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Use of the Government's coronavirus job retention scheme by companies in administration: Re Carluccio's Limited [2020] EWHC 886 (Ch)

– 16.4.2020

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Matthew has an impressive commercial practice with a particular specialism in insolvency and company law. He is also experienced in commercial fraud and asset tracing, and partnership and professional liability, allowing him to provide his clients with a wide commercial law service covering a range of commercial issues and disputes.

In a judgment handed down on Monday 13th April 2020 in *Re Carluccio's Limited (in administration)* [2020] EWHC 886 (Ch), Snowden J considered the application of the Government's Coronavirus Job Retention Scheme in administrations both as a matter of principle and in respect of the logistics and practicalities involved for office holders. Matthew Weaver considers the judgment and its implications in this briefing.

The Background

Carluccio's Limited entered administration on 30th March 2020 pursuant to a court order. Having traded as a chain of restaurants, it was forced to close all of its branches (over 70 nationwide) on 16th March 2020 as a result of the Government's strategy to combat the COVID-19 pandemic. As at administration, the Company had around 2,000 employees.

The Administrators' intended strategy for the Company was to "mothball" the business whilst trying to sell it to achieve a better result for creditors. As part of this strategy, the Administrators wished to retain the employees and claim on the Government's Coronavirus Job Retention Scheme ("the Scheme") rather than making the employees redundant. The intention was that the employees would then be transferred to any purchaser of the Company's business.

Whilst the strategy was relatively simple, it posed a number of possible problems. The Company was not able to meet any employment costs and incurring any additional liabilities to employees was not in the best interests of creditors. As such, only if the Administrators could limit the entitlement of retained employees to the sums received from the Government under the Scheme were they prepared to furlough the employees.

In order to limit the liability of the Company to sums received from the Government under the Scheme, the Administrators sent a letter to 1,788 employees in which a variation of their contracts of employment was offered to limit their salary entitlement to the sums received from the Government and to restrict the Company's obligation to pay those sums to as and when the Company received payment from the Government under the Scheme ("the Variation Letter"). By shortly before the hearing, 1,707 employees had accepted the proposed variation to their contracts of employment ("the Consenting Employees"), 4 had rejected it (preferring to be made redundant) ("the Objecting Employees"), and 77 had not responded ("the Non-Responding Employees").

The Issues

The issues confronting the Administrators and on which they sought the Court's determination were:

1. Was the Scheme open to companies in administration?

2. Had the Variation Letter been effective to vary the contracts of employment to limit any liabilities of the Company to the equivalent of the sums received from the Government under the Scheme (to be paid as and when the Company received the sums)? What was the position in respect of each of the three identified classes of employees (i.e. Consent, Objecting and Non-Responding)?

3. In what circumstances would the Administrators be held to have adopted the contracts of employment?

4. In particular, would not making any Non-Responding Employees redundant within the initial 14-day period post-administration, give rise to the Administrators having adopted those contracts of employment and thereby incurring liabilities to those employees?

5. Can the Administrators pay any sums received from the Government to the employees in priority to all other creditors of the Company?

The Decision

Application of the Scheme in administrations

Snowden J considered the Government's Guidance for the Scheme[1] and noted that the Scheme was open to companies in administration if there was "a reasonable likelihood of rehiring the workers". He agreed with the Administrators' interpretation that a sale of the Company's business to a third party who would then use the current employees would amount to a rehiring of any furloughed employees. What was more difficult was how the Scheme should operate within the existing insolvency legislation.

Variation of the employment contracts

The Judge concluded that the Variation Letter sent to employees clearly varied the employment contracts of the Consenting Employees. In addition, it would have the same effect in respect of any Non-Responding Employees who subsequently responded and accept the variation. As such, for those employees, the Company's liabilities for wages or salary will be capped at the amount of the grant received from the Government under the Scheme and the Company will not be obliged to pay those employees until the sums are actually received from the Government.

The position of the Objecting Employees was simple – their contracts would not be varied but would be terminated.

However, the position of the Non-Responding Employees was not as straightforward. Unless and until they responded and accepted the contract variation, Snowden J held that he could not conclude on the information before him that the absence of a response should be taken as a clear inference that they consented to the variation. Whilst implied variation of a contract of employment was possible[2], drawing such an inference was not appropriate where (in contrast to the situation in *Abrahall*) the employees concerned are not continuing to work for the company; the Variation Letter identified that a failure to respond and consent could lead to a consideration of redundancy for those employees; only a few days had elapsed since the letter was sent and there was no guarantee that some Non-Responding Employees had received the letter, still less considered it;

[1] Which can be found at https://www.gov.uk/guidance/claim-for-wage-costs-through-the-coronavirus-job-retention-scheme

[2] As confirmed in the Court of Appeal decision in *Abrahall v Nottingham CC* [2018] ICR 1425

and whilst the variation proposed appeared beneficial to employees, some employees had rejected it and, as such, the Court could not safely conclude that certain of the Non-Responding Employees would not also reject the variation.

Adoption of Employment Contracts

Pursuant to paragraph 99(5) of Schedule B1, a liability under a contract of employment which has been adopted by an administrator attracts what Snowden J referred to as "super-priority".

The issue of adoption of employment contracts was therefore key to the Administrators' intended strategy. By adopting all varied contracts, the Administrators could pay any monies received from the Government under the Scheme to the employees in priority to other creditors pursuant to paragraph 99(5) of Schedule B1 to the Insolvency Act 1986 ("Schedule B1") (see below for more detail). However, whilst the Administrators wished to retain the Non-Responding Creditors as employees, the did not wish to adopt their contracts and incur liabilities for the Company whilst not furloughing those employees under the Scheme and receiving payments for them.

Snowden J considered the cases of *Powdrill v Watson & Anor (Paramount Airways Ltd)* [1995] 2 A.C. 394, *Re Antal International Ltd* [2003] 2 BCLC 406 and *Nicoll v Cutts* [1985] BCLC 322 and confirmed that a mere failure by a company to terminate a contract of employment within 14 days of administration did not lead inexorably to the conclusion that the contract had been adopted by the administrator. What is required for adoption is *"some conduct by the administrator that amounts to an election or decision that those liabilities arising under the continued contract will be a "separate" (i.e. prior ranking) liability in the administration, rather than simply ranking as an unsecured claim."*[3].

As for the Consenting Employees, the variation of their contracts took place within the 14-day period post-administration. As such, the variation of the contracts did not have the effect of adopting those contracts. However, as and when the Administrators submit a claim under the Scheme or make payment to the Consenting Employees under their varied contracts, that would amount to adoption of those contracts. The Judge reached this conclusion despite wording in the Variation Letter which stated that the Administrators *"will not be adopting, and will not at any future date adopt, your contract of employment"*. Snowden J determined that this wording was not sufficiently prominent (nor was it particularly explicable as to its intention) and the Variation Letter taken as a whole was clear as to the Administrators' intentions. As such, the wording did not preclude adoption of the contracts by the Administrators.

As for the Non-Responding Employees, the Judge determined that should any such employee accept the variation after the initial 14-day period, this would not amount to adoption of the contract by the Administrators as it was not an act of the Administrators (but, rather, of the employee). Such a response would then put that employee in the same position as the Consenting Employees and their contract would only be adopted upon submission of a claim under the Scheme or payment to the employee under their varied contract of employment.

Importantly, as for any Non-Responding Employees who continue not to respond, merely declining to terminate their contracts will not amount to adoption of those contracts. Such employees would continue to be employed by the Company (albeit, not actually working) on the terms of their original, unvaried employment contract unless and until terminated and would be unsecured creditors in the administration but no more. The Judge was at pains to make clear that any efforts by the Administrators to chase the Non-Responding Employees for a response to the Variation Letter (or steps to ensure that they received the letter and/or a reiteration of the offer to vary the contract of employment) after the initial 14-day period post-administration would not be taken to be an adoption of the employment contract.

Whilst it was suggested by Unite the Union that the Administrators might, on the basis of an implied term within the employment contracts of mutual trust and confidence, be under a positive duty to furlough the Non-Responding Employees under the Scheme (alongside the Consenting Employees), this was rejected by Snowden J who concluded that there was no good reason why Administrators should not be under any duty to do something which would risk incurring super-priority for liabilities to Non-Responding Employees that would not be covered (at least, not in full) by any payments from the Government under the Scheme.

Ability to pay sums received to Employees

Snowden J considered that whilst it was entirely possible for monies lent or paid to a company to be held on trust in order to make specific payments (and, therefore, do not form part of the company's insolvency estate)[4], there

[3] See paragraph 78 of the Judgment
[4] See *Barclays Bank plc v Quistclose Investments Limited* [1970] AC 567 and *Carreras Rothmans v Freeman*

is no mention of the word "trust" in any of the guidance for the Scheme. As such, and subject to any provisions of this type that might find their way into the detailed legislation and regulations to be drafted to give effect to the Scheme in due course), the monies received by the Company under the Scheme would be assets of the Company and, therefore, subject to distribution in accordance with the insolvency legislation.

However, paragraph 99(5) of Schedule B1 would allow the Administrators to pay any sums received under the Scheme to the Company's furloughed employees if the varied contracts of employment were adopted.

The Judge rejected any argument that paragraph 99(5) of Schedule B1 did not apply here as the employees in question were not rendering any service to the Company (but, rather, were simply being furloughed) and concluded that paragraph 99(5) applied to the varied contracts of employment, thereby allowing the Administrators to implement their strategy and make payments of sums received from the Government to the employees in priority to other creditors.

Whilst obiter, Snowden J also identified that whilst not necessary in this case, the powers under paragraph 66 of Schedule B1 might provide an appropriate way for administrators to fill any gaps or deal on an ad hoc basis with particular issues of detail that might arise in implementing the Scheme[5].

The Implications for Administrators

This is plainly a helpful decision for administrators. Snowden J himself identified at paragraph 9 of his judgment, *"wherever possible, the courts should work constructively together with the insolvency profession to implement the Government's unprecedented response to the [Covid-19] crisis in a[n]…..innovative manner."* and office holders are likely to welcome this decision.

It confirms that the Scheme is open to companies in administration and identifies a mechanism for using the Scheme in order to "mothball" a business whilst trying to sell it. The wording of any variation letter sent by a company or its administrators will be important and administrators will need to ensure that it is sufficiently well worded to address the impact on non-responding employees and on the adoption of employment contracts. That said, the obiter reference to the possible use of paragraph 66 of Schedule B1 to "fill any gaps" is an encouraging glimpse into the proactive way in which the Courts may seek to allow administrators to take maximum benefit of the Scheme where appropriate and in the best interests of creditors.

Some of the difficulties with applying the Scheme in an insolvency are set out in the judgment and some clarity is given as to what will and will not amount to adopting contracts of employment. It also gives helpful guidance on the limit of any duty of administrators to claim under the Scheme.

Together with the recent Government guidance on the Scheme which confirms that in the event of sale pre-pack sale of a company's business the purchaser can continue to furlough employees or begin the process of furloughing employees who have transferred across as part of the sale under TUPE, this judgment is likely to provide some encouragement to insolvency practitioners that the Scheme is compatible with the rescue culture enshrined in Schedule B1.

However, a note of caution should be sounded. Given the urgency of this issue for the administrators of the Company, this hearing took place without representation on behalf of the employees or the Government and Snowden J identified (at paragraph 7 of his judgment) that his decision could not, therefore, bind the employees or the Government. Whilst Unite the Union made submissions (on the basis that some of its members were amongst the employees of the Company), this was an unopposed application and, as such, whilst it is likely to be persuasive, its value as a precedent decision is somewhat limited.

Mathews Treasure Limited [1985] 1 All ER 155

[5] Referring to the decision in *Re MG Rover Espana SA* [2006] BCC 599

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