

21st June 2016

BHS Submission to the Joint Parliamentary Committees

The entire Operations Board of BHS is extremely disappointed that, despite everyone's best efforts, we have been unable to find a buyer for the whole business. It is particularly disappointing given the amazing way in which all the people who work in BHS have conducted themselves in what has been exceptionally difficult circumstances, coupled with the tremendous support we have received from the British public. We would like to express our deepest gratitude for all of this support.

Sadly, the successful CVA alone was insufficient in resetting the business's finances. We also needed Retail Acquisitions (RAL) to deliver on the promises made by Dominic Chappell that his team would raise the necessary finance to continue the turnaround plan. Unfortunately, as the committee has heard, these promises were not fulfilled.

The trading figures since the Administration announcement clearly show what the Operating Board have known all along; this business was ripe for a turnaround. The business had reset itself structurally and had refocused itself operationally; it just lacked the financial resources to rebuild. We believe BHS has a place on the high street offering tremendous product at great value for money for the hard working woman in every household who buys for herself, her home and her family.

Reason for the Collapse of BHS

The turnaround plan had a number of central pillars; the critical four were the resetting of the store portfolio and their rent bill, the resetting of the central cost base to reflect the modern day retail environment, a solution to the pension deficit and the raising of cash resources.

It is very clear that the business failed due to the failure of RAL to sell properties and the abject failure of RAL in raising the necessary finance to continue the turnaround plan. Sadly, RAL took money out of the business, not put money in.

Another major contributing factor was the failure by the TPR to remove BHS from the pension debate with Arcadia to allow BHS to seek improved supplier credit terms and access third party funding from a wider lending pool.

Retail Acquisitions

1. Appointment of RAL staff

RAL appointed a number of senior people into positions within the business as so called experts to look after areas such as property, corporate finance, insurance and legal. These individuals were paid considerable sums of money and while no doubt experts in their field, they were not what BHS required to deliver the turnaround plan.

The connection of these individuals to Chappell, denoted a clear nepotistic environment at the very top of the business influencer pool.

2. Personal earnings from BHS within 13 months of ownership

BHS are only able to identify those payments it directly made to Chappell or Chappell's companies or figures identified from the Section 72 submission obtained by Darren Topp; it is not able to identify any payments made by RAL or other third parties to Chappell.

3. Cost of RAL staff

RAL connected persons were paid a total of £2.6m for the period March 2015 through February 2016. This figure relates to the following people:

- Dominic Chappell
- Eddie Parladorio
- Lennart Henningson
- Keith Smith
- Dominic Chandler
- Michael Morris
- Russell Strashun
- Paul Wareham
- Mark Sherwood

4. Advisors appointed

- Grant Thornton
- Olswang
- Savills (Property)
- Vail Williams (Property), Mark Sherwood was a partner at Vail Williams and was seconded to BHS on a 12month contract
- Lawrence Stephens (Lawyers)
- Kevin Lyons according to RAL was engaged in various forms of consultancy arrangements, for RAL.
- Aidan Treacy was engaged as a consultant CFO for RAL before becoming a Director of RAL in December 2015.

5. Management services agreement

RAL charged £1.4m in ongoing charges under the MSA agreement for the period March 2015 through February 2016. The MSA charges were on the basis of a 'cost plus mark-up' of RAL salaries of (initially) 25%. Further charges totalling £3.2m were charged relating to specific transactions as referenced elsewhere in this document. These charges were benchmarked by Eddie Parladorio and proposed to the board.

6. RAL Governance and Accounts

The following Directors of RAL resigned as recently as 24 May 2016;
Eddie Parladorio, Legal Director
Aidan Treacy, Finance Director

RAL has filed no accounts with Companies House. This is particularly troubling. Only by scrutinising these financial accounts can anyone hope to understand who profited from the demise of BHS and whether any third parties played a role. We are deeply concerned that the resignations of RAL Directors may result in the company being wound up without filing proper accounts.

7. Approach to management

Chappell always had his 'home' team; they were the close team made up of friends and family he brought into BHS on transaction or introduced during the 12 months of ownership– Mark Sherwood (BHS Property), Mike Morris (BHS Corporate Finance), Eddie Parladorio (BHS Legal), Russell Strashun (BHS Product Consultant), Paul Wareham (BHS Insurance), Lennart Henningson (RAL Director, BHS NED), Keith Smith (BHS Chair), Aidan Treacy (RAL CFO)

There was often a distinct 'us' and 'them' culture during the RAL ownership which Dominic Chappell encouraged

8. Conduct

Dominic Chappell demonstrated little effective governance. Pre transaction, immediately post transaction and towards the end of his ownership.

9. Financial Stewardship

Chappell saw no distinction between the company's money and his own personal money; he saw them as one and the same. The level of financial governance shown by Chappell was very poor. By way of example:

- Chappell attempted to buy a set of family holiday flights in December 2015 on the company travel budget; this was spotted by Darren Topp and stopped immediately much to the annoyance of Chappell.
- Chappell sought to take his December 2015 salary early ahead of departing on his family Christmas vacation to the Bahamas despite RAL having taken out millions of pounds since acquisition. HR allowed this payment on the basis of 'hardship' like they would with any other employee.
- Chappell instructed BHS treasury to make a loan to him of £90k to pay a personal tax bill in January 2016. Michael Hitchcock was abroad on a personal skiing trip at the time and Aidan Treacy (RAL CFO) authorised the payment in his absence. This was at a time when cash resources were limited and needed to pay both suppliers and employees payroll. Following legal advice BHS insisted on the return of that money which was duly returned within 10 days.
- **BHS Sweden**
The transfer of £1.5m of BHS funds to this independent and unaffiliated entity has already been documented.

- **Project Herald**

This was a RAL led project to look into moving the assets and trade of both BHS International and BHS Digital out of the BHS Group and directly into the RAL Group. This activity was being done outside of the knowledge of the BHS Executives and their Operating Board. At the point the CEO and MH become aware, RAL had incurred £0.3m in fees on behalf of BHS. Project Herald was never going to work with BHS in such a precarious cash position. Suppliers were already demanding increasingly unfavourable credit terms and the ability to attract external finance were severely limited. To move assets outside the BHS Group at this time would have feasibly cost the business up to £75m in negative cash flow as all suppliers would have demanded cash in advance to secure any future orders. The motive for moving assets out of the BHS Group to RAL must be seriously analysed. Despite the CEO and MH appearing to have quashed the RAL initiative.

BHS Governance

1. BHS Board Composition

Keith Smith (Chair) Chappell's Uncle/conflicted, Lennart Henningson (NED) Chappell's family friend/conflicted, Dominic Chappell (Executive) major shareholder/conflicted, Dominic Chandler (NED) lawyer/independent, Darren Topp (CEO) independent.

The majority of the Board were conflicted and in any Board vote Chappell would always have an implied majority. Despite the Chair/Uncle on more than one occasion arguing against a questionable Chappell initiative, it shows little or no corporate governance to have such conflict of interests at Board level.

2. Control of Board by DC

As a 90% shareholder of RAL and in turn a 100% shareholder in BHS, Chappell had 'absolute' control in any situation or contentious vote and this was articulated on more than one occasion by Chappell himself.

Relationship with Arcadia

1. Level of integration pre-transaction

BHS was a trading subsidiary of a major conglomerate, Arcadia, which would have relied upon a large amount of centrally provided services across, Logistics, HR, Finance, Treasury, Property, Procurement and Maintenance. The total recharge to the business pre transaction was £55m. There were also in excess of £100m in retail revenues taken by BHS for the Arcadia concessions that operated in the BHS stores. The operational contact with Arcadia would have been daily both pre and post transaction.

2. Process of dis-integration

There was a project team specifically set up within BHS to effect the Transitional Service Agreement (TSA) and ensure the migration of services over to BHS from Arcadia. This was called Project Crystal.

3. Services provided by Arcadia

IT (including web platform), Logistics & Supply Chain, HR, Finance, Treasury, Property Management & Maintenance, Procurement, and Legal Facilities. Many of these were 'pass through' costs.

4. Service agreement and value for money

The TSA summary of costs are:

Logistics £30m – Pass through cost

Systems £11m – Pass through cost

E-commerce £5m – Some pass through, some proportion of total Arcadia cost

Property (incl maintenance) £5m – Pass through cost

Facilities £1m

Finance £1m

HR £1m

Other £1m

Total £55m



Proportion of total Arcadia costs

Company Trading

1. Performance

For the period of ownership by RAL, BHS traded level on a like for like basis. Whilst this performance relative to other mid-market retailers was above average, the level of trading did not meet the expectation of the turnaround plan. This was in part due to a mild Christmas, which impacted negatively on the entire retail sector, but it also reflected the lack of funding placed within the company by RAL.

2. Performance of stores upgraded in accordance with the turnaround plan

Stores which has had food introduced alongside the low cost store modification were showing sales ahead of the chain, and last year.

Administration

1. CVA Process

The management team highlighted the need to undertake a CVA as the only way forward in resetting the store portfolio and associated rent bill for BHS, late autumn 2015. It was clear that the RAL members did not want to undertake a CVA, which subsequently became evident due to project Herald. Only after a weak Christmas trading period did the RAL members decide to follow the proposal and support the CVA process. The CVA process was run entirely by the management team of BHS with little or no involvement from Dominic Chappell. Dominic Chappell and his team were supposedly heavily involved in the raising of finance through the negotiation of Asset Backed Lending Facility and the sale of properties.

2. Decision to go into Administration

The decision to go into Administration was taken by the Board of BHS on 21st April 2016, following the decision that it was unable to meet the short term liabilities of the BHS business. The minutes of this Board Meeting are signed by Dominic Chappell.

The Board of BHS took the decision to appoint Duff & Phelps on 19th April 2016 and they entered the business on the 25th April 2016.

Pension

1. Deficit

The most recent triennial valuation of the pension fund showed an ongoing deficit of £250m and a Section 75 deficit of £570m.

2. Attempts to find solution

In early Autumn 2015, the Senior management, Darren Topp, Michael Hitchcock and Dominic Chandler, took it upon themselves to work directly with Chris Martin, the Pension Chairman, to see if they could find a workable solution to the pension deficit.

After engaging Grant Thornton to update the actuarial assumptions and their models, a workable solution in the form of Project Vera was presented to Chris Martin shortly before Christmas. Project Vera was essentially an updated Project Thor, which Arcadia has considered pre transaction in 2014. This proposal was then taken to the PPF and the TPR in January 2016.

Conclusion

BHS failed because of RAL's failure to invest or attract investment and provide a credible basis for the continued support of the supply base and associated extension of trade credit, whilst taking £17m out of the business. Matters were made worse by the lack of a speedy solution to the pension benefit.

So long as the pension deficit existed, along with the powers of the TPR to serve Contribution Notices on a business that was theoretical already bust by virtue of a pension deficit it could never fund over a reasonable period of time, the business was severely inhibited in raising external funding.

However, we believe firmly that the business could have survived had our owners delivered on their promises to raise appropriate funding or indeed had funding of their own. Their failure to deliver cash and repeated desire to remove cash from this business was the major contributor to demise of this iconic British High Street brand.