

## Practical guidance for administrators: dealing with furlough and expenses

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The Court of Appeal has upheld the High Court decision in *Debenhams*. The judgments, together with the recent decision in *Carluccio's*, provide essential guidance to administrators on the adoption of employment contracts, furlough and payment priority. We've set out a short practical checklist of what you need to think about in light of these decisions.

### The *Carluccio's* and *Debenhams* decisions – in brief

Due to expire at the end of June, the Government's Job Retention Scheme provides employers with cash grants of 80% of furloughed employees' wages up to a maximum of £2,500. In *Carluccio's*, the administrators took the decision to furlough employees. The High Court held that:

- > when furloughing employees, administrators can successfully vary employees' contractual pay with their express consent to match the furlough grant available;
- > employees consenting to furlough will be "adopted" only when administrators apply for or make payment under the Government scheme; and
- > non-responding employees will not be adopted merely through non-termination of their employment – their salary will be an unsecured claim only.

In *Debenhams*, however, the employees were furloughed before the administrators were appointed at a time when they had not consented to cap their pay. The Court of Appeal has upheld the High Court decision (and supports the conclusions reached in *Carluccio's*). As a result:

- > 14 days after appointment administrators will likely adopt furloughed employees if they continue the furlough arrangements; and
- > unless express consent is obtained to vary their contractual pay, employees, where adopted, will be entitled to payment of their usual "wages or salary" under the employment contract as administration expenses (in priority to other unsecured claims).

Together, these decisions provide essential guidance to administrators on the adoption of employment contracts, furlough and payment priority. The short checklist below provides guidance on the key questions you will need to consider.

### When are employment contracts adopted?

- > An "adopted" employment contract means that liabilities in respect of "wages or salary" (which includes sick pay and holiday pay) will have super-priority as administration expenses (Para.99(5)(b) Sch.B1).
- > There is a 14-day "safe period" following appointment during which adoption cannot occur.
- > Adoption connotes some positive conduct by the administrator amounting to "an election to treat the continued contract of employment with the company as giving rise to a separate liability in the administration" (*Powdrill v Watson*).
- > The Court of Appeal in *Debenhams* highlighted that the question is wholly objective: is the conduct of the administrator such that they must be taken to have to accept that the relevant amounts falling due under the employment contract enjoy super-priority? i.e. has the administrator taken active steps to continue the employment?
- > In "normal" circumstances, telling employees that the business remains open and that they should attend work in the usual way would constitute adoption.

## ADMINISTRATION: FURLOUGH AND ADOPTION CHECKLIST

### PRE-APPOINTMENT

<p><b>Determine whether furlough is appropriate</b></p>	<p>Government guidance suggests furlough should be used by administrators only where there is a reasonable likelihood of “rehiring” employees. The <i>Carluccio’s</i> decision indicates this should be the case in the event of a business sale. The <i>Debenhams</i> decision indicates that the furlough scheme will also be available to a “light touch” administration looking to retain value, reduce funding requirements and maximize exit options.</p>
<p><b>Check if employees have already been furloughed</b></p>	<p>If employees have already been furloughed, how many? As <i>Debenhams</i> highlights, employees already furloughed pre-administration will be “adopted” after 14 days from appointment of the administrators.</p>
<p><b>Check if furloughed employees consented to the arrangements</b></p>	<p>In an administration, unless they have consented to reduce their pay in line with the Job Retention Scheme, adopted employees will be entitled to their usual “wages or salary” as super-priority expenses. If not already in place, you will need to consider whether such consent arrangements should be put in place (see below).</p>
<p><b>Check any furlough consent terms</b></p>	<p>In particular you should check whether employees agreed to cap their pay to the amount of the available furlough grant. If not, this will determine the steps you need to take on appointment (see below). Note, for example, that Government guidance suggests that employees continue to accrue leave – and may take it – during furlough as per their employment contract and employers must ensure employees receive 100% of their usual pay. On adoption, “wages or salary” includes holiday pay. The potential mismatch between what is payable as an expense (on adoption) and the available furlough grant could be significant for large corporates with lots of employees (e.g. over a 3-month period, the excess holiday pay not covered under the furlough scheme would amount to some £1.28m in <i>Debenhams</i>).</p>
<p><b>Consider whether it may be appropriate to defer your appointment until the company obtains consent</b></p>	<p>If employees have already been furloughed but not yet consented, it may be appropriate for the company to vary employees’ contracts to minimize the effect of adoption by matching their salary to the furlough grant available. Whether feasible will depend, in part, on how many employees have been furloughed without prior consent, their salaries, their roles, the nature of the administration, the company’s liquidity situation etc.</p>

### ON APPOINTMENT – WHERE EMPLOYEES HAVE ALREADY BEEN FURLOUGHED

<p><b>Act within 14 days of your appointment</b></p>	<p><i>Debenhams</i> suggests that where employees are furloughed before appointment you must act swiftly within the 14-day “safe period” to get employee consent (if not given already) to be furloughed and to cap pay (i.e. at furlough scheme rates). After 14 days, by actively continuing with the furlough arrangements put in place before appointment (e.g. continuing to pay the wages or salaries of the furloughed employees) you will likely adopt employee contracts based on the pre-administration furlough terms. As the Court of Appeal in <i>Debenhams</i> highlighted, the fact that furloughed employees remained bound by their</p>
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	employment contracts (subject to the conditions of the furlough scheme) – e.g. by duties of loyalty, and by the obligation to provide their services as and when the company is able to re-open its stores – tended to support the conclusion that the administrators had continued their employment and adopted their contracts.
<b>Get express consent to cap pay</b>	Express consent provides certainty and will ensure that only the agreed varied pay, not the full usual employee pay, will have expense status as “wages or salary”. Both <i>Carluccio’s</i> and <i>Debenhams</i> indicate that you may validly request consent by e-mail. In <i>Debenhams</i> , for example, by the time of the Court of Appeal hearing, 13,056 employees consented to varied terms after the administrators’ appointment, with only 4 objecting and 10 not responding.  Relying on consent by conduct is not recommended - there will be limited conduct capable of evidencing such consent where employees are unable to attend work/perform duties etc.
<b>Consider if to make furlough pay conditional on receipt of grant</b>	This will ultimately depend on the levels of cash available in the business. In <i>Carluccio’s</i> , payment of employees’ pay was expressed to be conditional on the prior receipt of the furlough grant. In <i>Debenhams</i> , there was enough liquidity for furloughed employees to be paid, at least initially, out of cash reserves and then seek reimbursement under the scheme.
<b>Decide if to make non-responding employees redundant before day 14</b>	Your decision whether to make furloughed employees redundant before adoption on day 14 will be influenced by a range of factors, including how many employees have not responded, their pay levels, an assessment of whether redundancy will assist the purpose of the administration, the impact of non-responding employees (entitled to their usual pay) potentially being better off than consenting employees (whose pay will be reduced) etc. Remember that – depending on numbers – redundancies may require collective consultation. Whilst penalties for failure to consult collectively are not an expense of the administration, failure to follow these requirements may be reputationally sensitive for administrators.

## ON APPOINTMENT – WHERE YOU DECIDE TO FURLOUGH EMPLOYEES

<b>Get express consent to cap pay</b>	See above.
<b>Consider if to make furlough pay conditional on receipt of grant</b>	See above.
<b>Decide if to make non-responding employees redundant before day 14</b>	<i>Carluccio’s</i> , supported by the Court of Appeal in <i>Debenhams</i> , suggests that an employment contract of a non-responding employee will not be adopted simply because it is not terminated after 14 days. Amounts owing are likely unsecured claims. Simply doing nothing in these circumstances – not furloughing non-responding employees or accessing the scheme in respect of them – is unlikely to constitute the active conduct required for adoption. See above re possible collective consultation requirements.

## Key contacts



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