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**Chris Shaw**

Business, Innovation and

Skills Committee

House of Commons

London

SW1A 0AA

14<sup>th</sup> July 2016

**By email: [SHAWC@parliament.uk](mailto:SHAWC@parliament.uk)**

Dear Mr Shaw

**The sale and acquisition of BHS**

Thank you for your letter dated 1<sup>st</sup> July. My replies to that now appear below. I have used the same numbering as in your letter for ease of reference.

If I can help the Committee further in any way please let me know.

- 1. We have heard from numerous people that Dominic Chappell was representing BHS purchase as a done deal from November 2014. Was this your view at that time?**

My recollection is that in November 2014 Mr Chappell was of the clear understanding that he had support from Sir Philip Green to an outline proposal to buy BHS. I would not (and I do not consider that Mr Chappell would either) call this a "done deal" in any literal sense as, clearly, any transaction of this size would be subject to contract, detailed negotiation, due diligence and funding. Additionally, in this case Goldman

Sachs were given a 'gatekeeper' role and it was therefore also necessary to present the proposals to them for review.

**2. At what point did you have concerns as to whether BHS was technically insolvent?**

During the due diligence process RAL learned that Sir Philip Green considered the possible insolvency of BHS.

However, RAL and BHS management believed that the support provided by Sir Philip / Arcadia, to include :

- write-off of inter-company debt of £200m;
- promised support to resolve the pension deficit;
- promised support to resolve trade credit insurance issues;
- cash resources upon completion;
- property assets which could realise in excess of book value;
- a properly developed turnaround plan with the benefit of substantial retail expertise in management;

should enable a solvent turnaround of BHS.

At regular intervals, to include April 2015, August 2015 and December 2015, Olswang provided advice and guidance to the BHS directors to ensure that they were mindful of their duties and that the company was not insolvent. The threat of insolvency was greater post-Christmas and Weil Gotshal were then engaged by RAL to provide insolvency legal advice to the group, including their attendance at (usually) weekly board meetings to review the position.

The CVA proposals included revised trading forecasts and cash flow forecasts anticipating additional funding. During the weeks since the launch of the CVA the cash flow forecast had deteriorated for a number of reasons.

The main drivers were :

- a £7m shortfall due to poor trading up to the end of the Easter period;
- an expectation that the current poor trading conditions would continue to September 2016, resulting in an additional trading and cash loss of £7m;
- a net shortfall on property disposals of £10m (as against the property disposal plan in the CVA); and
- an inability to obtain necessary trade credit without having to provide letters of credit, causing a further shortfall of £ 10m;

Due to its existing position as secured creditor of BHS, and for other commercial reasons, it was believed that Arcadia would support BHS and provide the additional funding required plus support for BHS to purchase the 2016 autumn / winter range and Christmas goods and facilitate the drawdown of the proposed £ 60m 3 year working capital facility from Gordon Brothers Europe.

The belief that it was in Arcadia and Sir Philip Green's commercial interests to support BHS in April 2016 was backed by the successful sale of the Oxford Street lease, delivery of the CVA and the Head Office and store costs savings which would deliver £20m of additional cost savings (not in the turnaround plan) which could offset the shortfall in trading.

Arcadia received the revised cash flow forecast in early April and met with BHS senior management and the RAL CFO on 12<sup>th</sup> April for a detailed review of the business plan and cash flow forecast. At a meeting of RAL, BHS and Arcadia directors and advisers on Monday 18<sup>th</sup> April, Arcadia advised that they would not support the additional financing required and suggested that Gordon Brothers be approached to make up the shortfall but in the likely event that no further funding could be secured, the directors should consider administration no later than that same week. The outcome of this meeting on 18<sup>th</sup> April made it likely that BHS was technically insolvent and arrangements were made to limit and segregate future orders for goods and services and to ensure all payments could be justified as being in the best interests of creditors. It became clear by Wednesday 20<sup>th</sup> April that Gordon Brothers were not in a position to increase the amount of their loan significantly above the £60m facility that was on offer and the directors agreed at a meeting on the 21<sup>st</sup> April that BHS was now insolvent and administrators should be appointed the following day. However, a last-minute attempt to rescue the company by a sale to a trade buyer commenced that Thursday but on Sunday 24<sup>th</sup> April those discussions concluded unsuccessfully. BHS entered administration on Monday 25<sup>th</sup> April.

- a) **At the time of the sale the Board did not have the £120m working capital facility in place and Olswang advised against the transaction. Why was this advice ignored?**

It is not true to say that *"At the time of the sale....Olswang advised against the transaction"*. At no time, to my knowledge, did Olswang advise against the proposed transaction.

On 7 March 2015, four days prior to completion, Olswang wrote a letter to RAL at a time when it became clear that the Farallon facility was not going to be available prior to the anticipated completion date. There was some discussion at that time, referred to in their letter, that the directors might rely *"on a £ 40m bridging loan from Sir Philip Green on Completion"*. Olswang cautioned that dependence on such a bridging loan

carried risks, and they urged *"the directors not to transact until they have maximum commercial comfort that they will be able to satisfy the terms of the proposed £120m working capital facility from Farallon"*.

Olswang's views on the risks associated with the above course of action were entirely consistent with those of the board of RAL, and the proposal to rely upon a bridging loan from Sir Philip Green until such time as the Farallon facility was obtained was totally unacceptable and firmly rejected.

Between 8 March and 11 March 2015, alternative methods of generating sufficient cash resources to finance the turnaround were identified, and neither a bridging loan from Sir Philip Green nor the Farallon facility were relied upon or required.

Evidence has been given by Sir Philip Green, Paul Budge, Michael Hitchcock and Darren Topp that the cash available to BHS on completion, the proceeds of proposed asset sales and the HSBC bank facilities, together with further funding opportunities secured on BHS assets, was sufficient to implement its turnaround plan and therefore continue to trade solvently.

I add that, amongst other issues, it was at the forefront of the consideration of the Board of RAL that the acquisition of BHS involved the acquisition of a large trading group that was loss making. It was therefore vital that the Board was satisfied that the enlarged business would have access to sufficient cash to enable the enlarged Group to be able to meet its debts as and when they fell due.

The completion board minutes of RAL dated 11 March 2015 note that Grant Thornton, advising RAL, had undertaken extensive financial due diligence and interface with the management of BHS to understand the business plan, the turnaround plan and the cash flow needs of the business and had prepared a cash flow model which had been the subject of repeated revision and scrutiny over the 48 hours prior to completion. The Grant Thornton cash flow model confirmed that on completion, the enlarged business would have access to sufficient cash to meet its debts as and when they fell due over the next 12 months, noting that it would be necessary to raise some working capital facilities and also sell some real estate assets of the Group in the first three to six months to deliver such certainty.

Prior to completion, BHS had retained Vail Williams to advise on the property strategy. At completion, the Directors had comfort that (absent the property portfolio held by Carmen Properties Limited – which was encumbered to RBS but which was being refinanced to HSBC for £70 million and the Jersey property which was encumbered as to £20 million, but which was to be refinanced post completion) the balance of the BHS property portfolio was unencumbered. The Board was therefore

ultimately satisfied that a combination of cash at completion, the availability of the sale proceeds of North West House (which was to happen for £32m immediately following completion), the agreement by Sir Philip Green to contribute funds to RAL from the sale of Marylebone House (which would amongst other things cover RAL's acquisition costs) and also the offer from Sir Philip Green to help to procure a cheaper form of working capital facility than the facility that the Company was proposing with Farallon, meant that there was not only sufficient cash and assets available to meet the Group's cash flow needs, there was a reasonable buffer creating headroom over the BHS cash requirement.

- b) Grant Thornton's due diligence indicated that the Oxford Street store needed to be sold by September 2015 for BHS to remain solvent; but it only happened in April 2016. What was the cause and impact of the delay?**

It is not true to say that *"Grant Thornton's due diligence indicated that the Oxford Street store needed to be sold by September 2015 for BHS to remain solvent"*.

As stated above, Grant Thornton undertook extensive work to identify the cash needs of BHS, including costs associated with the turnaround, the costs of BHS separation from Arcadia, consultants and new RAL management. The "Summary Cash Flow" schedule in their due diligence report shows the opening cash and the funding due to come into the BHS Group in March and April 2015. In addition, it shows the directors' assumption, based upon professional advice from Vail Williams, that the Oxford Street property, being a highly desirable property in a most sought after location, could be sold realising a value of £50m.

Clearly, there were many variables that could delay a sale, including obtaining a satisfactory price. In addition, the sale of the Oxford Street property was only one of many options available to generate the additional funding that would be needed by BHS by October 2015, any one of which would have generated the funds needed for BHS to remain solvent including, for example only, the sale and leaseback of the Atherstone distribution site. The Grant Thornton report acknowledged this when it correctly concluded that *"failure to deliver this [Oxford Street sale] cash flow (or some other form of financing)"* would leave no headroom in the cash forecast. In the event, *"some other form of financing"* was secured and the delayed sale of the Oxford Street property had no impact on BHS's solvency. The board reviewed the Grant Thornton Report in detail and the possibility of a delay to the sale of the Oxford St property was clearly acknowledged in the RAL completion board minutes of 11 March 2015.

Turning to the cause and impact of the delay, the Oxford Street property sale completed on 31<sup>st</sup> March 2016. The initial cause of the delay was that BHS attracted

adverse publicity from a number of national newspapers following its acquisition by RAL. The BHS Board were concerned to maintain staff morale at the Oxford Street store and for this main reason it was decided not to openly market the property. This meant that the marketing would take longer as potential purchasers needed to be approached individually by the retained agents DTZ / Cushmans. July and August were challenging times to progress property sales as many of the key decision-makers were on holiday. Once the marketing commenced, the feedback was that the market was concerned that the freeholder was effectively a special purchaser and that if third parties came forward with an offer they might be used purely as a stalking horse. Also, the long lease had a number of unusual provisions within it that caused some potential purchasers not to take things to the next stage, Market sentiment weakened slightly towards the end of 2015 and the combination of factors detailed above delayed the sale. Whilst the agents failed to identify a purchaser who was prepared to enter a contract at the target price, indications were received at a lower amount; but the board was determined that BHS would achieve at least £50m from this asset sale.

The impact of the delay was minimal as the property portfolio realised more than the turnaround plan target, albeit there were additional interest costs from the September 2015 bridging loan. The proceeds of the Oxford Street disposal were applied to the repayment of the bridging loan and the profit on the Oxford Street store was realised in the balance sheet of BHS. The disposal of the Oxford Street store, together with other property disposals and the considerable reduction on property costs arising from the CVA, ensured that BHS over-delivered on property targets during its period of ownership under RAL.

**3. As a board, what persuaded you to hive off BHS's profitable international arm at a time when the company was in distress?**

I believe that the initial impetus for this proposal was a visit by Mr Chappell and Mr Topp to the Middle East franchisees in or about summer 2015. The feedback on the visit from Mr Chappell was that the franchisees were concerned about the financial stability of BHS and the impact upon their own businesses of a failure of the UK business and had suggested that if the BHS International business and trademark be held separately from the UK business, this would give more comfort for their continued investment in the BHS brand.

Over a number of months commencing in the summer of 2015, RAL, working with BHS legal advisors, Olswang, developed the thoughts and options on the possible hive off of the International division. Then, when Mr Treacy joined as CFO of RAL in November 2015, he was given the task of managing the development of a logical strategy for proposed hive off of BHS International.

It is fair to say that at an early stage, and at an Operations Board meeting in Dorset in late 2015, Mr Topp expressed some reservations toward the idea and Mr Hitchcock was against the proposal. However, Mr Topp did not completely rule it out subject to a full understanding of how it would work. In reply, Mr Chappell accepted that position.

Over the coming weeks and months, Mr Treacy regularly discussed this (and many topics) with Mr Topp. I, and others, joined in those discussions too, from time to time. It is right to say that there were considerable discussions to understand the possible different ways in which a hive off could be structured or organised and I believe Mr Topp's constructive comments were incorporated in the later refined proposals.

Mr Treacy confirmed at a certain point that Mr Topp had approved the engagement by BHS of the professional advisers to advise generally on the subject and in order to establish and understand the steps that would be involved should a positive decision in this direction at some time be made by BHS.

As I recall, there were 4 main reasons why the proposed hive off was pursued when the company was in distress, as follows :

- (1) The feedback from existing franchisees (as reported by Mr Chappell) that they would not further invest in BHS with the corporate structure as it was.
- (2) The significant decline in the profitability of the BHS International division against the turnaround plan and the opportunity to introduce new direction and focus to a stand-alone operation. It should be noted that the significant decline against the turnaround plan was only revealed through the financial review carried out as part of the investigation into a possible hive-off.
- (3) The opportunity to attract investment into the BHS International business in order to exploit opportunities. It was believed that such a positive development for BHS International would benefit the UK business in two ways :
  - a) by applying a fair-market valuation (rather than potential distressed valuations) to the international assets and an opportunity to retain a shareholding in the international division post new investment; and
  - b) reduced ongoing costs for the UK business (for example only, by website infrastructure costs being spread over multiple websites for international markets)

I attach an email sent by the RAL CFO setting out the hive off proposals in an advanced and developed state [ATTACHMENT 1].

- (4) Advice from the RAL CFO that a standalone BHS International division could be capable of securing working capital financing facilities in excess of the financing facilities available for BHS.

The proposed hive off of the BHS International division was not progressed in March 2016 (as had been previously mooted) due to the imminent CVA. It was agreed with advisors that the proposed hive off should be delayed until the CVA supervision period was completed.

**4. You were involved in Paul Sutton's proposal for BHS. He portrayed LEK and Deloitte as advisers. Was this an accurate description?**

I was briefly and only very intermittently involved in that proposal. Mr Sutton did refer to both as advisers.

Personally, I did not meet Mr Sutton's contacts at Deloitte but he referred to them on occasion. I cannot say if the description of advisers is accurate or not.

As to LEK, I did meet them, attending at their offices on one occasion to discuss matters relating to a possible bid for BHS. LEK seemed very capable and very interested in the possibility. I understood from Mr Sutton that he had regular contact with them and he told me that they were providing valuable advice to him.

- a) Mr Chappell also presented Kevin Lyons and Alan Jacobs as advisers. Was this an accurate description? When were you informed that they did not wish to work for BHS?**

I met both of those gentlemen with Mr Chappell on several occasions, both before and after the acquisition. Both were every experienced in their field and both were very knowledgeable and highly professional in their approach. I did not understand either of them to reject outright working for BHS. It was perhaps more a matter of timing.

Mr Chappell certainly relayed that he had received valuable advice from both of them at different times.

In the case of Mr Jacobs, I believe that such advice would have been of an informal nature as I understood that he was otherwise engaged with another company. That said, Mr Chappell did inform me that there was a possibility of



Mr Jacobs joining the BHS Board in some capacity at some point and that he had had ongoing discussions with him on that possibility.

As to Mr Lyons, he gave advice to RAL in 2015 that was paid for by RAL. As with Mr Jacobs, I understood from Mr Chappell that he was in discussions with Mr Lyons from time to time to see if he might join BHS in a more permanent capacity. As mentioned, I was never informed that either he (or Mr Jacobs) had rejected the idea of working for BHS.

**5. Is it true that RAL tried to take a £500,000 fee for its part in the Company Voluntary Arrangement? If so, why did that fee get blocked?**

It is not, to my knowledge, true to say that RAL sought such a fee (or any fee) for its part in the CVA.

**6. Why did you abstain from the decision on lending £1.5m to the company which owns Dominic Chappell's father's house?**

I voted against that decision at a RAL Board meeting. I did not consider this loan to be the business of RAL.

**7. Why did RAL secure expensive loans with ACE? What other options were explored?**

Initially, the non-executive directors of RAL were told by Mr Chappell that any equity investment into RAL/BHS was to be provided/secured by Mr Chappell personally. Those non-executive directors and I became aware that in the 48 hours prior to completion Mr Chappell was seeking a personal loan to fund the equity investment required by the transaction and that ACE was one of the parties approached by Mr Chappell. Just prior to completion, Mr Chappell changed this arrangement from a loan to him personally to a loan from ACE to RAL. I was not involved in that decision making and therefore am unable to explain why this loan was agreed or why in those terms.

By July 2015, in the absence of supplier credit insurance, BHS had been required to put up approximately £ 24m of cash to collateralise Letters of Credit plus further security bonds with service suppliers including, for example, electricity suppliers and card merchandisers. These unexpected cash calls combined with ongoing operating losses had accelerated the need to raise further cash by end June 2015.

During this period, RAL / BHS and advisors were engaged in continuing negotiations to secure a loan to cover the June rent quarter payments. Discussions were ongoing with, among others; Farallon Capital (whose identity has previously been disclosed) and others whose identities are the subject of existing confidentiality agreements including : a US based private equity fund with \$20bn under management; a UK based property fund with £500m under management and a London based European special situations fund with \$900m under management.

Due to the early stage of the turnaround, continuing operating losses, concerns around the pension deficit and the concerns previously stated by Farallon, none of the proposed providers would commit to providing the required funds in time to meet the June rent payments. In such circumstances, the ACE loan was secured late in June 2015 as a much less favoured, but rapid, solution to ensure the June 25<sup>th</sup> quarterly rent payments were covered.

#### **8. Why did BHS not enter into the CVA sooner?**

My understanding is that BHS did not enter the CVA sooner because it was a key pillar of the turnaround plan to seek to agree a compromise agreement with the Pension Trustees as an important first step to securing the financial viability of BHS.

I believe that the Committee has been given possibly misinformed or misguided opinions on this subject by BHS consultants and officers of the previous owners, and I take this opportunity to set out my understanding.

It was a condition of the Sale and Purchase Agreement (Schedule 8) of the acquisition of BHS Group that RAL was to agree a compromise to the pension liability as soon as reasonably practicable following completion and RAL believed that was a foundation building block for the long term financial viability of BHS. Arcadia's failure to honour Sir Philip Green's commitment to 'sort' BHS's credit insurance problem resulted in an unexpected cash flow need which absorbed very substantial amounts of management time and resources, thereby delaying other priorities. It was only after stabilising the cash flow of the business, by securing the bridging loan from Grovepoint in September 2015, that the business had the resources to continue to carry out the turnaround objectives, including seeking to resolve the pension liability and seeking to reduce the rent costs. Effectively, the serious cash flow crises arising from the withdrawal of trade credit insurance which BHS experienced from early 2015, became a very serious and very distracting concern for at least the first 6 months of the 13 months period of ownership of BHS by RAL.

### *Reducing the rent costs*

When Mr Hitchcock joined BHS in or around July 2015, he advised the BHS Board and RAL that he had experience at his previous company Beales of successfully agreeing rent reductions with landlords. As a result, I understand that Mr Hitchcock requested and was granted approval to approach the landlords to seek to agree rent reductions. I further understand that Mr Hitchcock met with KPMG in December 2015 and reported to BHS and RAL that KPMG had proposed a so called 'property CVA' which was explained by Mr Hitchcock as being a voluntary compromise with landlord creditors which would be legally binding and which would not impact on other creditors including the Pension Trustees/PPF.

The new RAL CFO, Mr Treacy, did not believe that there could be a CVA that did not involve all of the creditors and, accordingly, at the time (December 2015) RAL's view was that it was preferable for a compromise of the pension liability needed to happen prior to any CVA. Indeed at around the same time (December 2015), I was present at a meeting with Mr Chappell with specialist property advisers exploring options to negotiate lower rents with landlords without entering a formal insolvency process (this being something they were extremely experienced in).

However, the combination of the following :

- the poor Christmas trading, reported as being a £ 25m shortfall of sales against budget;
- the additional losses arising from poor sales margins in January (which I understood was as a result of selling excess stock at clearance prices);
- The revelation to RAL and BHS boards at the BHS Group board meeting of 14<sup>th</sup> January 2016, that the November 2015 forecasts had excluded a further £17m of profit risks which Mr Topp explained were only later disclosed as risks when they had a real likelihood of happening. In Mr Treacy's stated view, this had not been a prudent enough approach and had had the effect of distorting the cash flow forecasts, rendering them less reliable than they should have been (please note : I am not aware of what Mr Topp's reply to that is);
- worsening cash flow forecasts

convinced the BHS board and RAL to discuss a potential CVA. RAL and BHS met with KPMG on Tuesday 12<sup>th</sup> January 2016 to understand, from a highly experienced retail restructuring team, how a CVA might work for BHS. Following that meeting, Mr Treacy, CFO of RAL, by email to KPMG requested an additional '*...meeting focused solely on the pension implications of an early CVA....*'. This follow up meeting then took

place at 5pm on Thursday 14<sup>th</sup> January 2016. KPMG confirmed at that 14<sup>th</sup> January meeting that the proposal of a CVA would trigger a Section 75 liability. KPMG also said they had a conflict of interest in relation to advising BHS on pension aspects.

The specialist pension partners of Grant Thornton and Olswang confirmed that the proposal of a CVA would trigger a Section 75 debt and that the BHS pension schemes would transfer to the PPF. There was, as I recall, debate as to whether the CVA could be delayed for 3 to 6 months to facilitate Project Vera being completed so that the pension schemes would remain with the Trustees and not be transferred to the PPF.

Around the same time (January 2016) Mr Chappell met with Sir Philip Green in order to advise Arcadia of the financial difficulties of BHS and to request additional financial support. Sir Philip Green facilitated the release of a fixed charge over a property which was in turn refinanced by Gordon Brothers Europe, providing necessary additional working capital. The meetings between Mr Chappell and Sir Philip Green, sometimes involving advisors (including Deloitte and KPMG) and other directors, also produced Arcadia's consent to proceed with the planning of a CVA as being in the best interest of BHS and their own position as floating charge holder. A meeting was also arranged at short notice in January 2016 with the PPF to update them on the proposal of a CVA.

It was only after the above considerations and communication with stakeholders and the recognition that, due to the deterioration in trading and cash flow, a CVA could be a mechanism to rescue the company and avoid Administration, was the CVA given the approval to proceed.

**9. Were you concerned that RAL breached the covenants on the sale by extracting money from BHS? What discussions did the Board have on this issue?**

In short, RAL took the view that there was either no breach or, if that view was wrong, then it had been entirely caused by a prior breach of promise made to RAL. I explain this all further below.

The covenant referred to in your question is a covenant in the Sale and Purchase Agreement (SPA) between Taveta and RAL that available cash should be used for the day to day running of the business of BHS.

This SPA was the purchase of a loss-making business for £1. There was a separate commitment from Sir Philip Green to sell Marylebone House to RAL at an agreed price which would simultaneously realise £8.5m cash (from outside the BHS group) which the directors of RAL believed would, inter alia, fund their contracted professional and consultancy costs and expenses related to the very substantial acquisition work.

This commitment by Sir Philip Green was referenced in an email [ATTACHMENT 2] by Gillian Hague post-completion dated 12 March 2015 that the funds (namely the £8.5m) were due to be received on Monday 16<sup>th</sup> March 2015.

In the event, those funds did not arrive at the time they had been promised. Instead, they arrived many weeks later.

The said professional and consultancy fees and expenses (to include Grant Thornton and Olswang) were contractually due on completion. The available funding contained in the Completion Statement [ATTACHMENT 3] was designed to meet the cash flow forecasts of the BHS business. Within that Completion Statement was mention of the said £8.5m which was funding to be received by RAL (from non-BHS group assets). The cash flow forecasts for the enlarged group, as prepared by Grant Thornton, included the acquisition costs and provision for RAL running costs.

Accordingly, it is reasonable to say that such costs were part of the continuation and running costs of the BHS business.

It was always envisaged that RAL would bring required direction, financing and property and turnaround skills to support the BHS management team. As such RAL would be a 'Management Holding Company' being remunerated for its services through a Management Services Agreement ('MSA'). Very significant external expert benchmarking was carried out with leading professional firms (including Grant Thornton and PWC) to ensure that the management service charges were fair and reasonable and in line with the market. Furthermore, a considerable number of detailed discussions took place between the RAL and BHS directors to agree the detail of the MSA. Also, the RAL budget was shared with BHS to ensure full transparency of RAL costs.

For the reasons given, RAL did not "extract" money from BHS nor does it consider that it was in breach of covenants (or if it was then only because of a parallel funding promise being delayed). It re-charged BHS for costs that it incurred as per the agreed management services agreement and this related to the day to day running of BHS and the continuation of its existence as a significant trading business employing many thousands of people.

**10. Why did the Board accept a deal with no legal guarantees from Sir Philip Green on the pension scheme or trade credit guarantees? Why weren't they included in the SPA?**

- a) **At what point did you find out the company would not come with the pensions issue resolved? Why did the Board proceed anyway?**

All the negotiations with Sir Philip Green were handled by Mr Chappell, supported by Olswang, and I had no involvement in any detailed discussions with Sir Philip Green about what he would or would not include in the SPA.

However, Sir Philip Green emphasised on more than one occasion in meetings that I and others attended that his word was his bond. Sir Philip is a very high net worth, high profile businessman, knighted for services to retail, and it was not unreasonable to accept the assurances and oral commitments of such a man. As Olswang noted in their letter of 7 March 2015:

*“we note, however, the commercial comfort that the directors are taking from the representations from Sir Philip Green that he will continue to support the business post Completion and that he has a big commercial interest in ensuring that the Group continues to trade (given the large concession arrangements with Dorothy Perkins, Wallis and Evans) and also due to the reputational risk that he is exposed to should BHS fail. We do not doubt these commercial matters and note that great comfort could be drawn from them.”*

These matters were referred to extensively within the completion board minutes that I believe you have seen, including the following specific statement:

*“ during negotiations, SPG had made it clear to the board that his word was his bond and that if there was an obligation that he had given, he would honour such and the Board had taken him on his word on such matters and felt commercially satisfied that SPG would honour all pledges”.*

***Trade / supplier credit***

With regard to trade credit insurance, Sir Philip Green had stated that he (or Arcadia) was committed to resolving the trade credit insurance issue. This was understood to mean that, if necessary, Arcadia would arrange the reinstatement of credit insurance for BHS or otherwise find a solution which would enable BHS to obtain goods on normal credit terms.

## *Pensions*

In summary, the answer to the question can be summarised as follows, with further detail underpinning those four statements appearing below them:

- (i) there was a reasonable belief, on the basis of assurances from the Seller and its advisers, that a pensions solution along the lines of Project Thor could (and would) be delivered;
- (ii) the transaction was not detrimental to the pension schemes post completion, and the immediate post-completion position of the pension schemes was arguably enhanced by £50m (according to Deloitte);
- (iii) Sir Philip Green or any connected party remained exposed to any appropriate 'moral hazard' claims in any event; and
- (iv) the completion of the acquisition kept over 12,000 people in employment as opposed to the majority of those jobs being lost through an otherwise imminent insolvency.

RAL directors were informed by Mr Chappell towards the end of January 2015 that he had revived the deal to acquire BHS but that the deal would now come without the pensions deficit having been resolved in advance of the completion date. That said, there was a genuine belief that all parties (including Sir Philip Green) wanted a resolution to be found (that was affordable to BHS) and that this could be achieved post completion. As part of the solution, it was anticipated that the PPF would then acquire a very significant equity stake in the business.

Prior to completion there were two professional adviser teams advising RAL on pension matters, an Olswang team and a Grant Thornton team. Their work and reporting was extensive, clearly expressed and comprehensive. There were frequent discussions on pension issues and a separate RAL board meeting on 11 March 2015 to consider all aspects of the pension position.

We had been consistently informed, from November 2014 onwards, by various Arcadia personnel, and by Deloitte (acting for the seller), that Project Thor was supported by the Pension Trustees and was a deliverable solution to the pension situation. A few days prior to completion, Grant Thornton's email of 6 March 2015, quoted Deloitte as saying:

*"they (trustees and SPG) had now broadly agreed upon a figure of £50m and a deal that involved a promise of £15m from SPG, £15m from buyer and £20m of floating charge security (over stock) to cover a further £20m of future annual contributions..."*

This feedback from a meeting on 5 March 2015 between Arcadia, Deloitte, KPMG, the pension trustees and the Pension Regulator was very positive and influential. It was therefore reasonable for RAL to believe that a Project Thor type solution could be agreed soon after completion of the acquisition.

The RAL Board meeting on 11 March 2015 minuted that:

*“the directors had been told by the Seller that in the absence of a sale, further financial support would be withdrawn and that the companies in the BHS Group would enter into insolvency”.*

Additionally, we were advised that the Pension Regulator has extensive powers to seek financial contributions from previous owners of a business in certain circumstances and where significant scheme deficits had been allowed to develop, and that the sale of BHS would not prevent or impede the exercise of those powers. Accordingly, the clear advice was that Sir Philip Green or connected parties potentially remained liable in relation to the pension scheme deficit that had built up under their ownership.

This gave considerable added comfort when assessing whether the assurances received by Mr Chappell from Sir Philip Green (as reported to the RAL board) in relation to finding a solution for the long term pension deficit would be met, as it clearly demonstrated that it was potentially very much in Sir Philip Green’s interest to assist in that regard.

Separately, as has been confirmed in evidence to the Select Committee, the very basis of the Project Thor proposal was that BHS was on the verge of insolvency. Grant Thornton’s email of 6 March 2015 reported Deloitte’s feedback on a meeting on 5 March 2015 between Arcadia, Deloitte, KPMG, the pension trustees and the Pensions Regulator, at which *“all parties...could see that insolvency was inevitable”*. Insolvency would result in no further annual contributions being made into the pension schemes, and the loss of over 12,000 jobs.

By acquiring BHS and supporting management’s turnaround plan, it was RAL’s reasonable view that:

- a) pension scheme contributions of £10m per annum would continue and hopefully increase in the future as the turnaround plan improved the trading results of BHS.
- b) The terms of the acquisition included a commitment from Arcadia to pay £5m into the pension scheme in each of the next three years,



compared to nothing on insolvency (this £ 5m being part of the £ 10 m referred to in (a) above).

- c) The terms of the deal also provided for approximately £200m of Arcadia debt to be written off, meaning that in the event of an insolvency other creditors, including the pension schemes, would receive a higher pay out.
- d) Arcadia put in place security over BHS assets in support of their remaining £40m of debt due from BHS – it was agreed with Sir Philip Green that this security would be used for the benefit of the pension schemes.

In view of the above, the acquisition of BHS did not appear to be detrimental to the pension schemes compared to the alternative of BHS being immediately placed in an insolvency process. The completion of the acquisition kept over 12,000 people in employment and this was a very important consideration. It also ensured further payments / assets being applied towards the pension deficit than would otherwise have been the case.

At the RAL board meeting on 11 March 2015, the Board concluded that:

*“the directors were comfortable that the Schemes would probably be in a better position with an ongoing employer and the potential of a Project Thor type solution than the alternative outlined by the Buyer where they would be in insolvency imminently.”*

The board meeting also noted that:

*“the current proposal will have the effect of allowing the Bhs companies to continue to employ the approximately 12,500 staff (that number will fluctuate as the business plans are implemented) which the directors consider important given that the current financial position of the business and Schemes is not of the employees’ making.”*

The position of the RAL board is supported by the Taveta Investments Limited board minutes dated 25 March 2015 which have been submitted to the Select Committees and contain key information on the pension situation in March 2015.

Those minutes state that:

*“Sir Philip reported that the pension schemes and their advisers, KPMG, had confirmed that if a package of £55m was made available to the schemes post sale of BHS, the schemes would be no worse off as a result of the transaction.”*

*This would be provided through an undertaking by Arcadia to pay £15m (£5m pa for 3 years) to the pension schemes, plus the security over the £40m balance of the inter-company debt referred to above”.*

Submitted with those minutes is an email from Neville Kahn of Deloitte dated 27 March 2015 to various people at Arcadia, the pension trustees and their respective advisers, comparing the *“estimated returns to the pension scheme in the event that an insolvency occurred immediately after the transaction completed”*. That email includes the following:

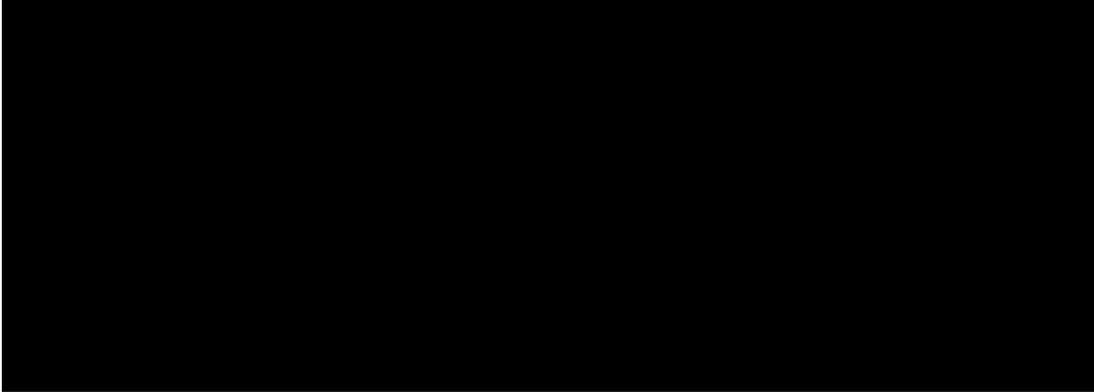
- *“estimated returns to the pension scheme of £77.9m compared to £26.4m pre-transaction”*
- *“Prior to the transaction there were £240m of inter-company balances between Arcadia and the BHS Group of which £200m has been written off and £40m is to be made available to the pension scheme”*
- *“the trustees would have recovered more post transaction than pre transaction”*.

Yours sincerely

**Edward Parladorio**

# ATTACHMENT 1

**From:** Aldan Treacy



## **Project Herald**

As messaged previously the Group has been working on a corporate restructure since October, called Project Herald. This project has been delayed due to resources applied elsewhere and in order to align the objectives of Herald with the detailed restructuring of BHS Ltd to be set out in the CVA proposal.

The purpose of Project Herald is to:

- (a) Improve the trading performance of BHS International and BHS UK by separating the businesses into separate legal entities
- (b) Prepare the International business for future investment which would also have the benefit of introducing additional cash into BHS Ltd
- (c) Transfer certain employees (no more than 15) from BHS (and potentially RAL) into BHS Services which would provide services to BHS Properties, BHS UK, BHS International. [BHS Services currently exists] Potentially BHS Services could provide services to non-BHS Group companies of RAL with benefits for all group companies

The note below summarises various steps as currently envisaged. There is a moving part as to whether the PPF will be offered and agree to an equity holding in BHS UK or BHS Group (an equity holding of >25% has tax implications on a re-organisation).

I also attach the BHS Reorganisation Agreement which was prepared independent of an impending CVA and the latest Draft Working Assumptions prepared by GT which will form the basis of a valuation.

The current scenario envisaged is as follows:

1. BHS International is incorporated as a subsidiary of BHS Limited.
2. BHS International acquires the business and assets of the International division from BHS Ltd at fair market valuation.
3. Consideration for the above is by intercompany loan
4. Advise the PPF of the long term objective for the International business – however any sale by BHS Ltd to another company would be after PPF become a shareholder of BHS
5. BHS Services remains as a subsidiary of BHS Ltd or becomes a subsidiary of BHS Group

I would welcome the input from Well and KPMG to help us to simplify the next steps as much as possible so that we can retain the benefits of the proposed re-organisation through the CVA.

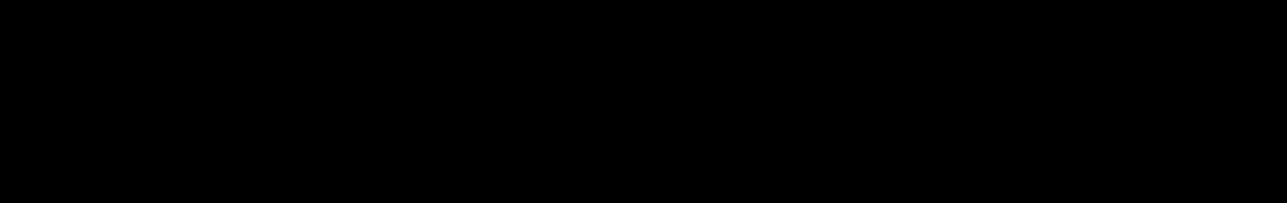
I have copied all the known key stakeholders in this project. Hopefully we can move forward with a smaller group so please forward queries and comments directly to me and we will add to the existing outstanding issues list.

Adam -- can we catch up tomorrow?

Regards,

Aidan

## ATTACHMENT 2



Balances at close of play today are shown below: key movements being the +£5m equity injection into the first account listed (BHS Group Ltd); £(3.6)m having been paid out of the AP account (2nd on the list) which is primarily the three transfers to Hudson Road that we discussed (ie the up-front payments); £19.8m having gone into the BHS Ltd No 1 account (the £18.66m transferred from us + some sales receipts).

You will note that we have not received the £32m relating to NWH which was due to be transferred from Olswang - we chased Olswang and left a message on your voicemail Stephen to ensure that you were aware, but I know you were in meetings - not sure what happened to this today?

I believe that the Carlisle proceeds and £8.5m re MBH is due to be received on Monday.

Please note that we will be transferring \$500k (USD) into the US\$ account at the bottom of the page tomorrow, to enable some trade payments due out in US\$ tomorrow. We have confirmed with Kathryn that we will transfer the Sterling equivalent of these dollars out of one of the Sterling accounts tomorrow. When you are considering the matrix of who can move what on these accounts it may be worth bearing this in mind - I wasn't sure when we spoke earlier whether Treasury would need to maintain the ability to move money out of these accounts going forward (I thought we could just leave that to Leeds) but short term at least it may be more sensible to leave this capability in Treasury too, to allow for items such as FX.

Regards

Final Statement.

	<u>£m</u>	
Gift Cards / Credit Notes	6.3	
VAT	5.5	
PAYE/NI	2.1	
Insurance	<u>1.7</u>	
	15.7	
Cash in Transit / early payments	<u>(4.9)</u>	
	<u>10.8</u>	10.8
Inc/Outs		
Ealing (6.9 - HKB 0.56 - Oxford 0.5)	5.84	
Onerous / Taxes	<u>7.0</u>	
Stays In	12.84	
Jersey	<u>(5.00)</u>	
	<u>7.84</u>	7.84

<u>7.84</u>	7.84
18.64	
32.00	
4.92	
8.50	

NW House  
 Carisle (Monday)  
 Marylebone House

11. March 2018

<u>64.16</u>	
5.00	
<u>69.16</u>	
25.00	
<u>94.16</u>	

Equity

Goldman's Facility      40  
 less Jersey              (15)

(Take off the early payments)