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Furlough and insolvency – are employees protected?

As more retailers and restauranteurs fall victim to insolvency, the Court of Appeal has confirmed that the contracts of employment of employees furloughed before a company is placed into administration will be treated as having been adopted by its administrators, therefore entitling the employees to “super-priority” status over other creditors.

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In the case of Re Debenhams Retail Ltd [2020] EWCA Civ 600 Debenhams’ administrators made an urgent application to the High Court to seek a direction as to whether the contracts of employment of its 13,000 or so furloughed employees would be adopted by them under paragraph 99 of Schedule B1 to the Insolvency Act 1986 if the employees remained furloughed and the administrators took no further action in relation to them, except to pay them the amounts they received under the CJRS. The administrators argued that if the contracts of employment were adopted, the “super-priority” status of the employees would place their ability to rescue the company at risk. One of their main concerns was that the estimated employees’ entitlement to holiday pay over 3 months would amount to some £1.28million as at the time of the appeal.

The Court of Appeal upheld the High Court’s decision and held that the administrators had adopted the furloughed employees’ contracts of employment for 3 reasons: (1) because they had continued to pay their wages up to the limits of the CJRS, (2) the furloughed employees remained bound by their contracts of employment and (3) in continuing to pay the employees, the administrators were acting with the objective of rescuing Debenhams as a going concern. The Court of Appeal acknowledged that whilst there may be good policy reasons to exclude the employment of furloughed employees from the scope of “adoption”, that was not the law as it stands.

The judgment is consistent with the previous High Court decision in the case of Re Carluccio's Limited [2020] EWHC 886 (Ch) and serves as a word of warning to administrators. It is also serves a useful reminder to employers of the main aim of the CJRS which is to preserve jobs. How this will play out when the government ends or curtails the scheme in some way will be interesting to see…

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