New administration solutions for struggling UK businesses: learning from Carluccio's restaurant case

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The severe economic disruption of coronavirus has left many businesses fighting to stay afloat. A new solution for management and finance teams could be the 'light-touch administration' approach, particularly coupled with the recent clarity on the interaction between insolvency law and the UK government's job retention scheme provided by a recent Court decision concerning the restaurant chain Carluccio's. As we discuss here, this process can provide a lifeline for struggling businesses, who can use it to keep their business intact for the short-term future.

HMRC's portal for claiming furlough payments opened yesterday. The Resolution Foundation has calculated that more than 9 million people (just under a third of the 32 million employees on PAYE) have been or will be furloughed, which means that the IT staff charged with keeping the portal up and running are clearly in for a difficult few weeks.

The Job Retention Scheme ('JRS') was put in place to encourage employers to furlough staff rather than making them redundant, allowing employers to claim a government grant to cover of 80% of regular salary up to a maximum of £2,500 per month. Employers who have furloughed staff in the expectation that they will pay employees once they have received the grant from the JRS will be desperate for the government tap to be turned on so that they can pay staff in April but HMRC have also said it will likely take 4-6 days to process claims.

For some businesses, the money – while a welcome relief – will only be part of what is needed to keep their business together in the coming months. Many businesses in the hospitality and retail sectors continue to face considerable uncertainty about when they will be able to reopen their doors and what restrictions will be in place over the coming months, which is making planning difficult even as payroll support from the UK government comes online.

However, comfort may be available through the creative use of restructuring tools, which can buy much needed time and breathing space. In our previous article, we looked at proposed changes to the insolvency law that are sure to bring a measure of relief to directors in troubled time. Just as notable, however, has been the insolvency industry's creative development of existing insolvency and restructuring tools, in conjunction with the JRS. A particularly good example of this can be seen in the recent Court decision concerning the casual dining chain, Carluccio's.

What happened to Carluccio's?

Less than a fortnight after the Chancellor ordered all restaurants to close on 16 March 2020, Carluccio's had to call in the administrators. By appointing administrators, the Italian food chain was able to benefit immediately from a statutory 'moratorium', which prevents its creditors from taking court action or enforcing debts. This provided welcome breathing space for the business. However, it was obvious to the administrators that a conventional approach to 'saving' the business – either through helping it to secure new investment or by marketing the business for sale to a new owner – was going to be next to impossible in the current climate. Their immediate focus was to keep the business in tact, for as long as possible, so that a rescue or restructure could be explored under different circumstances.

It was clear that unless the administrators were able to rely on the JRS, they would need to make the entire workforce redundant – which would be both terrible for the employees and would reduce the value of Carluccio's 70 restaurants. The administrators knew from HMRC guidance that they were entitled to use the JRS if they believed that there was a "reasonable likelihood' of being able to re-hire workers who were put on furlough but much else about how the JRS applied in an administration was unclear. A particular problem was that the law was unclear about whether any payments that Carluccio's received through the JRS could be 'earmarked' for employees specifically.

The administrators were in a bind and applied to the High Court for clarification. Under insolvency law, they had 14 days in which to make a number of decisions under the Insolvency Act. Of particular concern was whether and when they would be adopting the 2,000 contracts of the chain's staff.

The choice: to adopt the contracts or not?

The administrators faced a stark choice: if they adopted the contracts, liability for staff wages would be payable out of the assets held by the administrators in priority to the administrators' remuneration expenses and over floating charges. This would place a high degree of personal risk on the administrators who may have found that there was no money left after payment of employees to meet the administrators' fees or to pay their out of pocket costs for work on a plan to rescue the company.

If, by contrast, they did not adopt the employees' contracts then employees would not get the benefit of super-priority and their claims would merely be unsecured debts. In those circumstances it could be difficult to funnel the JRS grant to them. HMRC will pay the JRS grant to the employer but this means that it constitutes an asset of the company in administration and has to be dealt with in accordance with insolvency law. A fundamental principle of insolvency law in England is that all assets of a company should usually be shared equally between all of its unsecured creditors (employees, suppliers, landlords or banks). Therefore, as unsecured creditors, employees would likely receive pennies on the pound of unpaid salary which they were owed, despite the JRS payments being intended to allow the company to keep paying salaries.

What did they do?

The administrators sent letters to all staff proposing to vary their contracts, seeking their agreement to be put on furlough and to reduce wages to 80% of salary (capped at £2,500). They also informed staff that they would only pay them once they received the JRS grant from the government but they committed to passing on such grant money within seven days of receipt. **This type of variation may be a useful template for other employers who cannot afford to pay salaries until the JRS money is received.**

The Administrators made it clear that unless they received agreement from the individual staff members then in all likelihood they would be made redundant. Of the 2,000 staff, 1,707 accepted furlough, 4 declined and 77 did not respond at all.

The key questions, and answers

The key questions were whether (1) the proposed arrangements for those employees who had agreed to vary their contracts worked, and (2) the administrators could avoid inadvertently adopting the contacts of those 77 employees who had not responded to the variation letter.

(1)
Previous case law made it clear that simply letting the 14 day period expire would not amount to an adoption, something more – such as payment to staff – was necessary. As such the contracts of those employees who had consented to the variation had not yet been adopted. However, the Judge made it clear that once the administrators applied for the JRS grant and passed on the government grant money to employees, this would amount to an adoption of the varied contracts.

(2)
In respect of those employees who had not responded to the request to vary their contract, the Judge decided that the administrators would not be treated as having adopted their contracts simply because they had failed to terminate their contracts during the first 14 days of the administration. This allowed the administrators to carry on searching for the missing 77 employees. The Judge clarified that if non responders later consented to the variation, then the administrators would adopt those contracts once they applied for a furlough grant or paid such grant money to them. Those who continued not to respond would remain employed until their contracts were terminated and would merely be unsecured creditors of the company.

The Judge also clarified that the administrators were under no duty to apply for grants in respect of employees who had not consented to variation.

Crucially, this 'super-priority' for ongoing employees is only available to businesses which are in administration. It is not clear whether the result would be the same if a business applied for and received JRS and subsequently found itself needing to seek formal insolvency protection. It is possible that JRS payments, which had been received by the company and not distributed to employees prior to entering into administration, could fall within the general assets of the company and become available to other creditors.

Why is this case different and how can it help other struggling businesses?

The Carluccio's judgment is a first of its kind, and is an excellent demonstration of the capacity for flexibility and creativity in the English Courts and insolvency profession.

There is already considerable interest from other businesses in adopting a similar approach whereby 'light-touch' administration ensures the proceeds of the JRS are earmarked for employees to keep a business in tact for now, so that rescue and restructuring options can be explored more fully when greater economic certainty is available. Retail businesses such as Debenhams, Oasis and Warehouse look set to follow a similar course.

The key takeaway from the Carluccio's judgment is that 'light-touch administration' is available to businesses, and the Courts and insolvency professionals are showing a flexible and pragmatic approach to maximise its effectiveness as a tool to save jobs and businesses. Unlike some of the new restructuring tools that have been announced, employers do not need to wait for changes in the law to come into effect.

Over the coming weeks and months, as more businesses consider how best to weather the storm, this type of 'light-tough' administration should be given serious consideration. Businesses can enter administration quickly and cheaply through an out of court process and new protocols are set to allow existing management to remain in control of the day to day decision-making and minimise costs of the administration. Further, the supervision and input from an experienced insolvency professional could be invaluable, particularly in helping directors avoid pitfalls that might attract personal liability – something that remains a concern for some directors, despite recently announced relaxation of the rules.

Authors

Meriel Schindler

PARTNER | LONDON

Employment

+44 20 7597 6010

meriel.schindler@withersworldwide.com

Sinead Harris

PARTNER | LONDON, BRITISH VIRGIN ISLANDS

Litigation and arbitration

+44 20 7597 6269

sinead.harris@withersworldwide.com