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The consequences for administrators of furloughing employees – further clarification: Re Debenhams Retail Limited [2020] EWHC 921 (Ch)

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Matthew has an impressive commercial practice with a particular specialism in insolvency and company law. He is also experienced in commercial fraud and asset tracing, and partnership and professional liability, allowing him to provide his clients with a wide commercial law service covering a range of commercial issues and disputes.

In a judgment dated 17th April 2020 in *Re Debenhams Retail Limited (in administration)* [2020] EWHC 921 (Ch), Trower J determined an application for directions by the joint administrators of Debenhams which concerned the impact of the application of the Government's Coronavirus Job Retention Scheme in administrations and the recent decision of Snowden J in *Re Carluccio's Limited (in administration)* [2020] EWHC 886 (Ch). Matthew Weaver considers Trower J's judgment and its implications in this briefing.

The Background

Debenhams entered administration on 9th April 2020, the Administrators being appointed out of court by the Company's directors. Having experienced significant financial difficulties for a period of time (Debenhams plc – the former holding company within the group – entered administration in April 2019 and, shortly thereafter, the Company and its sister company, Debenhams Properties Limited, entered into CVAs[1]) it was forced to close all of its 142 department stores as a result of the Government's restrictions on retail outlets as part of its strategy to combat the COVID-19 pandemic. Its online business continues to trade but the future viability of that business appears uncertain.

On 25th March 2020, the Company wrote to around 13,000 store-based employees informing them of the Government's restrictions, the Company's intention to close all stores from 26th March 2020 and, as a result, the decision to furlough all those employees pursuant to the Government's Coronavirus Job Retention Scheme ("the Scheme") and to pay them only the 80% of their salaries (up to the cap of £2,500 per month) received under the Scheme. Between 25th March 2020 and administration, the Company furloughed a further 867 employees on the same terms. As such, by the time of the Administrators' appointment, the vast majority of the Company's 15,550 employees had been placed on furlough pursuant to the Scheme.

[1] Which were subsequently challenged by various of its landlords

The Administrators' strategy and concerns

The Administrators' intended strategy for the Company is to implement a 'light touch' administration, allowing the existing management to continue to exercise certain operational powers whilst the Administrators work with the management to stabilise the business during the COVID-19-related uncertainties, with the intention of rescuing the Company as a going concern. Part of this strategy involves "mothballing" the business and retaining the employees by continuing to furlough them under the Scheme.

On appointment, the Administrators considered that express consent should be obtained from all furloughed employees to avoid any doubt as to their agreement to being furloughed and their agreement to the associated pay reduction under the Scheme. As such, on 10th April 2020, the Administrators sent letters to the employees seeking their consent. By the time of the hearing, just over 12,700 employees had consented to the arrangements, 4 had objected and 359 were still to respond.

Whilst a significant number of employees had consented to the wage reduction under the Scheme, the Administrators remained concerned that if, by continuing to furlough employees under the Scheme, the contracts of all of the furloughed employees were deemed to be adopted by the Administrators, all of the employees' wages and salary entitlements would obtain super-priority under paragraph 99(5) of Schedule B1 to the Insolvency Act 1986 ("Schedule B1"). In respect of the employees that had not responded to the Administrators' letter, this would create a liability for the entirety of the sums due to them under their contract, thereby creating a shortfall from the Company's point of view in circumstances where the Scheme only covered 80% of those sums up to £2,500 per month. In addition, the Administrators were concerned that in respect of the consenting employees, there is presently little clarity provided as to the treatment of sick pay and holiday pay under the Scheme and, as such, the Company may remain liable for such sums which will gain super-priority and may not necessarily be covered by payments under the Scheme.

In short, the Administrators considered that if the contracts of employment were to be adopted by the continued furloughing, the difficult decision to terminate the employment of some or all of employees might have to be taken to the detriment of both the Company and those employees.

The Issue

The issue for the Court was whether, in circumstances where the Company had furloughed employees prior to administration (i.e. the furloughing and use of the Scheme had not been a decision taken by the Administrators – in contrast to the situation in *Re Carluccio's Limited*), the Administrators, by simply continuing the furlough scheme, would be taken to have adopted the contracts of employment.

The Administrators asked the Court to reach a different conclusion to that reached in *Re Carluccio's Limited* and to confirm, by way of declaration, that participating in the Scheme would not amount to the adoption of employment contracts by the Administrators.

The Administrators contended that Snowden J had erred in *Re Carluccio's Limited* in concluding, at paragraph 91 of that judgment, that in applying under the Scheme and/or making payments to furloughed employees, the administrators of Carluccio's were "*doing an act which could only be explicable on the basis that they were electing to treat the varied contract as giving rise to liabilities which qualify for super-priority*" and, therefore, adopting those contracts. The Administrators argued that an administrator can make payments under the Scheme pursuant to paragraph 66 of Schedule B1 and, as such, there is no requirement to conclude (as Snowden J did) that payments to employees under the Scheme must be by way of super-priority under paragraph 99 of Schedule B1 and, as such, must be pursuant to adopted contracts of employment.

The Decision

Trower J agreed with Snowden J's analysis of paragraph 99 of Schedule B1 and its effects in his decision in *Re Carluccio's Limited* and also with Snowden J's analysis of the authorities concerning the adoption of employment contracts. He also concurred with Snowden J that the absence of any actual services being rendered by the employees in question did not prevent the contracts of employment from being adopted by administrators. Whilst providing services to the company post-administration (and post the 14-day period after administration) is likely to provide a good litmus test for adoption in most cases, circumstances where employees are retained to ensure "*the viability of the future business and continued trading in the future*" may also be sufficient for contracts to be adopted.

In response to the Administrators' contentions that Snowden J was wrong, Trower J dismissed the main thrust of those submissions as missing the point[2]. Snowden J concluded that contracts of employment would be adopted by participation in the Scheme and payment of the employees by the administrators of Carluccio's. This conclusion did not depend on whether or not paragraph 66 of Schedule also allowed payments to employees in priority to other creditors[3] but, rather, his conclusions simply allowed him to say that, having adopted the contracts by participating in the Scheme, the administrators of Carluccio's were permitted (and, indeed, required) to make payment to the employees pursuant to paragraph 99 of Schedule B1.

In circumstances where the Administrators' arguments here were not advanced before Snowden J (quite understandably), Trower J declined simply to follow Snowden J's decision[4] but, instead, examined the question in detail. Trower J agreed with the Administrators that the authorities on adoption (most significantly, the case of *Powdrill v Watson & Anor (Paramount Airways Ltd)* [1995] 2 A.C. 394) confirm that for a contract to be adopted, there must be some identifiable conduct by the administrator which causes the contract to be continued and that the mere continuation of employment is not enough. However, Trower J's analysis of the *Paramount* case and of *Re Antal International Ltd* [2003] 2 BCLC 406 (two of the cases considered and cited by Snowden J in *Re Carluccio's Limited*) concluded that by continuing to cause a company to treat a person as an employee beyond the initial 14-day period post-administration[5], the contract of employment will have been adopted for the purposes of paragraph 99 of Schedule B1.

In applying those legal principles to the Debenhams situation, Trower J determined that in causing the Company to make an application under the Scheme and to make payments to the furloughed employees, the Administrators would be "*engaging in positive conduct which presupposes that the contracts of the furloughed employees continue to exist and treats that as being the case*"[6]. The Judge held that the purpose of the Scheme was to allow employers to retain their employees and pay them sums received from the Government which are to be treated as wages from the perspective of both employer and employee. Indeed, given the purpose of the Scheme, it would not be possible for the Administrators to participate in it without electing to treat the relevant contracts of employment as continuing.

Trower J addressed the Administrators' contention that Snowden J's test of "*doing an act which could only explicable on the basis that they were electing to treat the varied contract as giving rise to liabilities which qualify for super-priority*", and whilst he accepted that this was a slightly different test to that described by Lord Browne-Wilkinson in *Paramount*[7] he did not consider that it led to a different result.

In short, the acts of participating in and making payments under the Scheme can only be consistent with the Administrators treating the employment contracts as continuing and the Company in administration having continuing liabilities under those contracts, being separate liabilities that arise in the administration. If this was not the case, the Administrators could not make a claim under the Scheme as it could not procure the Company to participate in the Scheme without procuring it to pay the equivalent amount to the employee pursuant to an obligation which only arises by virtue of that employee's contract of employment continuing. Tower J also confirmed that it does not matter that the Administrators may not, in fact, want the Company to incur liabilities to the employees that qualify for super-priority. To that end, there is an objective element to what is meant by administrators electing to treat the contracts as giving rise to super-priority liabilities within the administration. What matters is whether there is a separate liability which arises out of the elective conduct of the administrators, not whether they subjectively want that liability to have a particular ranking[8].

Trower J accepted that in certain circumstances, such as where the company cannot obtain the consent of sufficient employees to vary their contracts to accept only the 80% of salary paid by the Government, the inevitable adoption of the contracts by application of the Scheme could lead to companies in administration declining to use the Scheme and making more employees redundant to avoid super-priority liabilities, thereby undermining the objectives of the Scheme (namely, to retain as many employees as possible). However, he did not consider that this would necessarily be the case (as both the Carluccio's and the Debenhams situations had demonstrated that steps can be taken to limit any further obligations to the equivalent of any sums received under the Scheme). In any event, Trower J did not consider that he could decline to follow the established

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[2] See paragraph 43 of the judgment
[3] Something that Snowden J in fact identified towards the end of his judgment in *Re Carluccio's Limited*
[4] On the basis that Trower J was not convinced that Snowden J's decision, as a judge of coordinate jurisdiction, was wrong
[5] As provided for at paragraph 99(5) of Schedule B1
[6] See paragraph 54 of the judgment
[7] At 449B – "*some conduct by the administrator….which amounts to an election to treat the continued contract of employment with the company as giving rise to a separate liability in the administration….*"
[8] See paragraphs 62 to 65 of the judgment

principles concerning adoption of employment contracts, even if the purpose of the Scheme was arguably undermined by the impact of his decision.

The Implications for Administrators

Whilst, like Snowden J in *Re Carluccio's Limited*, Trower J was keen in this judgment to emphasise that the Court will not ordinarily provide guidance to office holders on what they should or should not do within an insolvency, or what the consequences of intended actions might or might not be, Trower J endorsed Snowden J's comment that the courts should work with office holders to implement the Government's response to the COVID-19 in an innovative manner. In addition, like Snowden J, he concluded that he ought to give directions to the Administrators given the urgent nature of the decisions they faced as regards the future of the Company's employees notwithstanding that the Administrators here had the benefit of the decision in *Re Carluccio's Limited* which made it difficult to see how the Administrators could be criticised for proceeding on the basis of Snowden J's conclusions.

Trower J identified and was troubled by the inability of any interested parties to be joined as respondents to this application and, again like Snowden J, made it clear that his decision could not be binding.

However, despite those caveats, this decision provides further clarity on the implementation of the Scheme by administrators. Following this decision and the decision in *Re Carluccio's Limited*, administrators now have reasoned and consistent guidance from the Court confirming that:

(1) the Scheme is open to companies in administration;
(2) whether the administrator causes the employees to be furloughed or not (i.e. whether it was a step taken by the company pre-administration or by the administrators), by applying under the Scheme and making payments to employees, administrators will be taken to have adopted their contracts of employment irrespective of whether they want or intend the company to incur liabilities which have super-priority under paragraph 99 of Schedule B1 or not;
(3) having applied under the Scheme, a company's liabilities to furloughed employees pursuant to their contracts of employment obtain super-priority; and
(4) if contracts of employment are varied prior to applying under the Scheme, it is possible to limit such liabilities to the equivalent of the sums received from the Government under the Scheme.

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