Radcliffe Chambers
11 New Square Lincoln's Inn
London WC2A 3QB

T: 020 7831 0081
E: clerks@radcliffechambers.com
W: radcliffechambers.com

Radcliffe Chambers

The Court of Appeal provides confirmation on the implications of the use of the Government's coronavirus job retention scheme by companies in administration: Re Debenhams Retail Limited [2020] EWCA Civ 600

– 13.05.2020

Matthew Weaver
Call: 2002
Barrister

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 handed down on 6th May 2020 in *Re Debenhams Retail Ltd (in administration)* [2020] EWCA Civ 600, the Court of Appeal provided confirmation on the implications for office holders and insolvent estates of using the Government's Coronavirus Job Retention Scheme in administrations, following the previous first instance decisions on the issue in *Re Carluccio's Ltd* [2020] EWHC 886 (Ch) and *Re Debenhams Retail Ltd* [2020] EWHC 921 (Ch). Matthew Weaver considers the judgment and its implications in this briefing.

The Background

The background to the Administrators' first instance application before Trower, J is set out in my earlier briefing on that decision, a link to which is here.

Following the decision by Trower, J at first instance that participating in the Government's Coronavirus Job Retention Scheme ("the Scheme") was likely to amount to adoption of the contracts of employment pursuant to paragraph 99(5) of Schedule B1 to the Insolvency Act 1986 ("Schedule B1"), the Joint Administrators of Debenhams appealed to the Court of Appeal to reverse that decision and for a declaration that by paying employees furloughed under the Scheme, the Administrators would not be taken to have adopted the contracts of employment.

Since the hearing before Trower, J, the Administrators had received responses to their request to employees to consent to being furloughed under the Scheme and to receive only the sums paid by the Government under the Scheme from all but 10 employees. Only 4 employees refused to be furloughed, the remainder who responded agreed.

As such, with the exception of amounts such as sick pay or holiday pay, the Company's ongoing liabilities to employees were limited to the sums received from the Government, making the impact cost neutral. The Administrators estimated, however, that the holiday

pay liability of the Company for the next 3 months alone could total some £1.28 million.

The Appeal

The Administrators concentrated the appeal on the consequences of making payments to employees furloughed under the Scheme and whether that caused the contracts of employment to be adopted. The Administrators argued that paying employees furloughed under the Scheme did not amount to adoption of their contracts of employment for the following reasons:

1. Snowden, J had correctly identified the applicable test for adoption of contracts, as established in *Re Paramount Airways Ltd* [1995] 2 AC 394, but had misapplied it in *Re Carluccio's Ltd*. As payments made under the Scheme are reimbursed or funded by the Government, the Administrators did not need to make any election to treat employment liabilities has having super-priority under paragraph 99(5) of Schedule B1;
2. Trower, J applied the wrong test by concluding that what was required was conduct which made it plain that the Administrators were treating the contracts as giving rise to a different liability;
3. The appropriate test for adoption is whether the Administrators can be taken to have wished or agreed to adopt the contracts of employment. It is an objective assessment of the administrators' state of mind, judged by their words and conduct;
4. Further, there were various factors which tend to support the conclusion that the Administrators have not adopted the contracts, namely that (a) the furloughed employees were not providing services to the Company; (b) the furloughed employees' entitlement to salary is limited to the sums received from the Government, making the process costs neutral to the administration estate and rendering the Company simply a conduit for Government funds; and (c) any decision whether to terminate the contracts of furloughed employees will be made only once the Scheme has ended.

The Decision

The Court of Appeal started by identifying key features of the Scheme so far as they related to the issue of adoption. These include that (1) furloughed employees remain employed by their employer throughout the process; (2) a furloughed employee must be instructed to cease all work for the employer; (3) save for as regards working and attending work, employees remain bound by the terms of their employment contracts; (4) payments made to furloughed employees are treated as salaries or wages, subject to income tax in the hands of the employees and treated as income and expenses for the employer; (5) funds received under the Scheme must be used to pay employees; (6) the Scheme guidance anticipates decisions being made on furloughed employees when the Scheme ceases; and (7) an administrator can access the Scheme if "*there is a reasonable likelihood of rehiring the workers*".

In considering the leading decision on the adoption of employment contracts (*Re Paramount Airways Ltd*), the Court of Appeal confirmed that the mere continuation of an employment contract does not lead inexorably to the conclusion that the contract has been adopted. The question is not whether the employment continues but whether the officeholder has adopted the employment contract.

The Court were not satisfied that the judgments of Snowden, J and Trower, J displayed any significant difference in approach. Any difference in the way the judgments were expressed was explicable by the fact that each judge heard and had to address different submissions on behalf of the Administrators. In addressing the submissions in respect of the test to be applied, the Court concluded that the Administrators had misunderstood the approach taken by Lord Browne-Wilkinson in *Re Paramount Airways Ltd* and clarified that he was not introducing the intentions of an administrator as a relevant factor for deciding whether a contract had been adopted. The question of law for the court to determine is whether the conduct of the administrator is such that he must be taken to have adopted the contracts, not whether his conduct *evidences* an election by the administrator. Whether an administrator wishes to adopt a contract, consciously or otherwise, is not, therefore, a relevant consideration.

In the present case, the Court of Appeal identified the following facts which supported the conclusion that the Administrators had continued the employment of the furloughed employees and therefore adopted the contracts: (1) the Administrators will continue to pay wages or salaries to the furloughed employees pursuant to the employees' contracts of employment, with the employees' entitlement to payments derived exclusively from their contracts and tax payable accordingly by both the employee and the employer; (2) all of the furloughed employees have accepted continuation of their employment on certain terms and will remain bound by their contracts of employment; and (3) the Administrators are paying the furloughed employees with the objective of rescuing the Company as a going concern.

In addressing the points raised by the Administrators which were said to militate against an adoption of the contracts by them, the Court identified that (1) whilst it is right that the employees will not be providing services to the Company whilst furloughed, this is not sufficient in itself to avoid adoption. It was perfectly possible for an employee's contract to be adopted notwithstanding that he or she does not provide services to the company; (2) the fact that the Scheme might be cost neutral to the Company did not negate adoption. The Government could have created a scheme which did not require the employer to make the payments to employees as a conduit but it did not do so and the consequences of using the Scheme have to be decided by reference to its terms; and (3) whilst the ultimate decisions as to whether to rehire the employees will not be made until after the Scheme ends, the fact that the Administrators have taken steps to keep the contracts of the furloughed employees in being in the meantime, with the necessary reasonably expectation that the employees will be rehired, is supportive of those contracts being adopted.

The Implications for Administrators

Whilst the Court of Appeal shared the reservations of both Trower, J and Snowden, J, in making significant decisions in the absence of any argument being raised contrary to the Administrators' position, having had the benefit of the submissions below in both *Re Debenhams Retail Ltd* and *Re Carluccio's Ltd*, it was prepared to make final and binding determinations. As such, this decision does give office holders much needed the certainty concerning the consequences of using the Scheme in administration.

The Court of Appeal was clear, in making use of the Scheme and paying furloughed employees, the Administrators were treating the contracts as continuing and had adopted the contracts. The Scheme required the furloughed employees to continue to be employed and treated as employees (being paid wages and being bound by the vast majority of their contracts of employment). As such, if the Administrators wished to take advantage of the Scheme, they had to be taken to have adopted the contracts of employment.

As well as clarifying the position on adoption and the Scheme, the Court of Appeal also addressed, albeit obiter, the availability of paragraph 66 of Schedule B1 as a vehicle for administrators to make payments to furloughed employees. Whilst the Court were content that Snowden, J's focus on paragraph 99 of Schedule B1 in *Re Carluccio's Ltd* did not impact on the correctness of his analysis on adoption, the Court did indicate its view that paragraph 66 provided an appropriate and "*perhaps the most obvious*" source of authority for the payments to furloughed employees.

Finally, the Court noted the practical difficulties that may face administrators when considering furloughing employees under the Scheme. Whilst the vast majority of employees of both Carluccio's and Debenhams accepted a variation of their contractual terms (leaving only holiday pay and sick pay as outstanding super-priority liabilities if the Scheme was used), the Court accepted that other administrators may not be able to achieve this level of consent from employees and may therefore be faced with difficult decisions as to whether to retain furloughed employees, or place employees on furlough, rather than terminating their employment. To address this issue, the Court suggested that it might be considered that there are "*good reasons of policy for excluding action restricted to implementation of the Scheme from the scope of "adoption" under paragraph 99*". However, by applying the law as it currently stands, a finding of adoption was the only proper conclusion.

Administrators now have clear guidance on the impact of implementing the Scheme. However, the practical issues of securing mass consent to the variation of employment terms to make the Scheme viable in administration are likely to continue to pose significant problems together with the fact that holiday pay and sick pay will not be reimbursed under the Scheme but will obtain super-priority within the administration. These will continue to be matters needing consideration by office holders being deciding on the best course of action.

Finally, many office holders may well join with the Court of Appeal in considering an exclusion from adoption under paragraph 99 for implementation of the Scheme as desirable but as the law currently stands, unless Parliament provides for such an exclusion, adoption appears unavoidable if the Scheme is to be used in administration.

Radcliffe Chambers

Radcliffe Chambers is a barristers' chambers specialising in commercial, insolvency, pensions, banking and finance, private client, property and charity law.

Radcliffe Chambers and its barristers are regulated by the Bar Standards Board of England and Wales ("BSB"). When practising as barristers, they are self-employed. They are registered with and regulated by the BSB, and they are required to practise in accordance with the Code of Conduct contained in the BSB Handbook.

If you do not wish to receive further marketing communications from Radcliffe Chambers, please email events@radcliffechambers.com.