13th July 2016

Chairs of the Business, Innovation and
Skills Committee and the Work and
Pensions Committee
c/o Chris Shaw
House of Commons
London
SW1H 9NB

BY EMAIL

Dear Mr Field and Mr Wright

Bhs Inquiry

I respond below to the questions set out in your letter to me of 1 July 2016.

1. Can you tell us how the money generated from the sale of Carmen Properties Ltd was injected into BHS?

   The formulation of this question suggests that there is a misunderstanding on the part of the Committees.

   Carmen Properties Limited was purchased by Bhs Properties Limited on 13 March 2015. A copy of the share purchase agreement has been provided to the Committees. You will see that the consideration payable by Bhs Properties Limited as purchaser was £1.

   The purchase of Carmen Properties Limited in March 2015 contributed to a reduction in the Bhs rent bill from £10.2m p.a. to £1.4m p.a. Arcadia Group Limited also guaranteed a £70m loan for Carmen Properties Limited at a rate of 1.6% over LIBOR per annum.

2. Could you explain how expenditure on back office functions at BHS changed after they began to be provided by the Arcadia Group; and confirm that these services were provided at below cost?

   It is regularly inaccurately suggested that Arcadia and/or its shareholders extracted tens or hundreds of millions of pounds from what was a no profit services agreement. Hopefully what follows clarifies this issue.

   Bhs was run as a standalone business until it was acquired by the Taveta group in 2009. Part of the reason for that acquisition was the potential synergies of the back office operations, comprising services such as Systems, Logistics, Financial Accounting and Processing. Services were charged at cost to brands, with common costs equitably allocated based on sales or number of heads/stores. As Steve Denison of PwC confirmed to the
Committees at Q396: “there is no mark-up on those services so, whatever the annual cost is, it is just charged out across all the different businesses within the group”.

The categorisation of costs between cost of sales and Distribution/Administrative expenses changes as a result of the 2009 acquisition and the figures referred to by Michelle Thomson in her questioning of me at Q1774 (£36.3m and £57.7m) are not comparing like with like. For example, Systems costs of approximately £15m were included in Costs of Sales in 2008/9, but were categorised within Distribution and Administrative expenses in 2009/10.

3. Further to Qs 1781 and 1788-9, could you provide a more detailed breakdown on levels of capital expenditure in BHS in each year of your ownership, indicating for each year how much was spent on improving stores?

There was a total of £421m of capital expenditure on stores from 2000/1 to 2013/14. This breaks down as follows:

- £70.2m over the first 4 years:
  - 2000/1: £15.8m
  - 2001/2: £13.3m
  - 2002/3: £21.1m
  - 2003/4: £19.9m

- Again, contrary to what is often suggested, after the dividends were declared between 2001/2 and 2003/4, capital expenditure increased. It was £254.3m between 2004/5 and 2008/9:
  - 2004/5: £36.9m
  - 2005/6: £84.3m
  - 2006/7: £41.9m
  - 2007/8: £60.9m
  - 2008/9: £30.4m

- Following the acquisition of Bhs by the Taveta group in 2009, a further £96.2m between 2009/10 and 2013/14.
  - 2009/10: £36.4m
  - 2010/11: £17.3m
  - 2011/12: £32.6m
  - 2012/13: £6.8m
  - 2013/14: £3.2m

4. Could you clarify, in respect of the period from 2001-04, how much cash was generated, how much was paid in dividends, how much was used to pay off debt and how much was invested in the company?

Over the 4 years 2000/1 to 2003/4 the Bhs business generated £544m of cash from trading activities, plus a further £115m through the sale of fixed assets (including the Carmen sale and leaseback £106m) - resulting in a net cash inflow of £660m.
Cash utilisation was as follows:

- paid £81m of tax;
- paid £50m of interest/other servicing of debt;
- invested £66m cash in capital investment; and
- paid £380m of equity dividends (with a further £42.8m of the dividend declared in 2003/4 paid in 2004/5).

After a net £42m increase in bank debt (following a refinancing in 2004) resulting in net debt of £112m, overall the net increase in cash in the Bhs business over this period was £87m. See table below.

<table>
<thead>
<tr>
<th>Total 4 Years</th>
<th>(£m)</th>
</tr>
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<tbody>
<tr>
<td>Operating profit per statutory accounts (pre-exceptionals)</td>
<td>509.8</td>
</tr>
<tr>
<td>Add back depreciation (as per statutory accounts fixed asset note)</td>
<td>190.0</td>
</tr>
<tr>
<td>Less amortisation of goodwill credit</td>
<td>(162.2)</td>
</tr>
<tr>
<td><strong>Statutory EBITDA (pre exceptionals)</strong></td>
<td>537.6</td>
</tr>
<tr>
<td>Other working capital movements</td>
<td>6.9</td>
</tr>
<tr>
<td>Net cash in-flow from operating activities</td>
<td>544.5</td>
</tr>
<tr>
<td>Exceptional proceeds from sale of tangible fixed assets</td>
<td>114.9</td>
</tr>
<tr>
<td><strong>Net cash in-flow</strong></td>
<td>659.4</td>
</tr>
<tr>
<td>Net cash outflows from interest / servicing of finance</td>
<td>(49.6)</td>
</tr>
<tr>
<td>Total tax paid</td>
<td>(80.8)</td>
</tr>
<tr>
<td>Purchase of fixed assets</td>
<td>(66.1)</td>
</tr>
<tr>
<td>Acquisitions of BHS business (net of cash acquired)</td>
<td>(37.9)</td>
</tr>
<tr>
<td>Net cash inflow/(outflow) before payment of dividends</td>
<td>425.0</td>
</tr>
<tr>
<td>Equity dividends paid</td>
<td>(380.3)</td>
</tr>
<tr>
<td><strong>Net cash in-flow before financing</strong></td>
<td>44.7</td>
</tr>
<tr>
<td>Net cash inflow/(outflow) from financing</td>
<td>42.2</td>
</tr>
<tr>
<td><strong>Increase/(decrease) in cash</strong></td>
<td>86.9</td>
</tr>
</tbody>
</table>

5. What profits to BHS accrued directly as a result of the sale of properties to Carmen Properties Ltd (Q 1825) and what was the rationale behind this transaction?
Approximately £11m. (This is set out in the Bhs Group Limited statutory filed accounts for the year ended 30 March 2002.)

At the time (2001), with interest rates at around 5%, many businesses executed sale and leaseback deals to raise funds, rather than borrowing from banks.

6. When did you first let it be known that you were looking to sell the business (Q1888 & Q2049-56) and when did you first hear of interest in buying it from Mr Sutton?

There were a number of informal approaches prior to 2013, but nothing of substance materialised.

Robin Saunders indicated to us in around April 2013 that if we were interested in selling Bhs, Mr Sutton was a potential bidder. Discussions with Mr Sutton progressed until March 2014, when we decided to discontinue discussions as they were not going anywhere.

We gave serious consideration to selling Bhs from 2014 and by January 2015 it was being reported in the press that the Taveta group was looking to sell Bhs.

7. When were you first aware that Mr Chappell was part of Mr Sutton’s team? When did you let it be known to Mr Chappell or his team that you were willing to sell to him?

I was unaware that Mr Chappell had any role in Mr Sutton’s team and did not meet him as part of Mr Sutton’s team. At some point Mr Sutton’s name was mentioned in connection with Mr Chappell and we asked Mr Chappell to confirm through a statutory declaration that Mr Sutton was not involved in the Swiss Rock/Retail Acquisitions Limited bid.

The Goldman Sachs process with Mr Chappell/Swiss Rock started in October 2014 and I first met with Mr Chappell in February 2015. Sale discussions proceeded from there.

8. Can you confirm the date on which the file on Mr Sutton arrived (Q2000) and indicate what steps were taken to check whether its contents were true?

I am not clear on the date. In around May 2014 Mr Budge received information about Mr Sutton using my name as a reference in Monaco. I recall asking Mr Budge to follow up on this information and we decided that Mr Sutton was not someone we were prepared to do business with.

9. Can you confirm that neither you nor Arcadia board members had any contact with Mr Sutton after you told Mr Budge to disengage with him?

I had no further contact with Mr Sutton. I understand that Mr Budge was called by Mr Sutton in July 2014.

10. What specifically did you ask Goldman Sachs to do in respect of a) Mr Chappell and b) the negotiation of a deal (Q2033)? How were Goldman Sachs asked to liaise with your other advisers? What were the different roles?

As you are aware, other than an initial call to arrange for Mr Budge to be introduced to Mr Gutman and a subsequent discussion in relation to Farallon, I had no involvement in the Goldman Sachs process and I gave no instructions to Goldman Sachs. I did not ask Goldman Sachs to liaise with any of our advisers.

11. What verbal or other undertakings were made to Mr Chappell or his team by you or your representatives in respect of the pension scheme?
None other than those recorded in the contractual documentation. (Schedule 8 of the 11 March 2015 Bhs sale agreement recorded the undertakings given by Taveta Investments (No. 2) Limited (as seller) and Retail Acquisitions Limited (as buyer) in relation to the Bhs pension schemes.)

12. What requests were made to you or your representatives by RAL for access to tPR prior to the deal? What was the response?

I do not recall any requests on this. Retail Acquisitions Limited had their own pensions advisers at Grant Thornton who were free to contact the Pensions Regulator (as Mr Chappell has said they did) and they analysed the pensions issues as part of their very extensive due diligence exercise.

13. Could you please give an account of your meeting the tPR and others on 4 March 2015? What was presented to tPR? What was tPR’s approach to the meeting? Why did you leave early?

The letter to you from Adam Goldman, the Arcadia Group Limited Company Secretary, dated 11 March 2016 described the agenda and the meeting. As Mr Goldman stated:

“TPR then outlined its agenda and its proposed five attendees for the meeting in an email on 4 March 2015. The agenda was as follows:

1. Details of proposed sale, including:
   a. Price
   b. Treatment of intra group debt owed to and by the employer
   c. The provision of funding for ongoing trading
   d. The structure of proposed funding for ongoing trading and the purchase price

2. The identity of purchaser, their logic for the acquisition and their plans to ensure viability

3. The impact of items 1 and 2 on the pension schemes

4. The treatment of the schemes in the transaction

5. Will the buyer or seller be seeking clearance from the Regulator?

6. Information flows to trustee to enable them to understand the impact including:
   a. Visibility of the structure of the transaction
   b. Outstanding information requests in relation to moral hazard analysis

The requested meeting took place on 4 March 2015. At this meeting Sir Philip Green explained to the TPR that he was keen to ensure that the Bhs business was a success going forward and that he was agreeing the sale terms in such a way as to give it the best possible prospects for the future. The TPR was informed of key terms of the proposed sale of Bhs, including as to the equity the purchaser was to inject, the existing debt to Arcadia that would be written off, the position of the Bhs pension schemes and the plan for the business. The sale consideration of £1 was expressly referred to.

Specifically, in relation to the Bhs pension schemes, Sir Philip expressed his strong wish to agree a sustainable solution and there was a discussion as to the possibility of implementing a restructuring with the approval of TPR. TPR made it clear at the meeting that it had policies
to which it had to adhere and that it was not possible to depart from the policies even in the case of an urgent sale transaction. In particular, a restructuring could not be approved by TPR unless the sponsoring employer faced imminent insolvency. It was clear from the discussion at the meeting that a restructuring could not be agreed with TPR in the timescales available, even though the TPR had been involved in discussions since at least July 2014."

As the Committees have seen from the evidence provided, the Pensions Regulator had been aware of Project Thor since at least July 2014 and at no stage had indicated any in principle objection to it.

I was very clear at the meeting that we wanted to agree a sustainable solution for both the Bhs pension schemes and Bhs. I was keen to work with the Pensions Regulator to achieve this and I made this desire clear to them. I told them that I found it very odd that they could only enter into discussions to find a solution if the business was put in an insolvent position, but it was clear from the discussion that a restructuring could not be agreed with the Pensions Regulator in the necessary timeframe.

The meeting was held at Marylebone House. I did not leave early. The meeting adjourned, and the representatives from the Pensions Regulator left without requesting the meeting to reconvene.

14. Could you provide a copy of the third party valuation in respect of the sale of Marylebone House?

I do not understand the relevance of your focus on Marylebone House to your inquiries. Bhs has never owned the Marylebone House freehold. At the time of the sale of Bhs, Bhs Limited was given a two year lease at a peppercorn rent. This reduced the rent payable by Bhs Limited on Marylebone House from £2.175m per annum to zero.

You asked Mr Harris about the valuation of Marylebone House at length in the evidence session on 29 June 2016. He explained that there were a number of written offers received and also the in-house valuation expertise that we have. He also described the various external valuations and the Savills Disposal Options model, all of which I attach to this letter (with the names of the parties who made offers for Marylebone House redacted on one of the valuations).

15. What was the assessment of Arcadia Group prior [sic] of the proposals in the business plans for the renegotiation of rents post-sale? What advice was given to RAL or its advisors on this point?

We were the seller, not the buyer. It was not our job to advise the buyer. As you would expect, we had our own business plans for Bhs and shared them with SwissRock/Retail Acquisitions Limited. Together with their advisers, they had every opportunity to review, test and challenge the business plans. Grant Thornton in particular did a very extensive due diligence exercise on the Bhs business and produced a report. The Committees should obtain and publish this report to show the extensive work that was done.

The advisers were paid very large sums of money. I understand that Grant Thornton received fees of at least £4.4m and Olswang at least £3.7m.

I attach a copy of an email from Mr Chappell to Mr Budge of 6 February 2015 on the turnaround strategy for Bhs and SwissRock's plans for reviewing and developing it over the following weeks. You will note that it includes as a key action: "Renegotiate rents, particularly for underperforming stores which might not easily be re-let." We emphasised to
SwissRock/Retail Acquisitions Limited the importance of an aggressive approach to achieving early rent reductions and this was clearly understood by Mr Chappell.

16. Can you tell us when you were first informed that there was a retailer with an interest in a rescue for BHS?

As I told the Committees, this was on 22 April 2016.

17. When did you offer to contribute £5m towards a deal involving Sports Direct (Q 2304)? Who was this offer made to and why was it made?

At a meeting on 27 April 2016 at Arcadia’s offices, Mr Ashley told the administrators of Bhs that he wanted to buy the Bhs business and that as part of his offer he would commit to keeping all the shops open and jobs in place until at least the end of 2016. The purchase would include buying all of the stock, for which Mr Ashley offered to pay £10m. This amount was not acceptable to the administrators. It appeared that £15m to close the deal would work and I therefore offered the additional £5m to try to help the business be sold as a going concern.

The administrators agreed to meet again with Mr Ashley a week or so later to conclude the discussions. I was not involved in this next meeting, nor was anyone else from Arcadia. We were informed by the administrators that no acceptable offer was forthcoming from Sports Direct.

The above can be confirmed by the administrators and can now put an end to the suggestion that I tried to block a sale of the business. In fact, I tried to support a sale.

18. Did you require the transaction to be completed within 21 days (Q1502)? What was the reason for this timeframe?

As the Committees are aware, the Points of Principle signed on 16 February 2015 stated (at paragraph 22) that:

“Arcadia Group and Swiss Rock agree that Swiss Rock will have exclusivity to complete the acquisition by 9 March 2015. The parties agree that they will enter into good faith discussions about extending the exclusivity period if everything is progressing as planned by 9 March 2015, but the sale has not completed by then.”

An agreed period of exclusivity on the sale of a business is a prudent and standard commercial term. It was a matter of negotiation. The sale process, which started in earnest in January 2015, caused inevitable uncertainty and disruption for the Bhs business. We wanted to keep this to a minimum. The sale actually completed on 11 March 2015.

19. With reference to the activity log provided by Goldman Sachs, why was the offer of Swiss Rock not acceptable on 15 January, and what specific changes were made to this offer before the meeting on 28 January? Why did you change your mind about RAL needing a credible retail “front man” on board?

15 January 2015 was early in the sale process and prior to the grant of exclusivity to Swiss Rock/Retail Acquisitions Limited. We felt that there were a number of areas in which the offer might be improved. Mr Budge listed some of these in an email to Mr Gutman on 15 January 2015. At this stage, Swiss Rock/Retail Acquisitions Limited were making no proposals to address the pension issues even though we had rejected a “pension-free” sale proposal in December 2014. In addition, we felt there was a lack of clarity around the business plan.
After the offer was rejected, by text to Mr Budge on 19 January 2015, Mr Chappell stated: "We would need BHS clear of debt but could discuss a pension provision".

Mr Budge's email to Mr Gutman of 28 January 2015 identifies some of the key issues on which we were focussed by that date. I did not attend the meeting on that date but I understand that Swiss Rock/Retail Acquisitions Limited indicated that they would be willing to contribute to the pension provision and gave greater assurances regarding retail expertise, through Allan Jacobs and Kevin Lyons. They were both included in the document that Mr Chappell sent to Mr Gutman and me by email on 1 February 2015. At this stage we had still not granted Swiss Rock/Retail Acquisitions Limited exclusivity and negotiations continued.

We did not change our mind about the value of a credible retail front man. We were assured that this would be achieved. You have heard plenty of evidence on this issue and you will also note that the attached email from Mr Chappell to Mr Budge refers to the intention of Swiss Rock/Retail Acquisitions Limited to supplement the existing Bhs management team "with senior retail talent".

In conclusion I would like to try one last time to demonstrate the significant investments that we made in Bhs.

- As set out above, there was a total of £421m of capital expenditure on stores from 2000/1 to 2013/14.
- We lent Bhs £266m on an unsecured, interest free basis (the vast majority of which we wrote off when Bhs was sold). That is, on any view, an unusually supportive step given that Arcadia Group Limited could have taken security if it had decided to do so.
- All of the agreed pension contributions were made even though, as you have heard, Baker Tilly advised the pension scheme trustees that Bhs could not afford these payments without the support of the wider group.
- We provided Retail Acquisitions Limited with a solid balance sheet to take the Bhs business forward. I attach a further copy of the sheets that we previously provided to the Committees which record the c.£200m cash, facilities and unencumbered properties available to Bhs.
- We also guaranteed new borrowings.

On any fair review of the Bhs balance sheet on sale and of the support we provided to the Bhs business throughout, it is clear that we invested substantially in the business, we lent substantial sums to the business and we gave Retail Acquisitions Limited every chance with a solid platform to take the business forward.

Finally, in relation to Mr Wright's unnecessary outburst at the end of my evidence session, I hope that the explanation given above of the £5m offer to supplement any purchase offer by Sports Direct to help achieve a sale of Bhs as a going concern, will put that nonsense to rest as well.

Yours sincerely

SIR PHILIP GREEN