Carluccio's: the High Court issues timely guidance on the relationship between furlough, contractual variation and the administration of insolvent companies.

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A guide to the future ahead for TUPE and insolvency

1. On Easter Monday, 13 April 2020, the High Court (Snowden J presiding) handed down its judgment in the matter of ***Carluccio's Limited (in administration)*** **[2020] EWHC 886 (Ch)**. To add to the Easter joy, the furlough guidance was amended on 9 April 2020 and the judgment had to embrace the amended guidance. One of the clarifying amendments on 9 April was the confirmation that employees who transfer under TUPE after 28 February 2020 may be placed, or continue, on furlough. This has practical implications in the light of this judgment.

2. Further, the judgment is significant because it is the first decision examining aspects of the Government's Coronavirus Job Retention Scheme and its interrelationship with existing law, in particular in relation to contractual variation and the administration of companies pursuant to Schedule B1 of the Insolvency Act 1986 ("the Act"). The judgment is therefore of practical importance viewed against the unfortunate prognosis for the economy in the short term.

3. The full impact of the Covid-19 pandemic on the solvency of UK businesses remains to be assessed, but it seems likely that the UK lockdown will be an event that triggers the insolvency of many employers, with insolvency practitioners required to consider the availability of the Job Retention Scheme in the context of the administration of the employing company. This will impact on possible transfers out of the insolvent business. Further, the effect of furlough on contracts of employment is a matter which all employers who take advantage of the scheme will be required to address in some form, including the consequences of not obtaining the effective agreement of the furloughed employees. We examine both aspects below.

4. It should be noted at the outset that the judgment is not a holistic review of the Job Retention Scheme and does not seek to resolve the ambiguities and problem areas which have been identified within the Government guidance on the scheme. Indeed, the High Court in ***Carluccio's*** contemplated whether it would be appropriate to give judgment *at all* in the absence of the scheme's implementing legislation. That it was prepared to do so is an indication of the extraordinary circumstances which employers, lawyers and the courts face.

Background

5. The judgment arose out of the insolvency of the *Carluccio's* chain of restaurants. The company closed its branches on 16 March 2020 following the Prime Minister's advice that all restaurants should close as part of the Government's strategy for combatting the Covid-19 outbreak. The company thereafter entered administration on 30 March 2020. A separate article on the Littleton website addresses some of the changes which are proposed to the insolvency regime to create "breathing space" before administration, but these have not come in time to save *Carluccio's*

6. The administrators position before the Court was that they intended to pursue a sale of the business. This reflected the objective under Schedule B1 to the Act of achieving the best result for the creditors. As part of that strategy, the administrators wished to retain its workforce rather than make them redundant. However, due to the lack of funds available to the insolvent company, that could only be achieved if the administrators could access the Job Retention Scheme and furlough the company's staff without the company incurring any additional liabilities.

7. It is the present reality of many employers that they are required to make difficult decisions concerning the management of its workforce with only the limited information contained in the Government guidance to assist them. Conscious of the uncertainties which such a decision would entail, the administrators of *Carluccio's* applied to the High Court pursuant to paragraph 63 of Schedule B1 to the Act for directions on the legal basis upon which they might furlough large numbers of the company's employees. The issue of the employment liabilities and their priority was, as for any administrator, a point of particular concern. This prompted the urgency of the application as the 14 days window on adoption, considered below, was shortly to expire.

<u>Contractual variation</u>

8. Shortly after their appointment and in anticipation of accessing the scheme, the administrators wrote to all of the company's employees who were not required to assist them, offering to continue to employ them on varied terms so as to take advantage of the Job Retention Scheme (referred to in the judgment as "the Variation Letter").

9. The Variation Letter explained that:

- the administrators were seeking the agreement of the recipient to vary the terms of the employment contract;

- the recipient would be placed on furlough leave from the date of closure of the business, meaning their employment would continue but they would not be required to work;

- the company intended to apply under the Scheme for every eligible employee in full and understood that it will be provided with a grant equivalent to 80% of the employee's regular wages (excluding any fees, commission and bonus) up to a

maximum of £2,500 per month plus the associated employer's National Insurance contributions and minimum automatic enrolment employer contributions on the reduced salary;

- the company would not be in a position to pay employees until it had received the grant from the Government;

- the recipient's other terms and conditions would remain the same during furlough and their continuity of employment would remain unaffected.

(The terms of the Variation Letter are quoted at paragraph 24 of the judgment).

10. The Variation Letter invited employees to respond by email by 3 April 2020 in a form prescribed by the letter. It concluded by giving the following warning:

"*Please note that if the Company does not receive an email from you by the above deadline, the Administrators will need to review your position within the Company and may be required to consider the possibility that your role is redundant."*

11. Significantly, the Variation Letter did not state that a failure to respond would be deemed to indicate the employee's agreement to the proposal.

12. As at 10am on 7 April 2020, of the 1788 employees who received the Variation Letter, 1707 had accepted its terms, 4 had rejected it and stated that they wish to be made redundant, and 77 had not responded. These three categories of employee were referred to in the judgment as the "Consenting Employees", "Objecting Employees" and "Non-Responding Employees" respectively. The Non-Responding Employees therefore formed a small, but nonetheless significant, part of the workforce.

13. The Court considered whether there had been an effective variation of contract in relation to each category of employee. The existence of an effective variation was significant because it meant that the company could not be liable for wages or salary in any amount which exceeded the amount of the grant paid to it under the Job Retention Scheme for that employee. Further, the company would not be liable to pay the employee until it had received the grant funds.

14. The Court regarded the position as straightforward in relation to the Consenting Employees and the Objecting Employees. As to the former, there was an effective variation of contract. As to the latter, there was no variation and they would be made redundant.

15. The position of the Non-Responding Employees was more problematic and required the Court to consider the circumstances in which there will be an implied variation of contract. The law governing implied variation to contracts of employment is of some practical importance to employers since the circumstances faced by the administrators of *Carluccio's* are unlikely to be unusual. All employers with a

reasonably large workforce are likely to have employees who do not respond to the written proposal to furlough them and so may be left uncertain as to whether they have obtained an employee's agreement.

16. The Court considered the judgment of the Court of Appeal in *Abrahall v Nottingham City Council* [2018] ICR 1425 on the factors relevant to whether a contractual variation can be inferred from the employee's conduct. It quoted extensively from the judgments of Underhill LJ and Sir Patrick Elias in *Abrahall*. Without repeating those quotes, the pertinent points are these:

- The inference that an employee has accepted a contractual variation must arrive unequivocally. If the conduct of the employee in continuing to work is reasonably capable of a different explanation it cannot be treated as constituting acceptance of the new terms.

- Protest or objection at the collective level may be sufficient to negative any inference that by continuing to work individual employees are accepting a reduction in their contractual entitlement to pay, even if they themselves say nothing.

- The question of whether a contractual variation has been agreed does not need to be answered at the point of implementation. If an employee continues to work under the varied terms without protest, there may come a time when the only reasonable explanation for the employee's conduct is that they have agreed to the variation.

- Agreement to the variation will readily be inferred from the employee's conduct where the change is to the employee's benefit, such as where he is given a pay increase.

- A more difficult situation arises where the variation is to the employee's disadvantage and there is no compensating advantage, or it is being imposed to avoid a potentially worse disadvantage, such as being made redundant. Nonetheless, in an appropriate case it may be possible to infer agreement to the variation where the employee's only motivation in not protesting is to avoid the risk of redundancy.

17. The Court in *Carluccio's* observed that the circumstances of a proposal to furlough are different to those examined in *Abrahall* in the sense that, in a normal case, the employee continues to work and there is conduct from which agreement could be inferred. In the instant case, the Non-Responding Employees were entirely passive. Indeed, their only conduct relevant to whether agreement could be inferred was their failure to respond to the proposal.

18. Ultimately, the Court declined to find the absence of a response from the Non-Responding Employees gave rise to the clear inference that they had consented to the proposed variation. Consequently, there was no effective variation. In reaching this decision, the Court considered the following factors relevant:

- The Variation Letter required employees to respond positively in order to agree the variation and warned that a failure to respond could lead to redundancy. The letter did not suggest that a failure to respond would be taken as consent to being furloughed. Rather, it suggested the opposite.

- It had only been a matter of days since the deadline for a response had elapsed. There may have been other explanations for an employee's failure to respond, such as they had not received the letter or had not yet had the opportunity to consider its terms. It would require strong evidence to infer agreement from conduct where an absence of objection was over such a short period of time.

- Although the vast majority of employees regarded the proposal to furlough them as advantageous, there may nonetheless be legitimate reasons for an employee to reject the proposal, as indicated by the fact there were Objecting Employees. Those reasons may apply to a Non-Responding Employee.

19. There are several practical points arising from this judgement which employers furloughing its employees would be well advised to consider.

- Firstly, the terms of the written proposal sent to employees are important. If an employer wishes to minimise the uncertainty over whether a non-responding employee has agreed to the proposed variation, the original letter should state in clear terms that a failure to respond by the stipulated deadline will be taken as an indication of that employee's agreement and they will be furloughed nonetheless.

- Employers should consider sending written proposals by a means which shows that the employee received the proposal, such as recorded post or by email with a read receipt. By doing so, it removes any ambiguity as to whether the employee received the proposal and therefore was in a position to consent to its terms.

- The longer the period of non-objection on the part of the employee, the more likely it is that agreement will be inferred from their conduct.

- There may be other conduct, beyond their mere silence, from which the employee's agreement could be inferred. The Court in *Carluccio's* was forced to consider whether there had been an effective variation of contract at a time when none of the affected employees had received payment under the scheme. An employee's acceptance of reduced pay in accordance with the original proposal to furlough is likely to be powerful evidence of their agreement by conduct.

- If an employer has employees who refuse the proposal to furlough it may be sensible to consider the reasons for their refusal and whether those reasons may apply to any non-responding employees.

<u>Priority and the practical impact for administrations</u>

20. An early decision in any administration will be the approach to be taken to the workforce. In particular, administrators are conscious of the 14 day moratorium afforded them, following appointment, after which they may be taken to have adopted the contracts of employment of employees who have not been dismissed, per Para 99 of Schedule B1 of the Act.

21. The practical concern is that the liability to pay the wages or salaries of any adopted employees ranks in priority to the administrator's own remuneration and expenses as a charge on the insolvent company's property, para 99(4). Thus we find that administrators frequently make dismissals in the first 14 days of administration to reduce the wage burden, particular where the assets of the Company are limited and a balance has to be struck with retaining enough employees to retain the core business if a sale is hoped for.

22. Furlough provides a different strategy as if it is effective it would mean that the costs of the staff could be financed beyond the assets of the insolvent company and the work force retained. Thus if disposal of the business is planned it may be achieved with the workforce intact but "mothballed", as was intended here.

23. There was an issue as to whether any sums received by the administrators could be directed to the employees who were furloughed and how those employees who had not agreed were to be treated. The administrators sought the direction of the Court on these issues.

24. The first point addressed was whether the contracts of those employees not carrying out any duties could be adopted for the purposes of para 99. Snowden J's conclusion was that it was not a condition of adoption that the employee had to be rendering services, paras 71 to 74. Thus the contracts of employment of staff who are unable to work because of the virus or the collapse of the company may still have their contracts adopted by the administrator.

25. The Judge then reviewed the law on what amounts to adoption for the purposes of para 99 and applied this reasoning to the three categories of employee identified above: "Consenting Employees", "Objecting Employees" and "Non-Responding Employees" respectively.

26. He concludes that following the 14 days, making an application under the Scheme for an employee who had agreed a variation would be an act adopting their contracts. They would get super priority, but they have agreed to their payment being only on payment to the employer under the scheme.

27. Those who objected would not be adopted but terminated as redundant.

28. If the non-responding employee still had not responded by the end of the 14 days their contracts would not be adopted, thus their dismissal would not be compelled. Therefore, in practical terms an administrator who needs to vary terms and conditions to furlough staff can initiate that process within the 14 moratorium but

will not be taken to have adopted the contracts of those from whom it has not received agreement unless they actually are called upon to attend work or the administrator does something else to adopt their contracts.

29. It is also of note that the union, Unite, sought to argue that the administrators were under a duty to place employees on the furlough scheme rather than make them redundant. The Court accepted that such a duty might be implicit where the employee had agreed to the furlough variations but declined to find a wider duty.

The Practical Implications

30. Sadly, we are likely to see more businesses fall into administration. Many may be viable businesses saddled with debt from this crisis. There is then the prospect of TUPE transfers. But as one can see here, with no or little cost to the business the attractions of furloughing the staff to "mothball" the business for sale will make that path one which administrators will follow. That has practical consequences:

- The TUPEd business may be acquired with the "mothballed" staff. One must start from the position that this is a temporary cessation in activities and does not prevent a transfer nor break the assignment of any mothballed staff, see *Mustafa v Trek Highway Services [2016] IRLR 326 and Landsorganisation Danmark v Ny Molle Kro* [1989] IRLR 37 (ECJ);

- With the work force furloughed there would appear to be little excuse for not complying with the information and consultation obligations on transfer;

- Transferred staff can, it is now clear, be transferred into furlough with the new employer;

- This might secure the prospects of speedy business revival;

- But there remains the question of holiday entitlement. Whatever the position of the debate on directing the taking of holiday during furlough it is unlikely that administrators will do this so that transferees will take employees with the accrued holiday entitlements which have arisen through furlough;

- When furloughing enables the workforce to be "mothballed" at zero or minimal costs the reasons for dismissing any employees who are dismissed will be examined closely. It may mean that it is more likely that their dismissal was to make the business more sellable with the consequent risk for the transferee that liability for the dismissals transfers, see *Kavanagh v Crystal Palace FC 2000 Limited* [2013] EWCA Civ 1410 and the debate over the reasons for dismissals in an administration context.

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