maintain your current workforce because your operations have been severely affected by coronavirus (COVID-19), you can furlough employees and apply for a grant that covers 80% of their usual monthly wage costs, up to £2,500 a month".

The Scheme is intended to be available to companies in administration, as well as those who are not in an insolvency procedure. Guidance provides that "[w]here a company is being taken under the management of an administrator, the administrator will be able to access the [Scheme]. However, we would expect an administrator would only access the [S]cheme 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." Evidence showed that the Company's administrators had received several expressions of interest in the business.

Background — Treatment of Employment Contracts in Administration

The appointment of administrators does not terminate contracts of employment, which continue in effect unless and until notice to terminate is given or the contract is repudiated.

Under the Insolvency Act 1986 (paragraph 99, Schedule B1), liabilities for wages/salary arising out of contracts of employment adopted by an administrator are payable as a super-priority expense. They rank ahead of the administrator's own remuneration and expenses, which in turn have priority over the claims of floating charge creditors and unsecured creditors. Administrators have an initial "safe" period of 14 days during which actions of the administrators will not amount to adoption of any contracts of employment.

In contrast, employees whose employment contracts are not adopted do not gain the benefit of super-priority; their claims are instead merely unsecured provable debts.

For adoption to take place, "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"; what is required is "some conduct by the administrator … 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".[1]

Judgment

The ruling distinguishes employees based on their response to the Variation Letter, which expressly required employees to respond positively in order to agree the variation.

The court directed that the administrators could act upon the following bases.

- **Consenting Employees'** employment contracts were varied pursuant to the Variation Letter — i.e., they would be entitled only to payment of wages/salary at a level equal to the grant received under the Scheme (i.e., a maximum of 80% of normal pay, up to a cap of £2,500 per month, per employee), and only once received. Adoption of Consenting Employees' contracts would occur when the administrators paid them (under their varied contracts) or made an application in respect of them under the Scheme. Alternatively, although this was not anticipated, if funds were unexpectedly to become available to the administrators to make payments of wages to the furloughed employees prior to the receipt of monies from the Scheme, that too would amount to adoption of the varied contract. In either case, the 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.
- **Objecting Employees'** employment contracts were not varied; their employment contracts would not be adopted by the administrators. They would be made redundant and their existing employment contracts would be terminated.
- **Non-Responding Employees'** employment contracts would not be varied unless the employee were to accept the Variation Letter prior to termination of their contract, in which case adoption would occur as with other Consenting Employees. Those who continued to not respond to the Variation Letter would simply continue to be employed by the Company on the terms of their unvaried contract unless and until it was terminated, but they would merely be an unsecured creditor in the administration in respect of any claim under the contract.

The court held that the administrators were under no duty to apply under the Scheme for Objecting Employees or Non-Responding Employees (unless and until the latter became Consenting Employees).

Further applications are expected by other companies regarding similar employment issues.

Kirkland continues to advise in relation to a number of retailers and consumer-facing businesses. Enquiries on related issues should be directed to Elaine Nolan, Kate Stephenson or your usual Kirkland contact.

---

1. *Powdrill v Watson & Anor* (Paramount Airways Ltd) [1995] 2 A.C. 394..↩

Authors

Kate Stephenson

Partner / London

Related Services

Practices

- Restructuring