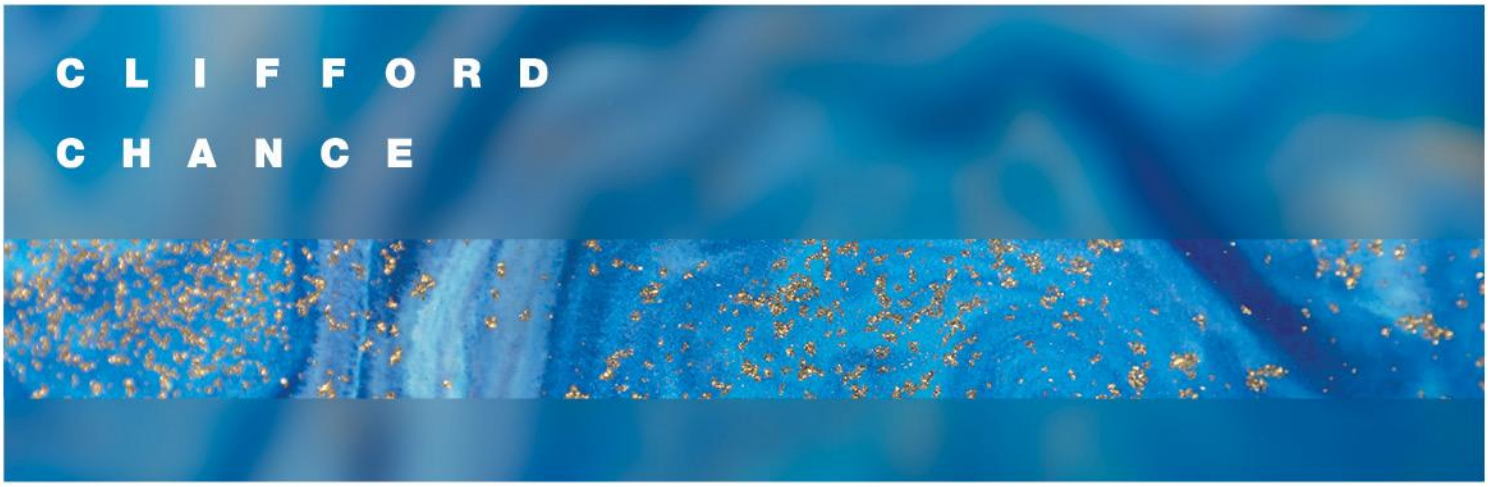

COURT OF APPEAL: ADMINISTRATORS OF DEBENHAMS AND THE CORONAVIRUS JOB RETENTION SCHEME

Today, 6 May 2020, the Court of Appeal, *In the Matter of Debenhams Retail Limited (in administration)* [2020] EWCA Civ 600 published its reasons for upholding a first instance decision, that the administrators of Debenhams had adopted the employment contracts of 13,056 employees who are the subject of the Job Retention Scheme (the Scheme).

The availability of the Scheme to companies in administration allows administrators to pursue rescue of the company as a going concern, in this case with the aim of resuming trading once the lockdown measures are lifted. The importance of the determination as to whether the contracts were adopted relates to the fact that certain entitlements for wages and salary enjoy a super priority above other claims in the administration, namely (i) the administrators' own expenses, (ii) claims subject to floating charge holders, and (iii) claims of unsecured creditors.

In the Debenhams case, as the employees had agreed to vary their employment contracts and limit their salary to the amounts available under the Scheme, the economic impact of the super priority status was limited to certain payments relating to excess holiday pay not covered under the Scheme amounting to £1.28m. It is important to note that other employment related entitlements such as redundancy payments, payments for unfair dismissal, protective awards or payments in lieu of notice do not attract the same super priority.

Of course, generally speaking while access to the Scheme may defer decisions relating to redundancies, employers when accessing the Scheme also need to consider in advance their position once the Scheme ends. In the context of administration, this consideration is more acute as the adoption of employment contracts attracting super priority at a time when a business is already in a formal process and with limited access to funding, makes the assessment of any need for variation of contract terms or steps to make redundancies, even more crucial. It is also worth noting that the judgment acknowledges that the terms of the Scheme itself expressly provide that it will not be appropriate for every administration.

KEY ISSUE IN THE CASE

The key question the court dealt with was whether employment contracts will be "adopted" by the administrators for the purposes of para 99(5) of Schedule B1 to the Insolvency Act 1986 (the "**Insolvency Act**") where those employees were placed on furlough prior to administration and the administrators take no action other than to pay the employees amounts due to be reimbursed to Debenhams through its participation in the Scheme. Where employment contracts are "adopted", wages and salary (including holiday pay) enjoy super-priority status (i.e. rank ahead of other expenses of the administration and the provable claims of other creditors).

Key facts

- Debenhams has over 15,000 employees.
- On 25 March 2020 Debenhams wrote to around 13,000 employees informing them that they would be furloughed and that they would be subject to the Scheme. Between 25 March and the appointment of the Administrators a further 867 employees were placed on furlough. Employees were told that they would receive 80% of their monthly wages up to a cap of £2,500 but that Debenhams would not pay additional amounts to any employees.
- Administrators were appointed on 9 April 2020.
- On 10 April 2020 the Administrators requested employee consent by email to the furloughing arrangements and the resulting variation of employment contracts.
- As at 15 April 2020 over 12,700 employees had consented, 4 rejected, and 359 had not responded.
- Trower J gave directions which the administrators appealed to the Court of Appeal.
- The Scheme provides a reimbursement equal to 80% pay, however furloughed employees continue to accrue holiday which if taken is payable at the normal rate of pay.

APPROACH OF THE COURTS

What does the original decision say?

That the administrators will be taken to have adopted the employment contracts in circumstances where, at any time after 14 days from the time of their appointment, they either:

- cause the company to make payments to employee(s) in accordance with their contracts of employment including amounts to be reimbursed to the company under the Scheme; or
- the administrators make an application in respect of such employee(s) under the Scheme.

What does the Court of Appeal decision say?

The Court of Appeal dismissed the administrators' appeal. Instead, it was held that, for the purposes of para 99 of Schedule B1 of the Insolvency Act, the administrators had adopted the contracts of those employees who had consented to be furloughed.

The reasons given for considering the varied employment contracts as being adopted (which did not differ from those given by Trower J at first instance) included:

- the administrators would pay the wages and salaries of furloughed employees pursuant to the terms of their employment contracts. Whilst in economic terms the company was simply a conduit for funds transferred under the Scheme, in legal terms the employees remain employed and will be remunerated under the terms of their contracts. For example, the renumeration will be income in the hands of the employees, chargeable to income tax.
- the employees who have accepted the continuation of employment and those who do not treat their employment as terminated would remain bound by the terms of their contracts (aside from the obligation to be available for work during the furlough period). For instance, furloughed employees would possibly be prevented under their contracts from undertaking other paid work while still being employed by the company, as they would remain bound by "duties of loyalty".
- the fact that the furloughed employees were not providing any services to the company was not sufficient in itself to show the employment contracts had not been adopted.

- in continuing to pay furloughed employees the administrators are acting with the objective of rescuing the company as a going concern.
- by not terminating the furloughed employees, the administrators have taken steps to keep the employment contracts in existence.

POLICY REASONS FOR SCHEME TO BE AMENDED

The judgment suggests that there may be good policy reasons for excluding action taken under the Scheme from the scope of the super priority available under para 99 of Schedule B1 of the Insolvency Act, but this would be something for the legislature to address rather than the Court.

What does the decision not say?

Interested parties are still at liberty to challenge the acts of the administrators.

The Government's Scheme guidance does not explain exactly how it should operate in the context of insolvency legislation.

It does not address the statutory obligations to consult with affected employees and/or employee representatives, including employees who may subsequently be made redundant or TUPE transferred to a purchaser or the extent to which there may be a special circumstances defence available where consultation obligations are not complied with.

Please see our previous briefings: Administrators and the UK Coronavirus Job Retention Scheme and Administrators of Debenhams and the UK Coronavirus Job Retention Scheme.

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