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Case No: CR-2020-002113

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES LIST
CHANCERY DIVISION

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 17/04/2020

Before :

MR JUSTICE TROWER

IN THE MATTER OF DEBENHAMS RETAIL LIMITED (IN ADMINISTRATION)

AND IN THE MATTTER OF THE INSOLVENCY ACT 1986

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- -

TOM SMITH QC AND RICHARD FISHER QC (instructed by **Freshfields Bruckhaus Deringer LLP**) for the **Joint Administrators**

Hearing date: 15th April 2020
- -

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE TROWER

Mr Justice Trower :

Introduction

1. This is an application by the joint administrators (the "Administrators") of Debenhams Retail Limited ("the Company") for directions pursuant to paragraph 63 of Schedule B1 ("Schedule B1") to the Insolvency Act 1986 ("IA 1986"). The application is very urgent and is made without the joinder of any respondent and without any adversarial argument from any other party. As I shall explain a little later, this has caused me to consider whether it was appropriate for me to grant any relief, but for reasons which I will explain, I have concluded that in the very unusual circumstances of the present case it is appropriate for the court to give limited directions to assist the Administrators in charting the right way forward.

2. The directions sought relate to the question of whether the contracts of employees who have been "furloughed" pursuant to the Company's participation in the Coronavirus Job Retention Scheme ("JRS") will be adopted by the Administrators (within the meaning of paragraph 99(5) of Schedule B1) if the employees remain furloughed and the Administrators take no further action in relation to these employees except to pay to them amounts that are to be reimbursed to the Company through its participation in the JRS. In the Administrators' skeleton argument these are defined as the Relevant Circumstances, a definition which I shall also use in this judgment. The precise terms of the order sought by the Administrators is a declaration that:

> "*None of the contracts of employees who have been furloughed will be adopted by the Joint Administrators if the employees remain furloughed and the Joint Administrators take no further action in relation to these employees except for issuing such communications as may be required to confirm the terms of the employees' ongoing engagement and to seek any required consent in relation to such terms and to pay to the furloughed employees amounts that are to be reimbursed to the Company through its participation in the Coronavirus Job Retention Scheme*."

3. The Administrators were appointed by the directors of the Company on 9 April 2020. The urgency of the application flows from the fact that they need to make a decision in the next few days as to whether or not to dismiss a significant number of the Company's employees. That decision will be informed in part by the answer to the question raised by the application. The reason for this is that, if the contracts of employment are adopted, the relevant employees will then enjoy super-priority status in the administration in respect of their wages or salary referable to periods post-adoption pursuant to paragraphs 99(5) and 99(6) of Schedule B1. This means that they will rank ahead both of the provable claims of other creditors and of other expenses of the administration, a consequence which may have a significant effect on the future conduct of the administration.

4. As Mr Smith QC and Mr Fisher QC say in their skeleton argument in support of the application, the financial consequences of adopting contracts of employment mean that these types of decision can be difficult in any administration. This is particularly acute

in the present case because the Company has more than 15,000 employees, the majority of whom have already been furloughed.

5. It is said that the viability of a rescue of the business through an administration will be significantly affected by the decision which the Administrators have to make. The reason for this is that the Company's business has been very severely affected by the closure of its retail estate made necessary by the Government's response to the Covid-19 pandemic. There is significant uncertainty as to when this will change and when an exit from administration can be achieved. The Administrators consider that the workforce will have an important role in ensuring the viability of the future business and continued trading in the future.

6. It is also said by the Administrators that it may well be the case that they would have no alternative but to dismiss the furloughed employees (who are not providing any services to the Company, and cannot do so under the terms of the JRS) if there is exposure to a super-priority liability for wages or salary over and above the amounts which will be reimbursed under the JRS. Because of the way that the JRS works (with which I will deal later in this judgment), and subject to the impact of consents which have been received from a large number of the furloughed employees, the extent of the exposure is the 20% shortfall between the JRS proposed reimbursement of 80% of wages subject to a £2,500 cap, and the liabilities under the contract of employment which are referable to the period after the time of its adoption (paragraph 99(5)(b) of Schedule B1). Subject to a substantial reduction for the consents I have mentioned, this exposure is estimated to amount to over £3 million a month.

7. Before summarising a little more of the factual background, I should explain that similar but not identical questions have arisen in the case of Carluccio's Limited, a company which went into administration on 30 March 2020. One of the differences in that case was that the administrators were seeking directions before implementing their intention to place a large number of that company's employees on furlough pursuant to the JRS, and they wanted the court's directions as to the IA 1986 consequences of doing so, while in the present case most of the employees have already been furloughed. The Carluccio administrators obtained directions from Snowden J during the course of last week and on Monday 13 April the judge handed down a comprehensive judgment (*In Re Carluccio's Limited* [2020] EWHC 886 (Ch) ("*Carluccio*")) dealing with a number of issues on the interrelationship between the JRS and the principles underpinning the adoption of contracts of employment by administrators. As will appear, Snowden J's conclusions on some of those issues are directly applicable to the matters which I have been asked to determine.

8. In the ruling that I gave at the end of the oral argument on Wednesday 15 April I declined to make the declaration sought by the Administrators but indicated that I would give them directions as to the course of action which they were at liberty to take. Those directions were that the Administrators be at liberty to act on the basis that they will be taken to have adopted any contract of employment between the Company and its employees in circumstances where, in respect of any particular employee or employees, at any time after 14 days from the time of their appointment:

> (1) the Joint Administrators cause the Company to make payments to such employee or employees under and in accordance with their employment

contracts including in respect of amounts which may be reimbursed to the Company by a grant under the JRS; or

(2) the Administrators make an application in respect of such employee or employees under the JRS.

These are my reasons for giving those directions.

The Company and its administration

9. The Company's business is well known. It is part of a group (the "Group") which operates 142 department stores in the UK and is the largest such retailer in the country. Its stores are located in high streets, shopping centres and retail parks. It also operates department stores in the Republic of Ireland and Denmark and franchise stores in other countries. There is also an online business which generates approximately 19% of its usual trading revenues.

10. Even before the intense pressures caused by the Covid-19 pandemic the Group was experiencing significant trading difficulties. This led in April 2019 to the then-holding company of the Group, Debenhams plc, entering administration followed by an immediate sale of the shares it held in other group companies to a new holding company owned by its finance creditors. Shortly thereafter, CVAs under Part 1 of IA 1986 were approved in relation to the Company and its sister company, Debenhams Properties Limited, the purpose of which was to rationalise their portfolio of leases and certain other liabilities in order to facilitate the implementation of the Group's turnaround strategy.

11. The approval of the CVAs was controversial and the Company's CVA was challenged by some of its landlords. In a judgment handed down in September 2019 (*Discovery (Northampton) Ltd v Debenhams Retail Ltd* [2020] BCC 9), Norris J dismissed all but one of the grounds of challenge, modified the CVA to deal with the provisions of the CVA which he had held to be in excess of the jurisdiction conferred by Part 1 of IA 1986 and declared that the CVA as modified was valid and enforceable.

12. Notwithstanding the CVAs, trading conditions for the Group remained difficult, a state of affairs which was exacerbated by the Covid-19 pandemic. This has proved to be what the Administrators have described as an acute challenge to the business since March 2020 which is expected to continue for several months. Initially there was a substantial reduction in footfall with a corresponding impact on revenue. This was then followed by the closure of the entire estate of stores when the Government imposed restrictions on the opening of non-essential businesses. At the moment the online business continues to trade but the Administrators consider that this too is vulnerable to further Government intervention to shut the distribution centres and difficulties in finding staff to work in them. There are also issues with respect to payment of suppliers.

The Coronavirus Job Retention Scheme ("JRS")

13. The structure and purpose of the JRS is described in detail by Snowden J in paragraphs 14 to 23 of his judgment in *Carluccio*. As he points out no draft legislation or regulations have yet been published and the details which are known to date are contained in online guidance from the Government to be found at

https://www.gov.uk/guidance/claim-for-wage-costs-through-the-coronavirus-job-retention-scheme (the "Scheme Guidance") which was first published on 26 March 2020 and updated on 4 April, 9 April and 15 April 2020. It makes clear that the online service is not yet available but is expected to be available by the end of April. The latest information is that, all being well, the online portal should be opening on 20 April.

14. The Scheme Guidance is addressed to employers and states the following by way of introduction, making clear that the payments are made to an employer to reimburse it for the payments which it itself has made to its employees:

> "*If you cannot maintain your current workforce because your operations have been severely affected by coronavirus (COVID-19), you can furlough employees and apply for a grant that covers 80% of their usual monthly wage costs, up to £2,500 a month, plus the associated Employer National Insurance contributions and pension contributions (up to the level of the minimum automatic enrolment employer pension contribution) on that subsidised furlough pay.*
>
> *This is a temporary scheme in place for 3 months starting from 1 March 2020, but it may be extended if necessary and employers can use this scheme anytime during this period. It is designed to help employers whose operations have been severely affected by coronavirus (COVID-19) to retain their employees and protect the UK economy. However, all employers are eligible to claim under the scheme and the government recognises different businesses will face different impacts from coronavirus.*"

15. It is clear that the JRS is intended to apply to companies in administration, although it does not explain exactly how the JRS is intended to work in the context of mandatory principles of insolvency law. In that regard, the Scheme Guidance contains the following passage under the section headed 'Who can claim':

> "*Administrators*
>
> *Where a company is being taken under the management of an administrator, the administrator will be able to access the Job Retention Scheme. However, we would expect an administrator would only access the scheme if there is a reasonable likelihood of rehiring the workers. For instance, this could be as a result of an administration and pursuit of a sale of the business."*

16. The Scheme Guidance contemplates that, under the terms of the JRS, employees continue to receive wages from, but cannot continue to provide services to their employer while on furlough, that the 80% grant is to be treated as income of the employer and that it is intended that the employee will receive from the employer at least the amount of the grant paid by the Government. It also contemplates that placing employees on furlough may involve variations in their contracts of employment, but

they must continue to be employees. The following parts of the Scheme Guidance illustrate these points:

> "*You can only claim for furloughed employees that were on your PAYE payroll on or before 19 March 2020 and which were notified to HMRC on an RTI submission on or before 19 March 2020.This means an RTI submission notifying payment in respect of that employee to HMRC must have been made on or before 19 March 2020. Employees that were employed as of 28 February 2020 and on payroll (i.e. notified to HMRC on an RTI submission on or before 28 February) and were made redundant or stopped working for the employer after that and prior to 19 March 2020, can also qualify for the scheme if the employer re-employs them and puts them on furlough"*
>
> *…*
>
> *"To be eligible for the grant, when on furlough, an employee cannot undertake work for, or on behalf, of the organisation. This includes providing services or generating revenue. Employers are free to consider allocating any critical business tasks to staff that are not furloughed. While on furlough, the employee's wage will be subject to usual income tax and other deductions."*
>
> *…*
>
> *"If you made employees redundant, or they stopped working for you on or after 28 February 2020, you can re-employ them, put them on furlough and claim for their wages through the scheme."*
>
> *…*
>
> *"Employers should discuss with their staff and make any changes to the employment contract by agreement. When employers are making decisions in relation to the process, including deciding who to offer furlough to, equality and discrimination laws will apply in the usual way.*
>
> *To be eligible for the grant employers must confirm in writing to their employee confirming that they have been furloughed. A record of this communication must be kept for five years.*
>
> *You do not need to place all your employees on furlough. However, those employees who you do place on furlough cannot undertake work for you."*
>
> *…*
>
> *"You'll need to claim for*:
>
> - *80% of your employees' wages (even for employee's on National Minimum Wage) - up to a maximum of £2,500 per month. Do not claim for the worker's previous salary.*

- *Employer National Insurance contributions that are paid on the subsidised furlough pay."*

…

"You can choose to top up your employee's salary, but you do not have to. Employees must not work or provide any services for the business while furloughed, even if they receive a top-up salary."

…

"You must pay the employee all the grant you receive for their gross pay in the form of money."

"Furloughed staff must receive no less than 80% of their reference pay (up to the monthly cap of £2500)."

"Employers cannot enter into any transaction with the worker which reduces the wages below this amount. This includes any administration charge, fees or other costs in connection with the employment."

…

"*Payments received by a business under the scheme are made to offset these deductible revenue costs. They must therefore be included as income in the business's calculation of its taxable profits for Income Tax and Corporation Tax purposes, in accordance with normal principles*."

17. In my view, Mr Smith QC and Mr Fisher QC accurately reflected the intended effect of the JRS in their skeleton argument when they said the following:

"*The intended effect of the JRS is therefore to delay the point at which a decision needs to be made as regards redundancies and provide an interim measure of support through the grant system to preserve the employed status of the workers. The policy is readily understandable: to avoid companies having to make employees redundant as a result of temporary difficulties caused by the coronavirus pandemic in order to preserve jobs and the productive capacity of the economy for the time when the current restrictions cease*."

18. On 25 March 2020 (i.e. before the Company entered administration), the Company wrote to approximately 13,000 store-based employees informing them that the Government required the Company to close all of its stores to trading and that they were being furloughed until further notice with effect from the following day. They were informed that they would not be carrying out any functions of their employment while they were furloughed and that they would be subject to the JRS. Each employee was

also told that they would receive 80% of their usual monthly wages up to a cap of £2,500 per month but that the Company would not pay any additional amounts to any employees. A further 867 employees were placed on furlough on the same terms between 25 March and the appointment of the Administrators.

19. This meant that 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 JRS. A skeleton workforce continues to carry out functions for the Group, including, among other things, to operate the distribution and support centres in relation to the online business and to undertake administrative functions, such as managing finance and supplier relationships. It is anticipated that over the course of the next few days further groups of employees will be placed on furlough on the same terms, as and when (by way of example) they return from maternity leave.

The Company's administration, the contracts of employment and the JRS

20. As I have already mentioned the Administrators were appointed by the Company's directors on 9 April 2020. The purpose of the administration is to rescue the Company as a going concern in accordance with paragraph 3(1)(a) of Schedule Bl. In his witness statement in support of this application one of the Administrators (Mr Geoff Rowley) explained that the Administrators are intending to conduct what he called "*a 'light touch' administration which would protect and retain value in the business, reduce new money funding requirements and maximise options for exiting the administration as a going concern*". To that end the Administrators' proposals currently include consenting to the exercise of certain operational powers by the current management and working with them to stabilise the business during the COVID-19-related uncertainty. They also propose continuing to pay suppliers that are critical to the online business on the basis that this is currently the sole source of revenue and helps to maintain value in the brand.

21. Before the administration, employees were not asked if they consented to the furloughing arrangements. However, on their appointment the Administrators took the decision that express consent should now be sought from all employees who had been furloughed to avoid any doubt as to their agreement to that status and the associated pay reduction. Accordingly, on 10 April 2020, which was the day after their appointment, the Administrators sent out 13,070 letters by e-mail seeking express employee consent to the furloughing arrangements. Mr Smith QC informed me on instructions that as at the date of the hearing consents had been received from just over 12,700 employees, there were four objections and 359 employees had not responded.

22. When this application was first issued, and in circumstances in which the consents had not yet been received, the Administrators also sought alternative relief to cover the possibility that the court holds that, in the Relevant Circumstances, the contracts of the furloughed employees are adopted for the purposes of paragraph 99(5). The alternative relief was a direction that the amount payable under those contracts is limited to the amount which can be claimed under the JRS, i.e. 80% of wages for the furloughed period, capped at £2,500 per month. They sought that direction on the basis that the furloughed employees had impliedly consented to a variation of the terms of their contracts of employment as a result of the letters sent to them on 25 March 2020. This relief is no longer sought in the light of the number of actual consents which have now been received.

23. Notwithstanding the consents to the furloughing arrangements that have been received, the Administrators remain concerned about adopting the contracts of those who have consented because there is no clarity on the treatment of sick pay and holiday pay under the JRS. While both those categories qualify for super priority as wages and salary for the purposes of paragraph 99, it is not clear how they will be taken into account when quantifying the capped 80% which is eligible for the government grant. The latest iteration of the Scheme Guidance (published on 15 April after the hearing) gives a little more detail on how sick pay is to be treated under the JRS but it remains the case that, although the vast majority of furloughed employees have now consented to the furloughing arrangements, there are still several hundred who have not yet responded.

24. Mr Rowley has explained in his witness statement that the payment process which the Administrators intend to follow is to pay each furloughed employee 80% of their salary up to £2,500 per month from the Company's available cash reserves, which are not the subject of any form of security. They will seek reimbursement of these amounts (plus employer's NI contributions and auto-enrolment pension contributions) from the Government under the JRS. The Company's ability to pay furloughed employees before making recovery from the JRS will continue for at least the next payroll period and possibly thereafter. He then explains that the principal purposes of this arrangement include ensuring that employees continue to benefit from the JRS while the Company is in administration, allowing the Administrators to consider and maximise the Company's options for exiting administration without adopting or dismissing any employees and allowing the Administrators to consult with employees and their representatives.

The Administrators' concerns

25. It is the Administrators' case that, if they would be considered to have adopted the relevant employment contracts as a result of their proposed course of action, this will not only have significant negative consequences for the Company and its employees, it will also have an adverse impact on the wider rescue culture underlying the administration regime. In particular and given that the relevant wages and salary would enjoy a super-priority status in the administration, the Administrators consider that, absent the agreed variation of the employment contracts, they may well have no alternative but to dismiss some or all of those employees and look to re-employ specific employees at a later date, as appropriate.

26. They consider that this would be an unsatisfactory outcome, because it would significantly reduce, at a very early stage of the administration, their ability to retain value in the business as they pursue options for its rescue and thereafter its exit from the administration. They say that this would undermine the purpose of the administration and would be inconsistent with the purpose and policy of the JRS itself. Mr Smith QC also submitted that, although the Administrators have been successful in procuring consent to the furloughing arrangements from a large number of employees, it is unsatisfactory that it has to be done this way in order to ameliorate the impact of adoption of the employment contracts of furloughed employees, and there will be other cases in which administrators are not so relatively successful in procuring the requisite consents.

27. I can readily understand why the Administrators take the view they do on the adverse impact of adoption if the consequence were to be that the employees are able to claim

super-priority for the full amount of their contractual entitlement to wages as at the time they are placed on furlough. There are unlikely to be the same adverse consequences where the employee has consented to what amounts to a variation of his contractual entitlement pursuant to the correspondence which was sent out by the Administrators the day after their appointment. Nonetheless, there remains real uncertainty about the full extent of the super-priority liabilities which may continue to subsist if adoption is held to have occurred, and this is bound to have an adverse impact on the Administrators' efforts to achieve the purpose of administration (the survival of the Company as a going concern).

28. Like Snowden J in *Carluccio*, I have been troubled by the fact that it has not been possible for any representative employees or other interested parties to be joined to the application, although I understand that the Government is aware of this application and has been provided with the papers. This means that my directions as to the law will not be binding and, like Snowden J, I considered whether it was appropriate to give directions to the Administrators at all. This is particularly the case as the Administrators already have the benefit of the *Carluccio* judgment which represents a clear statement of the legal position on the issues which arise on this application. It is difficult to see how they could be criticised for proceeding on the basis of his conclusions as implemented in the particular case of Debenhams with the assistance of their own expert legal advice.

29. Nonetheless, the Administrators would like as much certainty as possible on the position going forward, and in the present circumstances I think that it is appropriate for the court to do all that it can to assist the Administrators by addressing any areas of uncertainty, recognising all the while that the most it can do is give the Administrators liberty to act in a particular way without prejudice to the ability of an interested party to argue subsequently that its views were wrong. This comes close to giving an advisory opinion without proper adversarial argument, but in the exceptional circumstances of the present case I agree with what Snowden J said in paragraph 9 of his judgment:

> "*The COVID-19 pandemic is a critical situation which carries serious risks to the economy and jobs in addition to the obvious dangers to health. I think that it is right that, wherever possible, the courts should work constructively together with the insolvency profession to implement the Government's unprecedented response to the crisis in a similarly innovative manner*."

Adopting Contracts of Employment: the Legal Context

30. I now turn to the law on adoption of contracts of employment which is at the root of the Administrators' application. Paragraph 99 of Schedule B1 is concerned with the charges and liabilities which arise when an administrator vacates office and in relevant part provides as follows:

> *"(3) The former administrator's remuneration and expenses shall be–*
> *(a) charged on and payable out of property of which he had custody or control immediately before cessation, and*
> *(b) payable in priority to any security to which paragraph 70 applies.*

> *(4) A sum payable in respect of a debt or liability arising out of a contract entered into by the former administrator or a predecessor before cessation shall be–*
>
> *(a) charged on and payable out of property of which the former administrator had custody or control immediately before cessation, and*
> *(b) payable in priority to any charge arising under sub-paragraph (3).*
>
> *(5) Sub-paragraph (4) shall apply to a liability arising under a contract of employment which was adopted by the former administrator or a predecessor before cessation; and for that purpose–*
>
> *(a) action taken within the period of 14 days after an administrator's appointment shall not be taken to amount or contribute to the adoption of a contract,*
> *(b) no account shall be taken of a liability which arises, or in so far as it arises, by reference to anything which is done or which occurs before the adoption of the contract of employment, and*
> *(c) no account shall be taken of a liability to make a payment other than wages or salary."*

31. The effect of paragraph 99 of Schedule B1 was described by Snowden J in paragraphs 39 to 41 of his judgment in *Carlucci*o, in a passage with which the Administrators do not take issue (and with which I agree):

> *"39. The effect of these paragraphs is that liabilities for wages or salary arising out of contracts of employment adopted by an administrator following the onset of administration (subject to the condition that no act taken within the first 14 days of the administrator's appointment may amount or contribute to such adoption) are payable out of the assets held by the administrator in priority to the administrator's remuneration and expenses, which in turn have priority over the claims of floating charge creditors and unsecured creditors.*
>
> *40. This order of priority is confirmed at Rule 3.51(1) of the Insolvency (England and Wales) Rules 2016, which states (before setting out the priority among expenses of the administration) as follows:*
>
> *"Where there is a former administrator, the items in paragraph 99 of Schedule B1 are payable in priority to the expenses in this rule."*
>
> *41. In contrast, employees whose contracts of employment are not adopted in the first 14 days (in other words, whose employment is terminated by Administrators during this time or whose employment contracts are not adopted for some other reason), do not gain the benefit of super-priority under Paragraph 99(5), and their claims are instead merely unsecured provable debts."*

32. Paragraph 99 itself does not, however, deal with or identify in terms the circumstances in which a contract of employment is adopted by an administrator. For that it is

necessary to look at the authorities and the two most relevant ones are the important decision of the House of Lords in *Powdrill v Watson (Paramount Airways Limited)* [1995] 2 AC 394 ("*Paramount*") and Snowden J's decision in *Carluccio*. *Paramount* explains the general principles and *Carluccio* applies those principles to facts which are very similar to the present case.

33. In *Carluccio*, Snowden J analysed the authorities on the meaning of the word adoption in some detail (see in particular paragraphs 57 to 68 and 75 to 89 of his judgment). These parts of his judgment explain the history of the concept of adoption in this area of the law and its development with admirable clarity and I agree with all that he says. They are not criticised by the Administrators who also agree with what he had to say.

34. However, the Administrators challenge the correctness of Snowden J's conclusion on how those principles should be applied where an administrator makes payments to furloughed employees and also makes applications under the JRS in relation to those payments. In particular they say that he was wrong in the conclusion that he reached in paragraphs 91 and 92 of the judgment where he said as follows:

> "*91. However, it seems to me clear that, as and when the Administrators make an application under the Scheme in respect of the Consenting Employees or make any payment to the employees under their varied contracts, this would amount to adoption of the varied contracts of employment. Alternatively, although this is not anticipated, if funds were unexpectedly to become available to the Administrators to make payments of wages to the furloughed employees prior to the receipt of monies from the Scheme, that too would amount to adoption of the varied contract. In either case, applying the concept of adoption as explained by Lord Browne-Wilkinson in Paramount at page 449B, the Administrators would be 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.*
>
> *92. Accordingly, I consider that such steps would enable super-priority payments to be made to the furloughed employees under Paragraph 99(5) using the grant monies as and when received under the Scheme; or in the alternative would enable payments to the employees to be made from other funds of the Company, which would be reimbursed when the grant money was paid.*"

35. The directions which Snowden J then gave are set out at the end of his judgment and the declaration which it is said was wrong is as follows:

> *"(1) In relation to the Consenting Employees:*
>
> *…*
>
> *b. Adoption (within the meaning of paragraph 99(5) of Schedule B1 of the Insolvency Act 1986) … of the employment contracts (as varied in accordance with the Variation Letter) of the Consenting Employees will occur upon the earlier of*

a) the Joint Administrators making payments to the Consenting Employees under their employment contracts (as varied in accordance with the Variation Letter); or

b) the Joint Administrators making an application in respect of the Consenting Employees under the Scheme.

36. The Administrators argue that Snowden J did not explain why he concluded that the acts of making an application under the JRS and making a payment under contracts of employment (albeit ones varied to reflect the furlough conditions applied by the JRS) constituted adoption of those contracts. In particular they say that he does not explain why the Administrators would thereby "*be 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 that he was wrong to reach that conclusion.

37. The Administrators also say that Snowden J's conclusion in paragraph 91 is only explicable by reference to comments which he made in paragraph 56 of his judgment when dealing with the relationship between paragraphs 66 and 99 of Schedule B1, which were they submit a misunderstanding of the inter-relationship between those two provisions:

> "*However, it is clear that Paragraph 99 is the provision which is specifically designed to deal with the ability and obligation of Administrators to pay wages or salary to employees in an administration. I do not consider, and Ms Toube QC did not seek to argue, that paragraph 66, as a lex generalis, can modify or override the lex specialis of Paragraph 99: c.f. Re Allders Department Stores [2005] ICR 867 at [22]. In my view, it is therefore clear that any analysis of the present position must commence with Paragraph 99."*

38. As I have already mentioned, in *Carluccio* the relevant employees had not yet been placed on furlough, and the administrators were concerned to ensure that the monies which they receive from the JRS grant could be applied in payment of wages. In that context the questions which arose were not limited to the circumstances in which the administrators in that case were to be treated as having adopted the contracts of employment so as to give rise to super-priority. They extended to the statutory source of the administrators' ability to pay the employees ahead of the company's other creditors despite the fact that their claims were also provable because they arose under contracts entered into prior to the administration. That was the context in which Snowden J identified paragraph 99 of Schedule B1 as the provision specifically designed to deal with the ability as well as the obligation of Administrators to pay wages or salary to employees in an administration.

39. That is not a question which arises in the same way in the present case, but the Administrators say that Snowden J's reasoning on this point was flawed and caused him to reach the wrong conclusion on the declaration that he made in *Carluccio* to the effect that by participating in the JRS, the Administrators would be adopting (within

the meaning of paragraph 99 of Schedule B1) the employment contracts of furloughed employees. They say that it was flawed because there is no reason why payments to employees cannot be justified under paragraph 66 of Schedule B1 which provides that "*The administrator of a company may make a payment otherwise than in accordance with paragraph 65 or paragraph 13 of Schedule 1 if he thinks it likely to assist achievement of the purpose of administration*". They say that it is not necessary to invoke paragraph 99 to do so.

40. As will become apparent I do not consider that it is necessary for me to engage in this debate because I think that Snowden J was correct in any event in what he said in paragraph 91 of his judgment, irrespective of the reasoning he adopted in paragraphs 55 and 56. However, I am inclined to the view that in the normal case it is perfectly appropriate to identify paragraph 99 of Schedule B1 not just as the source of the obligation to pay wages as a super-priority administration expense but also its necessary concomitant i.e. the statutory basis for the administrator's ability to do so. Explicit reliance on paragraph 66 of Schedule B1 is therefore not needed for that purpose, because the ability to pay flows inexorably from the combination of (a) the adoption of the contract which is part of the conduct by the administrator of his functions and (b) the fact that paragraphs 99(4) and 99(5) then provide for the liability to be payable out of the assets.

41. True it is that paragraph 99 is concerned with the position at the time the administrator leaves office, but it is well understood that administration expenses, of which liabilities arising under adopted contracts are one category (Rule 3.51(1) of the Insolvency (England and Wales) Rules 2016) are payable as the administration progresses. As Dillon LJ said in the Court of Appeal in *Paramoun*t [1994] BCC 172, 180:

> *"Although strictly sums payable are, under s.19(5), only payable when the administrator vacates office, it is well understood that administrators will, in the ordinary way, pay expenses of the administration including the salaries and other payments to employees as they arise during the continuance of the administration*."

42. It follows that, even though it is clear that paragraph 66 of Schedule B1 is capable of being used as the basis for an ability to pay employees out of the usual ranking of priorities where it is necessary or appropriate to do so for the purposes of achieving the purpose of administration (see *Re MG Rover Espana SA* [2006] BCC 509 and *Re Collins & Aikman* [2006] BCC 861), I agree with Snowden J that this is not the obvious place to start when considering how they should be discharged during the course of the administration. In any event, the fact that paragraph 66 is an available statutory source for the ability of administrators to make payments to employees if necessary was accepted by Snowden J in paragraphs 111 and 112 of his judgment.

43. But in any event, it seems to me that this submission misses the point. It is clear from paragraph 91 of his judgment that Snowden J considered that the contracts of employment would be adopted by the acts of participation and payment that constitute the Relevant Circumstances in the present case. This conclusion did not depend on the question of whether or not paragraph 66 of Schedule B1 might also be available as a source of the statutory ability to pay employees. It simply enabled him to say that, in the light of the adoption of the employment contracts of the Carluccio employees,

paragraph 99 of Schedule B1 permitted and indeed required the administrators in that case to actually make the payments which participation in the JRS required Carluccio to pay.

44. I could of course approach this argument on the basis that I should simply follow what Snowden J, as a judge of coordinate jurisdiction, has said without further enquiry unless I was convinced that he was wrong. However, I think that it is necessary to examine the position in rather more detail because it is not clear to me that the points now made by Mr Smith QC were advanced in *Carluccio,* nor that anyone in that case thought that it was in their interests to do so. This carries no implicit criticism of anyone, not least because I have concluded that his argument fails. However, it has thrown up issues on the approach adopted by Snowden J which I think it is appropriate for me to address.

Paramount

45. As I have already intimated, the meaning of the word "*adopted*" as used in the statutory predecessor to paragraph 99 (the now-repealed section 19(5) of IA 1986) was subjected to the authoritative analysis of the House of Lords in *Paramount*. In that case, a week after the commencement of the administration, the administrators wrote to the relevant employees (who were pilots), confirming that their salaries would continue to be paid in the administration, but asserting that the administrators would not be adopting their contracts of employment or accepting personal liability in respect of them. The pilots continued to work for the company for four months and were paid their wages whilst the administrators sought a buyer for the business as a going concern. When those attempts to find a buyer failed, the administrators terminated their employment. The pilots claimed that their contracts of employment had been adopted by the administrators under what was then section 19(5) of IA 1986 and that they were entitled to super-priority for payment of their contractual rights. Evans Lombe J and the Court of Appeal found in favour of the pilots.

46. The House of Lords dismissed the appeal, although it is evident that Lord Browne-Wilkinson did so with some regret. In his speech, he explained that the policy behind the new law providing for the super-priority of liabilities arising under contracts of employment adopted by administrators and receivers was to correct the mischief disclosed by *Nicoll v Cutts* [1985] BCLC 322, namely that an employee who had rendered services during a receivership or administration was at risk of being unable to recover his wages for such services. He then also explained that Parliament's solution had thrown up a consequence which was inimical to the rescue culture. This was because the super-priority extended beyond wages for the services actually provided during the insolvency, ranked ahead of all other expenses (including the administrators' own remuneration) and officeholders were given a wholly inadequate period of time to decide whether or not to adopt the relevant contracts. The effect was that administrators were making more employees redundant than might otherwise have been the case in order to avoid the risk of incurring the liabilities which would flow from adoption.

47. Against that policy background, Lord Browne-Wilkinson concluded that it was appropriate to adopt the following approach to ascertaining the Parliamentary intent (at p.445B-D):

> "*In my judgment, in order to determine Parliament's intention it is necessary to look at the joint effect of adoption followed by the statutory consequences said to*

flow from it. If the words used by Parliament have a meaning which is consonant with its presumed intention not to frustrate the rescue culture and not to produce unworkable consequences, then in my judgment that construction should be adopted. If, having had regard to those factors, it is impossible to detect a more limited parliamentary intention then the literal words of the sections must be given effect to. Only if the consequences of not departing from the literal meaning of the words produces an absurd result is it legitimate for the court to reject those words and seek to determine what Parliament in fact meant. I will therefore first consider the consequences of the decisions appealed from in somewhat greater detail, before turning to the proper construction of the statutory words."

48. Adopting that approach, Lord Browne Wilkinson's analysis proceeded as follows (at pp.448B-449B):

> "*The meaning of the word 'adopt' in s. 19 and 44 of the 1986 Act therefore has to be gathered from the context in which it is used. It is important to bear in mind that the appointment of an administrator or receiver does not terminate the employee's contract of employment with the company. Only if the company (acting by the receiver or administrator) gives notice terminating the employment or, by failing to pay wages as they accrue due, repudiates the contract of employment will the contract with the company terminate. Therefore, so long as wages are paid by the company the employee remains the employee of the company. The Court of Appeal lost sight of this factor when, in the passage I have quoted, they wondered how the employee continued to be employed if there had been no adoption by the receiver. Therefore, the mere continuation of the employment by the company does not lead inexorably to the conclusion that the contract has been adopted by the administrator or receiver."*
>
> "*It is common ground that adoption does not mean an assumption of personal liability by the administrator or receiver since there is no question of an administrator accepting personal liability under s. 19. Nor in my judgment can it mean 'fail to disclaim' as in s.323 of the Companies Act 1948 since, as I have said, the issue is not whether the company is liable on the continued contract but whether the liability on the contract is to have a higher priority. Nor can adoption connote doing such acts as would be sufficient to make the payments due an expense of the administration since s.19(4) gives such expenses a different and lower level of priority and in* Nicoll v Cutts *it was held that such liability was not an expense of the receivership. In my judgment, as Mr Sumption submitted, adoption in s. 19 and 44 can only connote some conduct by the administrator or receiver 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 or receivership."*

49. The Administrators rely on the conclusion that the mere continuation of employment does not lead inexorably to the conclusion that the contracts have been adopted. They

also submit that the final sentence of the second paragraph I have just quoted constitutes the *ratio* of the decision, and that conduct sufficient to constitute an election by them of the type described is required. I agree that this passage is plainly an important part of Lord Browne-Wilkinson's reasoning to which I will return, but it is also important to have regard to what he then went on to say. He considered whether it was possible for an administrator to adopt only some of the liabilities arising under a contract and concluded, albeit with regret, that it was not. He then finished this section of his speech with the following passage:

> *"For these reasons, I am most reluctantly forced to the view that in the Act of 1986 the contract of employment is inevitably adopted if the administrator or receiver causes the company to continue the employment for more than 14 days after his appointment."*

50. Lord Browne-Wilkinson then concluded his speech with this summary (at p.452C-D):

> "*I therefore reach the following conclusions: (a) for the purposes of both section 19 and section 44 an employee's contract of employment is "adopted" if he is continued in employment for more than 14 days after the appointment of the administrator or receiver; (b) it is not possible for an administrator or receiver to avoid this result or alter its consequences unilaterally by informing the employees that he is not adopting their contracts or only doing so on terms; (c) in the case of both administration and receivership the consequence of adoption of contracts of employment is to give priority only to liabilities incurred by the administrator or receiver during his tenure of office.*"

51. I agree with the Administrators that it is clear from his speech as a whole that for adoption to take place it is necessary to identify some conduct by the administrators which causes the relevant contract to be continued. Thus, each of the passages I have cited in paragraphs 48 to 50 above contemplates the Administrators doing something positive after the 14 day period has expired. The phrases are "*connote some conduct … which amounts to an election*", "*if the administrator … causes the company to continue*" and "*if he is continued in employment"*. The mere continuation of employment is not enough (see the passage from Lord Browne-Wilkinson's speech at the end of p.448 that I have cited in paragraph 48 above), but if the employee "is continued" in employment for more than 14 days that is sufficient.

52. From these passages it seems to me that Lord Browne-Wilkinson contemplated that, by continuing to cause the company to treat a person as an employee by any action taken subsequent to the expiry of the 14 days period, the contract of employment will have been adopted for the purposes of paragraph 99 of Schedule B1. This is important when applying to the facts of the present case to what Lord Browne-Wilkinson said in the last sentence of the citation I have included in paragraph 48 above:

> "*adoption in s. 19 and 44 can only connote some conduct by the administrator or receiver 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 or receivership".

53. The need for relevant conduct of some sort is well-illustrated by *Re Antal International Ltd* [2003] 2 BCLC 406, a case in which Laddie J was satisfied that there was no conduct by the administrators which could be said to amount to an election to treat the contracts of employment as continuing. The reason for this conclusion was that the administrators in that case found out that the company had certain employees a few days after the 14 day period had expired and then did nothing amounting to an election to continue:

> "*I think the important direction given in the Powdrill case is that contained at ... p. 449. It is necessary to look at the facts and to decide whether there has been some conduct by the administrator or receiver which can legitimately be treated as an election to continue the contract of employment. In my view, Miss Hilliard is right in this case in saying that there is no conduct by the Administrators which could be said to amount to an election to treat the contracts of employment as continuing. Her arguments have persuaded me that in this case the administrators have at all times, once they knew of the existence of the contracts, made it clear that they elected not to continue the employment of these employees. It follows that I will give the Administrators the declaration which they seek."*

Adoption in the Present Case

54. It seems to me to be clear, and I did not understand Mr Smith QC to argue to the contrary, that by causing the Company to make an application under the JRS and in making payment to the furloughed employees of a capped 80% of their contractual entitlements, the Administrators will be engaging in positive conduct which presupposes that the contracts of the furloughed employees continue to exist and treats that as being the case. The reason for this is that the terms of the JRS itself enable the employer to obtain reimbursement for a proportion of what are characterised as the wages which it pays the employee and requires a sum representing the full amount of the grant to be paid to them as wages. The whole purpose of the JRS is to enable employers to retain their employees and, while they are retained under the JRS, the amounts they are paid by the employer continue to be treated as wages from the perspective of both employer and employee.

55. Based on the approach taken by Laddie J in *Re Antal* those considerations alone would cause the contracts of employment of furloughed employees in the present case to have been adopted where those actions occur after the 14-day period has expired. The question asked by Laddie J was whether the conduct in issue could legitimately be treated as an election to continue the contract of employment. As I understand the structure of the JRS and the steps which must be taken to claim under it, it would not be possible for the Administrators to participate without electing to treat the relevant contracts of employment as continuing. It would also be contrary to the purpose of the JRS, which is designed to facilitate employee retention and requires the relevant employees to continue as such.

56. However, as Mr Smith QC pointed out, Snowden J (basing himself on what was said by Lord Browne-Wilkinson at p.449B of his speech in *Paramount*) formulated a slightly different test. In paragraph 91 of his judgment in *Carluccio* he said that the question was whether the Administrators *"would be 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"*.

57. Mr Smith QC then submitted that the positive acts of participation and payment which I have already described cannot be said to amount to an election to treat the furloughed employees' contracts of employment as giving rise to liabilities which qualify for super-priority because of the very particular context in which the acts of participation and payment will occur in the present case. In particular, the Administrators relied on what they asserted to be the absurdity of contracts of employment being adopted when services were not being provided under them and went on to submit that the underlying purpose of the JRS would be undermined if the contracts were to be adopted in the Relevant Circumstances. The substantive effect of their submission was that any decision as to the continuing employment of the Company's employees should be able to await the time at which the furloughing of those employees (and the operation of the JRS) comes to an end.

58. As Mr Smith QC and Mr Fisher QC said in their skeleton argument:

> *"50. Indeed, a conclusion that on the facts of the present case the contracts of Furloughed Employees would be adopted would be contrary to two clear policies of the Government and Parliament:*
>
> *(1) First, it would undermine the understandable policy underlying the JRS of seeking to preserve jobs and the productive capacity of the economy, since it may well mean that the Joint Administrators (and other administrators in other cases) would have to make employees redundant notwithstanding the JRS. This is of course the very outcome that the JRS is intended to avoid; and*
>
> *(2) Secondly, it would undermine the "rescue culture" described above. As the evidence of Mr Rowley makes clear at [45]-[48], concluding that the relevant contracts of employment have been adopted will make any attempt at a rescue of Retail's business significantly more difficult. It may force the Joint Administrators to make employees redundant, depriving them of a workforce necessary to seek to rescue the business or sell it as a going concern."*

59. It is clear from Lord Browne-Wilkinson's speech in *Paramount* that policy considerations are relevant to the true construction of the word "*adopted*" in paragraph 99 of Schedule B1, but I do not accept that the absence of services being provided under a contract of employment is, of itself, a good reason why those contracts should not be treated as being adopted in any particular case. Doubtless the continuing provision of services by an employee is a good litmus test in most cases in which the question arises, but that will not always be the case, more particularly where one of the reasons that the employees are being retained is because they "*will have an important role in ensuring the viability of the future business and continued trading in the future*". In the present case it is evident that the retention of employees for that purpose underpins the way in which the administration of the Company is being conducted and the ultimate

achievement of its objective. Put another way, employee retention is one of the necessary incidents to achievement of the purpose of administration.

60. But it is also said that the policy underlying the JRS itself would be undermined if contracts of employment were to be adopted where administrators do no more than participate in the JRS and make payments to a company's furloughed employees. That is of course right if the consequence of any determination that contracts had been adopted were to be that more employees than would otherwise be the case would lose their jobs. I am not sure, however, that this is established on the evidence, because the experience in this case (and it would appear the experience of the Carluccios administrators as well) is that pragmatic solutions work relatively effectively, including in particular the willingness of most employees to agree to variations to their contracts of employment, so that only the varied liabilities for which the Company will be reimbursed under the JRS in any event, will (albeit only theoretically in light of the reimbursement) end up as qualifying for super-priority.

61. Even if that were not to be the case, I do not consider that the mere fact that the JRS is designed to try and prevent employee redundancy in the context of companies driven into financial distress by the Covid-19 pandemic, can of itself prevent the contracts of employment from being adopted if that is the consequence of established principles of construction of paragraph 99. *Paramount* makes plain that paragraph 99 must be construed if possible in a way which does not undermine the rescue culture, but that principle can only go so far where the design of the JRS requires the administrators to act in a manner which cannot be regarded as anything other than adoption in accordance with established principles.

62. Reverting to *Paramount* those established principles of construction require the court to consider whether the acts of participation in the JRS and payment to the furloughed employees (the Relevant Circumstances I identified at the beginning of this judgment) constitute an election of the type described by Lord Browne-Wilkinson (at p.449B) i.e. "*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 …"* This is a slightly different formulation from the one adopted by Snowden J in paragraph 99 of *Carluccio*, but not in my view a difference which leads to a different result.

63. In my judgment these acts of participation and payment are only consistent not just with the Administrators treating the contracts of employment as continuing but also with the Company in administration having continuing liabilities under them, being separate liabilities that arise in the administration. If that were not to be the case the Company in administration could not make the claim under the JRS. As Mr Smith QC accepted in argument, the Administrators could not possibly procure the Company to participate in the JRS without procuring it to pay the equivalent amount to the employee. The obligation to do so arises under the continued contract of employment which the Company in administration is required to honour as a condition of participation in the JRS.

64. In my view it is plain that the Company thereby comes under a separate liability incurred in the administration which flows from the continued existence of the contract. It arises in circumstances in which the Administrators elected to take steps which require them to treat the contract as continuing to give rise to liabilities to which the

Company is subject in its administration. The effect of this occurring is that those liabilities are then entitled to the super-priority for which paragraph 99 provides.

65. I should add that it cannot matter that the Administrators may not want the Company to incur liabilities which qualify for super-priority. To that extent there is an objective element to what is meant by the administrators electing to treat the contracts in a particular manner. What matters is whether there is a separate liability arising in the administration which has arisen out of elective conduct by the Administrators, not whether they subjectively want that liability to have a particular ranking. The ranking flows from the election to do something after the expiry of the 14-day period which gives rise to a separate liability arising under the contract of employment, not the other way around.

Disposition

66. For these reasons I concluded that it was likely that the occurrence of the Relevant Circumstances would cause the Administrators to be held to have adopted the contracts of employment of the furloughed employees. In light of the considerations that I have described earlier in this judgment, and the considerable uncertainty arising out of the Covid-19 pandemic and the operation of the JRS, I also concluded that it was appropriate for the court to give the Administrators the directions that I have indicated. They cannot operate as a complete defence to any subsequent challenge, but by carrying out their functions in accordance with those directions the Administrators will at least have the protection contemplated by paragraph 68(2) of Schedule B1.