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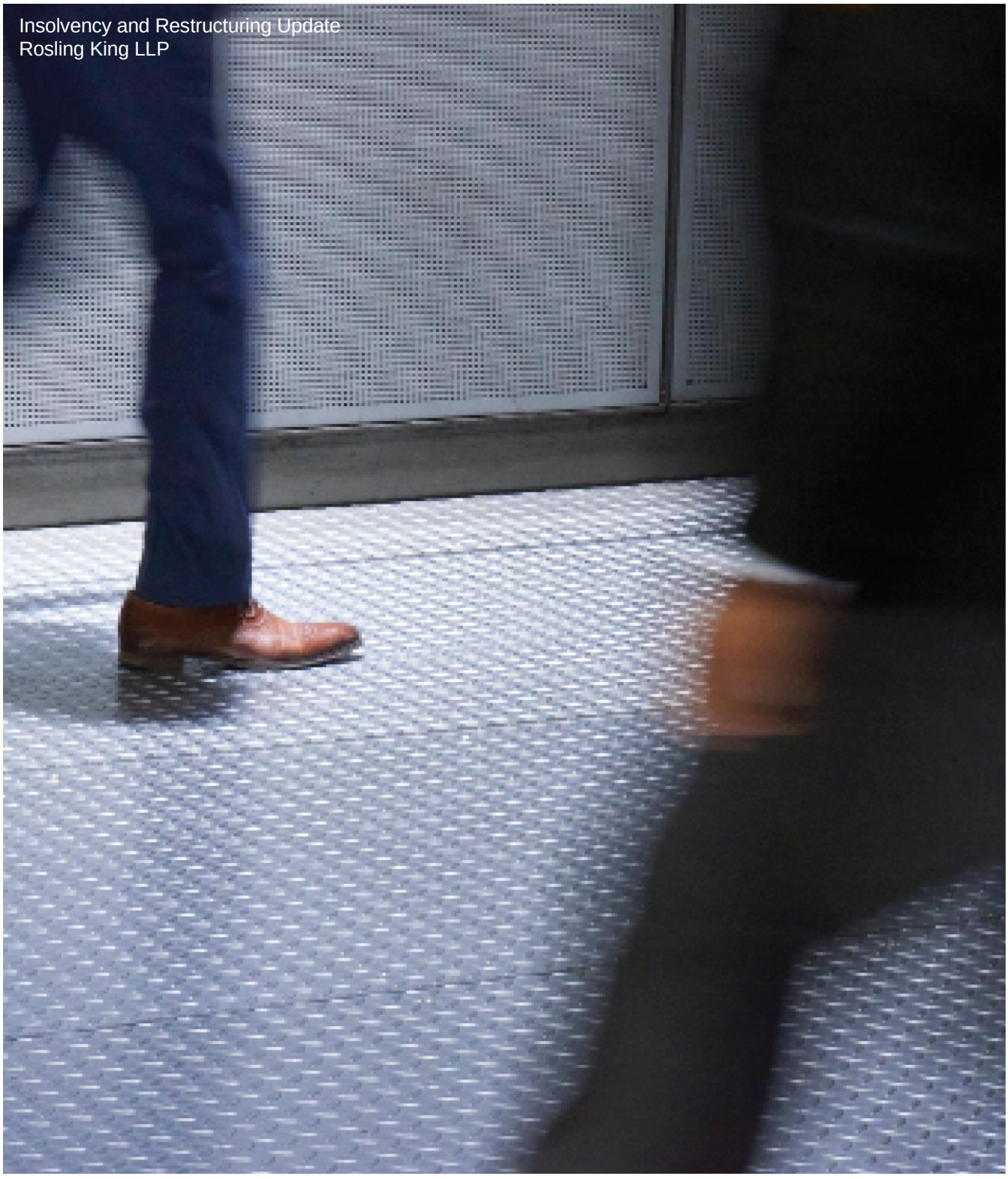

Background

Administrators have sought court guidance on how the Government's Coronavirus Job Retention Scheme ("**JRS**") will operate in the context of their administrations. Under the JRS, an employer can apply for a grant to cover the cost of continuing to pay its workforce up to 80% of their regular salary (currently up to a maximum of £2,500 per month) where their services cannot be used due to the current Coronavirus pandemic ("**COVID-19**"). The Chancellor has announced the scheme is to be extended to October 2020 but no further. As part of this, the Government's contribution will taper in September and October so the employer has to contribute 10% then 20% respectively towards the 80% wage coverage (whilst the Government's contributions drop to 70% and 60%). Furthermore, the JRS will close to new entrants from 30 June 2020.

Companies in administration are eligible under the JRS where there is a reasonable likelihood of the company rehiring furloughed employees in the future, which might be achieved by way of sale of the company for example. The issue is whether participation in the JRS can amount to an "adoption" of the relevant employees' contracts of employment within the meaning of the Insolvency Act 1986. Whether the contracts of employment are adopted is key, as adopted contracts benefit from a super-priority status in the administration. This means that the wages under those adopted contracts will rank ahead of claims of creditors and other expenses of the administration.

The Carluccio's Administration

The administrators of Carluccio's Limited ("**Carluccio's Administrators**") were appointed on 30 March 2020 and their strategy was to preserve the company's business and seek a sale. To enable this sale would require the ability to retain employees and claim under the JRS. The Company had no money with which to pay wages; and so, unless it could take advantage of the JRS, and, importantly, limit its liability for wages to the amount that it will be able to obtain under the JRS, the Carluccio's Administrators would be forced to make the workforce redundant. This would have had a prejudicial effect on the value of the business they were hoping to sell. Therefore, on appointment, Carluccio's Administrators sent a letter to employees offering continued employment on varied terms which took advantage of the JRS.

The Carluccio's Administrators were, at the time, within the 14 day "safe period" during which their actions could not amount or contribute to the adoption of contracts of employment. Whilst the majority of employees responded accepting the variation of their terms, and a small number rejected it, concern arose in relation to those employees who had not responded at all. Accordingly, the Carluccio's Administrators applied to the High Court for guidance.

The Debenham's Administration

The administrators of Debenhams Retail Limited (the "**Debenhams' Administrators**") were appointed on 9 April 2020. Their strategy was also to rescue the company as a going concern by stabilising its business during the COVID-19 related uncertainty. The company had already

placed the majority of its employees on furlough leave prior to the administration. The issue for the Debenhams Administrators was that, if they were deemed to have adopted the employee's contracts, the super-priority would catch not only the amounts applicable under the JRS but also amounts that would not be covered by the JRS, such as 20% of holiday pay entitlements. By the time the case was heard by the Court of Appeal, it was estimated that holiday pay that might not be covered by the JRS (but that might nevertheless be payable) would amount to £1.28 million per quarter. The issue was heard in the High Court, after the Carluccio's hearing, and subsequently appealed to the Court of Appeal.

High Court Judgment – re Carluccio's

In the Carcluccio's case, Snowden J considered in detail how the grant monies under the JRS would be distributed in accordance with the order of priorities under insolvency legislation. He referred to Paragraph 99(5) of Schedule B1 of the Insolvency Act 1985 ("**Paragraph 99(5)**") under which a company's liability for wages arising out of adopted employment contracts are payable in priority to the administrator's remuneration and expenses. However, this would not apply in respect of contracts held to have not been adopted in the first 14 days of the administration.

The Judge considered the House of Lords decision in *Powdrill v Watson & Anor (Paramount Airways Ltd*) ("**Paramount**"), the leading case on "adoption" in the context of Paragraph 99(5). In particular, he focussed on the reasoning of Lord Browne-Wilkinson, who highlighted the importance of considering the rescue culture when interpreting the insolvency legislation. As such, Snowden J held that paragraph 99(5) should be interpreted to give the effect to the JRS in support of Government's efforts to deal with the economic consequences of COVID-19.

On the matter of adoption, Snowden J argued that it would be unwelcome to conclude that furloughed employees could not have their contracts adopted simply because they were not able to provide services as this would mean the JRS could not operate as envisioned. However, he held that mere continuation of employment does not lead to the conclusion that the contract has been adopted by an administrator, and that an administrator's conduct must amount to an acceptance or election to give super-priority to the employee's claim for wages.

In reaching his conclusions, Snowden J distinguished between the three categories of employees. In respect of the employees that consented to the variation, they were now employed in accordance with the variation and any application made by Carluccio's Administrators under the JRS, or any payment made under the varied contracts, would amount to adoption as they would be held to be taking steps to enable super-priority payments of wages. In respect of the employees that objected, these contracts were neither varied nor adopted. In respect of the employees that had not responded, their unvaried contracts of employment would not be treated as having been adopted by the Carcluccio's Administrators by mere failure to terminate the contracts. Whilst such employees continue to be employed, they would rank as unsecured creditors in the administration in respect of any claim made under the contract. Adoption would only occur if they agree to the variation and when Carluccio's Administrators act by making an application under the JRS.

High Court and Court of Appeal Judgments – re: Debenhams

Debenhams' Administrators sought to challenge the conclusion reached by Snowden J on the basis that he did not explain why he concluded that the act of making an application under the JRS or payments under contracts of employment (albeit those which give effect to the JRS) reflect adoption. The Debenhams' Administrators referred back to leading caselaw of *Paramount* and argued that the employees had to carry on providing services to their employer for their contracts to be adopted. They argued that adoption was therefore incongruous with the JRS, where furloughed employees are prevented from providing any services to the company during the furlough period.

The High Court and Court of Appeal (upholding the High Court decision) disagreed. The Court of Appeal upheld that the administrators would be deemed to adopt the contract of employment of a furloughed worker when they either applied for a grant under the JRS or paid their wages.

The Court noted that while there may be good reasons why the meaning of "adoption" under the insolvency legislation should exclude administrators' actions where they are restricted to implementing the JRS, such exclusion cannot be accommodated under the law as it stands.

Commentary

These decisions will have relevance in the coming months with the extension of the JRS to October 2020. Given the cut-off of 30 June 2020 for new entrants to the JRS, it is likely that if an administrator has to deal with the JRS, it will be in the context of how to deal with employees already on furlough under the JRS (as in the Debenhams case).

The key point to note is that, unless employees have waived their entitlement to a portion of wages not covered by the JRS, on adoption of that employee's contract, the amount not covered (but payable) will be a super-priority claim against the company in administration. Similarly, other liabilities which are not covered currently by the JRS (like accrued holiday pay) will have super-priority as well. Therefore, administrators using the JRS will have to quickly determine what the liabilities could be in respect of furloughed employees and whether they should mitigate those liabilities through contract variation or redundancies.

Should you wish to discuss this caselaw or anything relating to it, please contact Alexander Pelopidas or the partner with whom you usually deal.