

Business, Innovation and Skills Committee with the Work and Pensions Committee

Oral evidence: The sale and acquisition of BHS, HC 54

Monday 23 May 2016

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Members present: Rt Hon Frank Field (Chair), Iain Wright, Richard Fuller, Richard Graham, Craig Mackinlay, Steve McCabe, Amanda Milling, Jeremy Quin, Amanda Solloway, Michelle Thomson

Questions 198 - 601

Witnesses: Ian Greenstreet, Partner, Nabarro, Tony Clare, Partner, Deloitte, David Clarke, Partner, KPMG, Richard Cousins, Partner, PwC, and Emma King, Partner, Eversheds, gave evidence.

Q198 Chair: Welcome. I wish to read a statement to you and then, if I may, give you some idea of the timetable we would like to work to. The statement obviously thanks you all very much for coming and gives you some context to our questioning.

The Pensions Regulator, the Serious Fraud Office and the Insolvency Service have all written, assuring us that our inquiry is not impeding their investigations. We recognise, however, that the lawyers among you in particular may have obligations to your clients in terms of not disclosing information that is subject to legal professional privilege. We understand that Taveta and Arcadia have opted not to waive legal professional privilege in relation to advice provided to them. None the less, I am sure that you will want to help as much as possible, in a constructive way, in analysing these issues. That said, it is clearly your call how you use your professional privilege. If we are unhappy with it, we can go to your regulators to see whether they think you have called this correctly, and of course there is the possibility of bringing you back.

I will chair the first session, and Iain will chair the two subsequent sessions. In our first session, while many Members will wish to come in, we have three main themes. Jeremy will lead on Project Thor. In true celebration year, Richard Bedford will do the sale, Richard Gloucester will do the recovery plan and Iain will look at the auditors. May I ask you to begin by saying who you are, for the sake of the record? Could you tell us your status within the companies, as opposed to the pension scheme, and how those two great matters weighed with you as professionals in the advice you gave? Emma, we will begin with you.

Emma King: My name is Emma King. I am a partner in the law firm Eversheds, and I specialise in pensions. My role and the role of Eversheds in this matter has been to advise the trustees of the BHS pension schemes, and at all times we were providing them with details of the legal and regulatory landscape within which to consider all of the matters that we will be talking about today.

David Clarke: My name is David Clarke. I am a partner with KPMG. I lead our employer covenant offering. We specialise in understanding and assessing the strength of businesses who sponsor final salary pension schemes. We were appointed by the trustees, and our initial role from our appointment on 19 February 2014 was to help the trustees evaluate the Project Thor proposal.

Tony Clare: My name is Tony Clare. I am a partner of Deloitte and a specialist pensions partner. We were advising Taveta Investments Ltd—the shareholder who is the owner of BHS Ltd. We were instructed to consider a restructuring of the company—BHS—and the pension scheme, with a view that all the members would receive a better outcome than the potential of going into the Pension Protection Fund and receiving compensation.

Ian Greenstreet: I am Ian Greenstreet. I am a partner at Nabarro, which is a law firm, and I specialise in pensions law. We were advising Taveta Investments Ltd and giving specific pensions advice, working alongside Deloitte, because there is a division of responsibility in this sort of area on the legal aspects and the financial aspects.

Taveta Investments Ltd owned Taveta Investments (No. 2) Ltd, and Taveta Investments (No. 2) Ltd owned Arcadia and BHS Group at the time of the sale. Taveta Investments (No. 2) sold BHS Group. As a firm, we have provided pensions advice to various entities in the Taveta group since 2009, and we ceased providing advice in 2015 when the main client partner left to join another firm and took the business with her.

Chair: Ian, if I may, I will come back to you about that structure before I go to Jeremy.

Richard Cousins: I am Richard Cousins. I am a partner at PwC, and I am a pensions actuary. I have given advice to Taveta since 2009, when BHS was brought into the Taveta group. I ceased giving advice in relation to BHS midway through 2013.

Q199 Chair: Ian, we were given a diagram of the companies, and we have at the top of it Taveta Ltd in Jersey, Taveta Investments and Taveta Investments (No. 2). In your experience, where did the power lie?

Ian Greenstreet: The main UK holding limited is Taveta Investments Ltd. The ultimate controlling shareholder is Lady Christina Green and her immediate family, as stated in the accounts.

Q200 Chair: Right, and would she chair or did someone else chair the two investment companies?

Ian Greenstreet: She would not—she is just the ultimate, controlling owner, so the responsibility for any sale would rest with the board of Taveta Investments Ltd, which controls Taveta Investments (No. 2), although I suppose as Taveta Investments (No. 2) was selling—

Q201 Chair: Could you remind us who the chairman was during this saga?

Ian Greenstreet: Apologies—I would tend to deal directly through the company secretary. I believe it is Lord Grabiner.

Q202 Chair: But whoever that chairman was, they would be responsible to Lady Green.

Ian Greenstreet: No, they would be responsible to the entity.

Chair: Right. Very good, thank you. I am still not clear, but no doubt we will come back to who was the key chairman.

Q203 Jeremy Quin: Richard, may I start with you? You ceased to be auditors to BHS in 2013—is that correct?

Richard Cousins: No. I know you are talking to the auditor a little bit later. I ceased acting, giving pensions advice, in relation to BHS in 2013.

Q204 Jeremy Quin: That is helpful. At that stage, how would you characterise the BHS pension scheme in terms of its health and ability to carry on as a going concern?

Richard Cousins: In terms of the pensions scheme in 2013, we had just completed the valuation process for the 2012 actuarial valuation and at that point it was very clear that the cash funding arrangements were at the long end—in other words, they were 22, 23 years, which you have to say for a pensions scheme is a serious concern.

Q205 Jeremy Quin: Absolutely extraordinary. In terms of the relationship between the pension fund and ultimately the broader Arcadia Group, I assume that you were looking for some reassurance. Obviously you have to look to the BHS board and BHS itself, but I presume you were reliant on there being a guarantee of some sort from the wider group to BHS.

Richard Cousins: No. When the valuation was looked at—the trustees use covenant advisers to look at that valuation—my understanding was that they were only looking at the BHS business that was the sponsor of the pension scheme at that time. So the pension scheme was only supported by BHS Group Ltd.

Q206 Jeremy Quin: Okay. Emma, you would have been providing legal advice to BHS's directors at the time.

Emma King: No, the trustees of the pension scheme—

Q207 Jeremy Quin: The trustees of the pension scheme. The same question though: from their point of view, were they comfortable that they had full resources and could operate purely on the basis of BHS resources?

Emma King: Whether they were comfortable or not, that is the state of affairs. The only company that they could legally look to from a trustee perspective was the sponsoring employer, which was BHS.

Q208 Jeremy Quin: What type of process did they go through to reassure themselves about the adequacy of the situation they found themselves in?

Emma King: That is probably more an actuarial question than a legal question, because an actuarial valuation and the recovery plan put in place to deal with any deficit is very much led by the scheme actuary in terms of the advisory team. We were advisers at that time—we have been advisers to the trustees since 2009—but we played a peripheral role in relation to that valuation. That said, I understand that the trustees took specialist covenant advice as to what could be afforded by the company in relation to recovery payments, as has already been mentioned, and they took that advice in hand when agreeing the recovery plan that they put in place.

Q209 Jeremy Quin: From whom did they take that advice?

Emma King: I understand that was Baker Tilly.

Q210 Jeremy Quin: Okay. We have not got them here today, but we may well come back to them. I believe it was Deloitte who came in at the time of Project Thor.

Tony Clare: That is correct.

Q211 Jeremy Quin: Could you talk us through what you found in the pension scheme at the time, and then Project Thor and its objectives?

Tony Clare: Sure. There are two pension schemes: there is a staff pension scheme and there is a senior executive pension scheme. The senior executive scheme has a better funding level than the main staff scheme. This is a purely historical fact, I suspect just relating to the investment performance and the maturity of the different schemes. The staff scheme is an unusual scheme. In total across the two schemes there are about 22,500 members. But, given the history of the business as a retailer with part-time workers and quite a high attrition rate, a lot of the members have really got relatively low earnings and quite short service. So, of

those 22,500 members, about 16,000 of them had a benefit that was relatively small, with a value probably of less than £18,000.

We were instructed by Taveta Investments Ltd to review the pension scheme to see whether we could agree a restructuring that would protect the Pension Protection Fund and deliver the members a better outcome than the potential insolvency of BHS Ltd. At that point, we had been informed that BHS Ltd had been loss-making for seven or eight years consecutively, despite the best endeavours of management. It was a trading company only because Arcadia lent it nearly £200 million over that period to enable it to continue to trade. Of that £200 million, I would have thought that between £50 million and £60 million passed directly to the trustees as deficit repair contributions anyway over that period.

Q212 Jeremy Quin: Who instructed you on Project Thor?

Tony Clare: The directors of Taveta Investments Ltd.

Q213 Jeremy Quin: Okay, so it came from the top, rather than the BHS level?

Tony Clare: Correct.

Q214 Jeremy Quin: Without a Project Thor-type solution, what did you think was the prognosis for the BHS pension scheme?

Tony Clare: We were informed by our client that, as it had been loss-making for seven or eight years, the group was no longer willing to support those losses indefinitely, and that ultimately the business would go into insolvency if a solution could not be found.

Q215 Jeremy Quin: Can you talk us through what Project Thor would have involved and how you thought you could get a solution that would work in the interests of the pensions and the employees?

Tony Clare: I think it is important to be aware that Project Thor has three strands to it. One element is indeed the pension scheme. A second element is that the owners of BHS Ltd, who had lent over £200 million at that point to support the company, would write off their debt—certainly to the extent that they would have received a recovery in the event of insolvency, so they would not get any more. The other key suppliers and stakeholders to the business—primarily the landlords—would also take an impairment on their rents. So there were effectively three strands to it.

On the pension scheme, the structuring was that those members I mentioned earlier, who have got relatively small benefits, HMRC have a particular rule that says that you can provide them with what is called a wind-up lump sum—a cash payment in lieu of a small pension payable many years hence. There is guidance set out by HMRC on how that should apply. Effectively, the part of the structuring of the pensions element is that those members would be offered on a voluntary basis the option, if they wish, to take a cash lump sum now

or, if they wish, to transfer to a new scheme. The members who have got benefits above £18,000 could also transfer to a new scheme, but the proviso in the instruction we were given is that the benefits in the new scheme must be greater than the benefits that the members would have received through insolvency going into the PPF. The aim was to protect those members, but also to protect the PPF.

Perhaps I should be clear that there was no expectation that we would be able to provide all of the benefit in full. The alternative was insolvency and compensation from the Pension Protection Fund. Project Thor on the pensions side was purely intended to offer people on a voluntary basis a better option and a better level of value than would be payable from the PPF. The cost of it would be met by Arcadia.

Q216 Jeremy Quin: Okay. Other colleagues will want to go into where the pension got to at the start of this process. All we are focusing on right now is where Project Thor could have led. How advanced did you get with the Project Thor discussions? Was it a fairly baked-out solution? Did you get to a scheme that you thought had a high probability of success? Where did you get to?

Tony Clare: We investigated the numbers and looked at the costings. We worked out that it was going to cost tens of millions of pounds. We approached our client and explained, “If you want to go down this solution, it will cost you, in addition to writing off the bulk of your inter-company debt, cash of several tens of millions of pounds.” The instruction was, “Well, if that’s what it costs, that’s what it costs. We need to deliver a better outcome for these members.” We then engaged in a transparent process with the trustees and their advisers, some of whom are sat here today. We provided full information about the proposals and the alternative, which was the compensation from the Pension Protection Fund following the insolvency of BHS Ltd. We had a robust and professional negotiation with the trustees and their advisers, and we reached a written heads of terms agreement with those trustees. Thereby, all the parties were supportive of the principles of Project Thor, which I have outlined—that members will receive optionality on a voluntary basis to have a better outcome than going into the PPF, and that the owners would write off the bulk of their debt, and would write the cheque to fully fund the pension scheme on a self-sufficiency basis going forward—

Q217 Chair: What do you mean by the term “fully fund”?

Tony Clare: There are various measures to fund the pension scheme. I would say this is one of the most difficult things to explain. What I mean is that the pension scheme has its own existing assets, and it needs a top-up payment because it has a deficit. We can all understand what the value of the assets are in the pension scheme; it is a monetary matter. It is the value of the assets that you can sell. On the other side of the equation is “How much money do I need today to pay all those pensions when they fall due over many years to come?”

Q218 Chair: But there is one way of doing that, isn’t there? It is to buy the scheme out with an insurance company.

Tony Clare: There are many ways to do it.

Q219 Chair: So if we are trying to think of ballpark figures, the figure mentioned for that is £571 million, isn't it, or something like that?

Tony Clare: I believe that is the figure that was in the KPMG company voluntary agreement document.

Q220 Chair: But on this heads of terms scheme, those with small amounts could take their money and use it.

Tony Clare: Correct.

Q221 Chair: Those who had a slightly more substantial amount were offered a better deal. Was that a heading, or were there figures at this stage to guarantee them the better deal?

Tony Clare: The figures were calculated on an assumption that the moneys would be invested following the top-up contribution, and the investment return that would be achieved would be the return available on long-dated Government stock—long-dated gilts—plus an average return, over the long term, of 50 basis points, or 0.5% per annum more than gilt return.

Q222 Chair: What were the actual figures? They are pretty low, aren't they?

Tony Clare: The figures at the time, when we did our first calculations, were based on the gilt yields prevailing at the end of December 2013, which is when we first got the data. I think the figure at that first point was £50 million to £55 million, with the expected top-up payment. That figure crept up to £80 million as gilt yields fell. The market conditions are not in the control of Taveta or indeed the trustees, so as gilt yields have fallen over the period, the cost of the top-up and indeed of the buy-out—the £571 million figure—has gone up and up and up.

Q223 Chair: On this, the aim was to make sure they got a better deal than being in the PPF.

Tony Clare: And to fund the pension schemes at a very high level to give them a high level of certainty that they would receive those benefits.

Chair: They wouldn't drop back.

Tony Clare: Correct.

Q224 Jeremy Quin: I was going to ask why this fell through, which goes to the point of the scheme. You went to the regulator in July 2014, and at that stage, the regulator did not feel there was sufficient information to take a view on it, which seems to contradict the high level of certainty you had.

Tony Clare: Well, I think it is a question for the regulators why they didn't feel they had sufficient information. What I would say is that Taveta, in accordance with our advice, had provided full information to the trustees and their advisers, but they had reached the same conclusion that we had: this was the best option. They were supportive of the heads of terms. We had a draft clearance application to the Pensions Regulator, which we had passed in draft, as we had agreed with the trustees and their advisers, for them to review. They had provided their comments, their comments had been incorporated and all the parties were supportive of reaching a compromise, which you should remember is only one leg of the three that applied to Project Thor. The owners of the business had committed to writing off their debt, and to writing the cheque to top up the pension scheme. If we had the clearance of the regulator, we still had to go to the landlords and suppliers to agree that they would also reduce some of their terms.

Q225 Jeremy Quin: Just to clarify, you said that the trustees and their advisers were on board with the plan as it had been formulated; there was an agreed heads of terms between you. The other people are nodding.

Tony Clare: That is correct.

Q226 Jeremy Quin: So you are all in agreement on that. Why didn't you put in a proper formal application to the Pensions Regulator?

Tony Clare: We were proposing to do that. The clearance went in in draft, for discussion purposes. In terms of our process, if I remember correctly we first notified the regulator in early July—from memory, 7 July. We had quite a long, detailed conversation with the regulator on 10 July to explain what is, in fairness, quite a complicated restructuring—this is not a plain, vanilla-type solution. We took them through that on 10 July. The regulator then reverted back to the trustees and their advisers to hear their opinion on whether they were in agreement and why they were supportive of it, so they were doing quite a lot of due diligence at that point. It was in draft, so if we needed to make any amendments following that proper, open and transparent consultation process, we could still do so. The ultimate aim was to put in a final draft clearance that would have been penned by the owners and the trustees supporting that application.

Q227 Jeremy Quin: I am trying to work out which person on the panel is best able to talk to the trustees' viewpoint on the scheme. Is KPMG able to posit a view? I have heard various contradictory points. My understanding was that the trustees were not wholly convinced, or had not seen enough detail at that stage to be able to sign off on Project Thor. Can either Eversheds or KPMG help on that point?

David Clarke: From a financial perspective, as Tony has noted, these structures are quite complicated and have a number of hurdles. One of the key issues that needs to be addressed, as is perhaps evident to you, is what the scheme would receive by way of an insolvency if this type of restructuring did not take place. During early 2014, a big piece of our work was trying to take a draft estimated outcome statement, which was prepared by Deloitte and set out its view of what the schemes would receive in an insolvency, and see whether we agreed with that, because that number, or the number that resulted from that process, was acknowledged as one of the drivers for the level of funding that would be provided to the scheme. As you can imagine, trying to prepare that type of analysis for a sub-group such as BHS is complicated. There are a number of very significant assets—properties and so on—and liabilities, such as landlord claims.

We had a number of exchanges with Deloitte in respect of its estimated outcome analysis because, to be open, we didn't agree with some of the assumptions it made, although there is an area of judgment to be applied here. The discussions took place for several months, but I concur that, in principle, faced with the alternative of insolvency, the trustees were supportive of investigating and pursuing a Project Thor-type proposal. From my recollection, it is not the case that by the time we got to the draft clearance application, all the numbers and analysis had been bottomed out and agreed.

Q228 Jeremy Quin: Presumably that is what the regulator's problem was. That is for the regulator to say, but it was still asking for information at the end of July 2014. As I understand it, that wasn't forthcoming, and I just wonder why that was the case. Was it that you were having second thoughts on the Project Thor proposal, or were the numbers just not there at that stage?

Tony Clare: No, I think Mr Clarke expressed it very accurately: we were still trying to agree where the actual estimated outcome statement figure would be. It is not a matter of fact; it is a matter of judgment. We recognised that it went in in draft, and that figure was still blank in the document. One of the principles we had agreed with the trustees in the heads of terms is that the cost to the owners of BHS—their cash cost—has to be greater than the recovery the trustees would get through the alternative, which is insolvency. That is a matter of principle that was accepted by the parties. That figure was then up for debate among the parties until they finally reached an agreement on what it would be.

Q229 Jeremy Quin: So why was there this pause for the regulator? The regulator was asking for information and that was not forthcoming, and Project Thor was put on hold. Talk us through what actually happened with that. You weren't putting in a final application, so it is not fair to blame the regulator, because it never had a final application from you to say, "This is what we want to do."

Tony Clare: That is true. We were through the period of the summer and into the autumn of 2014. As you can imagine, this is a significant distraction for the management of the group. This is taking up all of their time as they approach what, for a retailer, is their most critical period of trading—coming up to Christmas, and making sure they have the right stock and a strong Christmas trading period. Therefore, management took the view that they

wished to pause the Project Thor engagement and to revisit it in January. The management would focus and try and turn around BHS over Christmas to improve its trading.

As a consequence, we were instructed to notify the Pensions Regulator that we wished to pause Project Thor, and to focus on trying to turn the business around and improve its trading over Christmas. We sent that notification to the Pensions Regulator. The Pensions Regulator then wrote back and asked our client to formally withdraw the clearance application. Our client was concerned at the time that if they withdrew the application, albeit it was in draft at that phase, we did not want to go back and start from square one if we concluded, following the Christmas trading, that insolvency was inevitable. However, the regulator had a telephone conversation with Deloitte and was keen that we asked our client to withdraw the clearance application, so we did. We notified the regulator that the application was withdrawn, but that if we resubmitted it in the new year, we hoped we would get exactly the same team and that there would not be any undue delay in getting up to speed on what was, we fully concur, a complicated restructuring.

Q230 Jeremy Quin: Thank you. David, you must have been upset about that. This was a missed opportunity for the pensioners.

David Clarke: First, if it is helpful, I concur with the timing. The trustees were notified by the group, and I think by Deloitte, on 5 September that Thor was going to be put on pause, and then the clearance application was withdrawn on 17 October. The chairman of the trustees, Mr Christopher Martin, who I think you will be seeing later in the week, had numerous discussions around that time with the group and pointed out that, having been told that effectively there was a risk that support would not continue to be provided to BHS, and that BHS was a struggling business, the schemes effectively had a zero covenant from that point in time and something needed to be done to make sure that the schemes were safeguarded. While it is not my area of expertise, that, for instance, triggered a review of the schemes' investment strategy to make sure that there was not the risk that that could not be covered by the legal entities responsible for supporting it. It was a difficult situation. The messaging was the same: revisit in late Jan, after the Christmas trading. The trustees made it very clear that that left them with a challenge over the intervening period.

Q231 Jeremy Quin: Where do you lay the fault for not getting it done and secured in the summer or early autumn?

David Clarke: As Mr Clare has said, these are very complicated scenarios with multiple stakeholders who need to find agreement. The trustees engaged. It was better than insolvency. I am afraid we get to September where we were informed that Thor is on pause. We were not privy to the discussions between the regulator and the group as to exactly why that was decided.

Q232 Jeremy Quin: Shouldn't you have been leading those discussions? Surely it is normally the trustees and their advisors who talk to the regulator, rather than a third party.

David Clarke: Clearance, which is the process used, wrapped around Project Thor, is a company-led initiative—a company-led process. It is not something the trustees can do. Trustees cannot submit a clearance application to the regulator.

Q233 Jeremy Quin: But the trustees have to sign off on their satisfaction of it.

David Clarke: The trustees have to add comments in one paragraph in a clearance application. A clearance application is normally 15 pages.

Q234 Jeremy Quin: Do you feel the regulator acted properly and efficiently on the information that was provided to it?

Emma King: From my perspective, as we have discussed, the regulator received the application in draft. Before it really went anywhere, there was a decision taken, as we have heard, to have a change of approach and to pause the project until after Christmas trading, so I am not sure—

Q235 Jeremy Quin: So at no stage did they have a final application.

I have one last question, Chair, if I may. We are all aware that there are other companies with schemes that may also be in similar difficulty. Do you think the Project Thor approach was unusual? Do you see this as a positive attempt by the company to find a positive solution better than the PPF for the employees and pensioners, or was it just making it slightly prettier for a future sale?

Tony Clare: It was certainly not the latter; a lot of time and effort went in. Just to give you a flavour, Mr Quin, we were instructed to go down to extreme granularity, looking at the benefits under every scenario. We were looking at such situations as the benefits paid to multiple orphans in the event of a member dying under the PPF or dying under the new scheme, and ensuring that all beneficiaries are better off under every circumstance that we can envisage. There is a lot of work looking at all those factors and what the pay-outs would be.

The first part of your question was around whether this is an option for other schemes that are in difficulties. The answer has to be yes; it is not a unique situation. For example—these matters are in the public domain—the Kodak pension scheme went through a similar restructuring. Members were offered a wind-up lump sum or a transfer to a lower benefit that was higher than what they would get from the Pension Protection Fund. A similar restructuring was done with the Uniq pension scheme—the former Unigate dairy pension scheme—and those members got a similar outcome: a better outcome than they would have done from the PPF.

Q236 Jeremy Quin: So—this really is my last question—is there anything further that could be done? We all want to be in a situation where we do not need to look at restructuring—that is self-evident—but in circumstances where restructuring is required, is

there more that could be done from the regulator or the legal environment to ensure that these schemes can be more easily processed and put in place? Perhaps David wants to answer that question first, which will give you a chance to pause for breath, Tony.

David Clarke: As Mr Clare has noted, these type of arrangements have been done before. I have personally been involved in a number that have worked and avoided insolvencies, but they are complicated and they are not common. They are not common partly because of the level of complication.

Q237 Jeremy Quin: But there is no obvious impediment that any of you can look to and say, “If you sorted that out, it would make it easier for these things to work for the benefit of pensioners in the future”?

Tony Clare: If the principle was accepted that it is better for members to have a benefit greater than the PPF compensation and to protect the PPF as a statutory objective, that would give greater impetus, I think.

Chair: That is really helpful.

Q238 Amanda Milling: This is a question to both Mr Clare and Mr Clarke, but first to Mr Clare from Deloitte. You said that the trustees were presented with Project Thor in January. In the autumn, it was paused because of trading conditions and the concern that it would take too much time. I am interested in understanding when Project Thor started in terms of beginning to come up with the concept and idea. How much time was taken before January 2014—before it was presented to the trustees?

Tony Clare: Before January 2014. We were only engaged formally in January 2014 to provide pensions advice. In advance of that, I had been asked whether we could think of anything that could deliver a better outcome for the members than the consequences of insolvency, and I had given some thought with colleagues as to what the options were and whether anything at all could be done. We met the directors of Taveta to talk through, effectively I would say, what is the art of the possible, in advance of January. Was a great deal of time and effort put into that? I would not say it was a great deal of time at that stage of the proposal. It was more about the potential options we could do to give these members a better outcome than they would receive from the Pension Protection Fund.

Q239 Amanda Milling: There is another aspect of this that I want to understand. You said that you were liaising and having discussions with the trustees from January. Why did it take several months before you started to talk to the regulator about something that was a pretty significant major restructure of the scheme?

Tony Clare: Because it takes time to inform all the trustees that the best option available is a restructuring such as Project Thor. It takes time to undertake all the necessary actuarial calculations. It takes time to analyse all the beneficiaries and to be comfortable that everyone will be in a better position than under the alternative of going to the Pension Protection Fund, and it takes time—quite rightly—for the advisers to the trustees, in

supporting the trustees, to take a sceptical line on whether something is really the best that we can offer the members of the BHS pension schemes. It takes time for them to challenge it and to apply due rigour to reach the conclusion that, regrettably, this is the best that can be offered under the circumstances.

Q240 Amanda Milling: Mr Clarke, what is your view on this time period and the discussions with both the company and the Pensions Regulator?

David Clarke: I was only appointed on 19 February 2014—we were appointed directly to deal with Thor—so in terms of your initial question, I do not know what happened pre then. On the day we were appointed, we submitted questions through Deloitte as advisers to the group in respect of Project Thor. They centred on two points; one was, “Was BHS Ltd, as the sponsor to the scheme, unviable on a stand-alone basis?” Clearly, if it could have continued to trade and support its schemes in the normal course, you would not have needed Project Thor. The second question was, “If there was an insolvency, what would the schemes, as an unsecured creditor, recover?” As I mentioned earlier, that figure was a driver of the offer being made to the schemes. We issued our initial report on those two points on, I think, 7 April, but it was not complete—there were gaps. We were still liaising with the group, and indeed Deloitte, on the information.

My recollection of events is that once it was clear that this was something that the group was seriously considering, that it had understood the likely funding cost—Mr Clare pointed out that that would have been tens of millions of pounds—and that it was engaging fully with the trustees, rather than testing a proposal that might be put back in its box once the costs were understood, the regulator was then made aware of it, because it looked like something that was going to be proactively pursued by the group. My memory is that the trustees informed the regulator of Project Thor in early June 2014.

Q241 Amanda Solloway: I am just thinking about the pause that you have been describing. I get that, for retail, the period before Christmas is clearly busy, although I think that a lot of retailers will say that January, when it is suggested that it started again, is potentially one of the busier ones. When we say it was too busy, was it that it was too busy to do the Thor project, or was it the belief that Christmas would possibly trade out of the situation? If that is the case, who was involved in the Thor project who could not be involved in it because they were involved on the retail side, if that makes sense?

Tony Clare: Your questions are perhaps better addressed to the management of Taveta at the time. My recollection is that the decision to pause Project Thor was based on a concern of the group—not just BHS but Arcadia—that both retailers and management needed to focus on the day job. Therefore, there was a distinct possibility that BHS could have a strong trading Christmas and could stem the losses. There was a question of whether it could it perform well enough to continue to merit the support of Arcadia.

Q242 Chair: Tony, the managers were not negotiating with you, were they? I assume that during the year companies make decisions about what they are going to sell at Christmas

and they then get that into the shops and all sorts of people help to sell it, but these negotiations are not really to do with the Christmas trade, are they? You were not asked to turn up to help in the activity. I can see that there is a strategic role for some people who might be worried about what trade is happening over Christmas, but that has already been decided, hasn't it? If it was a bad period at Christmas, it made these negotiations more, not less, important, did it not?

Tony Clare: I fully accept that. If I have given you the impression that store managers were involved in these negotiations, that is not the case.

Q243 Chair: No, you said that the store management were busy. Of course they were.

Tony Clare: Correct.

Chair: The team doing this negotiation were not selling goods in the shops, were they?

Tony Clare: No, they were not front-of-house retail staff. They were finance staff within the head office function. They also clearly have an important role during the busiest part of trading on the cash flows and the profitability of the business.

Q244 Chair: To see what's happening, sure. But it could have been called either way, couldn't it? Could it have been more or less important to get it through?

Tony Clare: I don't know the answer to that question, Mr Field. I think it is really one for the management of Taveta.

Chair: Yes, but if one is interested in the pensions.

Q245 Richard Fuller: I am conscious of the time, so I shall be quick and move on. We have had chapter one. Chapter two is the time of the sale of BHS to Retail Acquisitions or Swiss Rock, as it was known previously. Maybe this question is just to the advisers at the Taveta level. Mr Greenstreet from Nabarro, when was your firm alerted to the sale?

Ian Greenstreet: We were formally instructed on 27 February. I think we were aware that a sale might be in the offing in about mid-February.

Q246 Richard Fuller: So for that specific company, you were aware for how long before it was publicly announced? It was about three weeks, wasn't it?

Ian Greenstreet: About that.

Q247 Richard Fuller: And you, Mr Clare: when was Deloitte advised?

Tony Clare: We were notified of the potential to dispose the business—

Q248 Richard Fuller: To Swiss Rock/Retail Acquisitions specifically?

Tony Clare: No, not specifically. We were notified in early February that a number of parties had approached—unsolicited, I understand—Taveta with a view to purchasing BHS.

Q249 Richard Fuller: So my question was: when were you alerted to the sale to Retail Acquisitions?

Tony Clare: When was I notified the sale had completed, or when it had exclusivity?

Q250 Richard Fuller: You were advising Taveta on its pensions, I guess.

Tony Clare: Correct.

Richard Fuller: And you were about to have a sale of a pension fund that had enormous deficits. When was your firm advised that a sale was being made to Retail Acquisitions? Mr Greenstreet from Nabarro knew in the middle of February. When did you know?

Tony Clare: Perhaps I should be clear about our role. We were not the corporate financial advisers to Taveta on that sale. We provided pensions advice in advance of that on the Project Thor restructuring option. We were notified that a number of people were bidding, including RAL, as it became. We were instructed on 6 February to notify the Pensions Regulator that the company was likely to be sold. When we got down to knowing the preferred bidder was Retail Acquisitions, it must have been some time after 6 February. I would have to check when we were informed that it was the only bidder that was likely to continue.

Q251 Richard Fuller: So it's a bit vague at the moment as to whether Deloitte should have known or did know about the sale to Retail Acquisitions. Is that a fair summary of what you just said?

Tony Clare: No, I don't believe it is.

Q252 Richard Fuller: Well, I am not quite clear myself.

Tony Clare: Perhaps it might help if I were to reiterate it. We were notified, in the first week of February, that management had been approached by third parties with a view to purchasing BHS. We were asked to notify the Pensions Regulator of that change of events and circumstances on 6 February, which we did. We were not instructed to support or assist Taveta Investments in negotiations with any party in terms of price, structure, approach to the

disposal, terms and so on. I am not party to when Taveta decided that the bidder it would choose to sell to was Retail Acquisitions.

Q253 Richard Fuller: To be fair, I am still not at all clear about when Deloitte did or did not know. That is from your own recollection, but perhaps you need to go back. At the moment, let us just assume that you learnt about it in the newspapers after the sale was completed. Is that fair? You were not actually involved in making any assessment about Retail Acquisitions Ltd.

Tony Clare: We were not involved in making any assessments whatever on Retail Acquisitions Ltd.

Q254 Richard Fuller: Thank you. Mr Greenstreet, you did know about it. What role did Nabarro take, specifically on the pensions?

Ian Greenstreet: It might be useful to explain what lawyers do. Lawyers typically do not get involved until you have heads of terms, because if you instruct too early, you can incur more costs. We became involved after the heads of terms had been agreed, and our role as pensions advisers—we were working alongside Linklaters, who were dealing with the main corporate aspects of the deal—was specifically to provide pensions advice. Typically, in a transaction of this sort, a pensions lawyer will negotiate the warranties with the buyer and prepares things like statements. There are no other pension schemes apart from these schemes. There is no litigation. We will be involved in a disclosure exercise, and we will also be involved in advising on pension law matters generally, in so far as they may impact on the transaction—the regulator’s powers, and things like that.

Q255 Richard Fuller: In terms of the future viability of the pension scheme, what was your assessment?

Ian Greenstreet: That would not be the role of the pension lawyer.

Q256 Richard Fuller: So that was not part of your responsibility?

Ian Greenstreet: No.

Q257 Richard Fuller: Maybe I could ask the two advisers at the BHS pension fund. When did you become aware, Ms King, of the sale to Retail Acquisitions Ltd?

Emma King: The trustees were first informed that a sale was a possibility, rather than an unpausing of Project Thor, in very late January or early February. Thereafter, the trustees and advisers asked a series of questions as to what that sale might look like, who the sale was going to be to, et cetera. We also assisted in providing some documentation on pensions as

part of the due diligence exercise. That documentation went to Arcadia, presumably to supply to the purchasers.

Q258 Richard Fuller: Specifically, when did Eversheds become aware of the sale to Retail Acquisitions Ltd?

Emma King: The trustees attended a meeting with Arcadia on 4 March. At the end of that meeting, I understand, one of the shareholders of the purchaser attended, and we were briefed, as a consequence of that meeting, by our client as to the identity of the shareholder.

Q259 Chair: These are incredibly important events, but people are rather vague about dates. You said that you first heard about it at the end of January or the beginning of February. Did a letter arrive, did a phone call come or did someone have a conversation with you, or what?

Emma King: On 2 February my trustee clients were asked to sign up to confidentiality agreements. Ahead of that, I think there had been press speculation that there might be a sale, which prompted questions on the part of my clients as to what was happening.

Q260 Chair: But you had no other information from the company, other than what you read in the press, until 2 February when you got something actually written down?

Emma King: It was a request that, before any further information would be provided, we sign up to confidentiality agreements.

Q261 Mr Wright: Very quickly, to Mr Clare—I should declare that I worked for Deloitte until 2003—when did your work with Project Thor come to an end?

Tony Clare: Our work on Project Thor came to an end—“paused” might be a better way to express it. We were invited to attend a meeting with our client and Retail Acquisitions Ltd on 18 February. The purpose of that meeting was to explain to Retail Acquisitions Ltd and their advisers, Olswang and Grant Thornton, how Project Thor—which is complicated, as we have covered—was constituted, how it would work, the level of engagement with the trustees and their advisers, and where we had got to. It was a question and answer session, and at that point we ceased to be involved. There was a pause on Project Thor. We were not advisers on that transaction—the only role we played was to pass information as to where we had got to on the pensions work pre-disposal. We effectively ceased to be engaged, probably for the best part of the year.

Q262 Chair: Did they give you a letter at some stage to say “Thank you, that’s it”?

Tony Clare: No, Mr Field. We never received that letter.

Q263 Mr Wright: Did you just pull off your engagement team at a certain time, and then you were paid up until that point?

Tony Clare: That is correct.

Q264 Mr Wright: And that was 18 February? Did I hear you correctly?

Tony Clare: We stopped providing pension services on 18 February because the business was sold shortly thereafter. We were re-engaged back in January 2016.

Q265 Richard Fuller: You are all advisers to the various parts of this company, a sale is about to be made of British Home Stores to a group whose lead has been identified as once, twice or three times bankrupt, there is no retail experience in the team and there are questions about its funding as it made the acquisition. In the interests of time, I just want a quick yes or no: did your firm formally express any concerns about the capability or competence of Retail Acquisitions as an acquirer? Yes or no? We will start with you, Miss King.

Emma King: No, because that was a question for others. From the trustee perspective, it is not for the trustees to judge who a potential purchaser of a sponsoring employer should be.

Richard Fuller: Mr Clarke?

David Clarke: In my capacity as financial adviser to the trustees, we submitted numerous questions on 25 February in respect of the potential purchaser, including what working capital facilities they would have, what security package would go in place, the deal timetable, and whether the buyer had started pensions due diligence and so understood what they were acquiring. We would have done that whoever the acquirer was, but we were aware that, from our perspective, the buyer was effectively what appeared to be a newly set-up acquisition newco that was set up specifically for the purposes and so had no trading history. There was no ability to look at past accounts, for instance, to see where it was coming from and we were particularly concerned as to its ability to continue to trade and fund both BHS, which was clearly loss making, and the schemes.

Q266 Richard Fuller: To be clear, you did express—your firm expressed—a series of questions about the potential viability of the acquiring company?

David Clarke: We did, which were submitted to the group and their advisers in writing, at least on 25 February.

Q267 Richard Fuller: Thank you. Mr Clare, from Deloitte's point of view, did your firm formally express any concerns about the competence and capabilities of the acquirer?

Tony Clare: We did not. We were not instructed to do any due diligence on Retail Acquisitions. At law we follow our contractual obligations and do not go beyond, so we did not do so.

Q268 Richard Fuller: Thank you. Mr Greenstreet?

Ian Greenstreet: I am a bit constrained in what I can say about advice, but I would comment generally that it is not the sort of thing that pension lawyers would normally advise on.

Q269 Richard Fuller: Okay. I will take that as a no—my interpretation. Mr Cousins, for PwC it is probably more of a question for your colleague at the audit level. I don't know if you wish to go and be briefed so you can answer the question yourself.

Richard Cousins: Only inasmuch as the only information that I ever passed to them around a potential sale, without knowing the details of the purchaser, is to ask questions over the moral hazard, but they were already looking into that. The instruction I got back when I asked the question, when I heard of it for the first time, was, "We are already in dialogue with the regulator."

Q270 Chair: Before I give Richard Graham the question, could I quickly ask all of you a question? At this key point of the negotiations, did any of you yell out, "What about the regulator?" Emma, did you at this stage think the regulator had a role here, please?

Emma King: Absolutely. As soon as the trustees were told that a sale was a possibility, we informed the regulator of that. Throughout these discussions that are being referred to, to try to find out as much information as we possibly could about the potential purchaser and about the sale, we involved the regulator.

Q271 Chair: Emma, can you remember the date you did that, please? I can come back to you if you're looking at notes.

Emma King: Yes. Can you come back to me?

Q272 Chair: I would love to. David?

David Clarke: The trustees gave an initial update to the regulator on 29 January 2015. They provided a fuller email update on 25 February, including some of the questions that had been posed. As Miss King has already noted, there was an all-party meeting, which neither of us was at, with the trustees and the buyer on 4 May—sorry, March, forgive me. The regulator was involved.

Q273 Chair: I will come back to you, if I may, David, on what the regulator did, because you sent two communications.

Tony, did you think the regulator was relevant here at all, or was it irrelevant to your frame of reference and your duties?

Tony Clare: Clearly, we have a duty to act in all the public interest and we discharge our work in accordance with all our professional guidance, objectivity, integrity and so on.

Q274 Chair: Did you tell the regulator what was going on?

Tony Clare: Yes, as I explained earlier, Mr Field, we were instructed by our client to notify the regulator on 6 February, and we sent an email to the regulator on that date confirming that the business would be put up for sale.

Q275 Chair: Great; and did you have any response?

Tony Clare: I could check the file, but I don't think we did until 3 March. I would have to check the file; I don't want to mislead you.

Q276 Chair: If you could. It is very important. Ian?

Ian Greenstreet: I am afraid I can't comment on specific advice we gave or didn't give in relation to the transaction.

Chair: Richard?

Richard Cousins: As I said a moment ago, when I heard about it at the meeting on the 25th when I was discussing Arcadia pension arrangements with them I raised the issue of "I've heard about a transaction—have you told the regulator?" and was told they had.

Q277 Chair: The date, again, Richard?

Richard Cousins: That was 25 February.

Q278 Chair: And which meeting was that, where you raised that?

Richard Cousins: It was an Arcadia pensions meeting with the team that looks after the Arcadia pension schemes, which I advise over.

Q279 Chair: Can I just ask Emma and David, what response did you get to your email or emails to the regulator, please; and when did you get them?

Emma King: The regulator wrote to the trustees by email on 12 February—quite a lengthy email setting out what—

Q280 Chair: Can you remind me? That was in response to what?

Emma King: That was in response to the trustee informing the regulator of—actually it was probably in response to the company notice on 6 February.

Q281 Chair: 6 February—and the regulator replied when, please?

Emma King: The regulator emailed the trustees on 12 February to remind the trustees of the duty to mitigate any financial detriment that might be caused in consequence of a transaction or sale such as this, and of its moral hazard powers.

Q282 Chair: And did they suggest a meeting with you—the regulator?

Emma King: I can't recall that they did suggest a meeting at that moment.

Q283 Chair: If not, you will correct the record for us, won't you?

Emma King: I will.

Q284 Chair: David, you sent your emails in; what was the response from the regulator, please?

David Clarke: As I mentioned—I am probably just repeating—on 25 February we submitted queries in respect of the sale and the potential acquirer to the group and their advisers. On the same day the chairman of the trustees wrote to the regulator explaining what questions had been asked and also pointing out that the potential purchaser, whom he had met with, was well aware of the pension obligations that were being taken on. The Pensions Regulator emailed back that same day requesting an urgent call or meeting, and a call was held the next day on 26 February.

Chair: Brilliant; thank you all very much.

Q285 Richard Graham: I want to lead us back, in a sense, to the beginning of some of your appointments. Can we start with you, Emma? You were appointed in 2009. Can you just confirm, first of all, who appointed you and who were there already as advisers or consultants to the pension scheme?

Emma King: Yes, Eversheds was appointed in 2009. Personally, I joined the team in January 2014, so forgive me if I am a little hazy on some of the detail, here. I can come back

to you and confirm in writing if it is important to you. The appointment was from the trustees of the pension scheme.

Q286 Richard Graham: Yes; were you aware that they had any other advisers at that time?

Emma King: The actuarial advisers throughout our appointment, I believe, have been Towers Watson—now Willis Towers Watson—on the actuarial side. I can't recall any other advisers other than Baker Tilly, who I referred to previously as specialist covenant advisers.

Q287 Richard Graham: So during that period 2009 to 2014 Eversheds were the legal advisers. Did you have any contracts working for Taveta, Taveta Investments, Arcadia, BHS or any of the other groups that had a—

Emma King: Not as far as I am aware, no.

Q288 Richard Graham: And who paid Eversheds's fees? Was it paid by the pension scheme or by the corporate?

Emma King: I will have to confirm to you, but it would be usual for it to be from the pension scheme, although in some circumstances the company does pick up the trustees' legal costs.

Q289 Richard Graham: Some of these questions may be difficult for you, given that you joined the team in 2014, but I would be very interested to know: when Eversheds were appointed in 2009 almost the first thing that your company would have had to do was advise on the 2009 triennial review. At that stage, when the triennial review was submitted, in June 2010 the Pensions Regulator opened a funding case to challenge the trustees on the recovery plan—whose length was 12.5 years at that time. In mid to late 2010: “the Pensions Regulator learned the trustees negotiation had secured improvements over the company's original recovery plan”. Do you know what those improvements were, and how they were arrived at?

Emma King: I'm afraid I cannot help you with that, not only because I was not on the team at the time, but because my understanding is that Eversheds was not actively involved in those discussions, which were led by the actuarial advisory team, the scheme actuary.

Q290 Richard Graham: But as the legal adviser, surely you would have played a role in giving advice?

Emma King: A legal adviser's role in relation to valuations changes from client to client. Some clients like legal advisers to be very involved; others do not. It seemed to be very much an actuarial-led discussion. We would set out the framework for the trustees—the regulatory framework within which they have to operate in terms of valuation—but then, in

terms of negotiating the detail of the funding to come in, that is much more dealt with by the scheme actuary, rather than the lawyers. It was not unusual that we were not closely involved.

Q291 Richard Graham: So the negotiation with the company was purely on the valuation, as far as you know.

Emma King: I wouldn't know.

Q292 Richard Graham: The Pensions Regulator decided to close the case in March 2011, with comments to the trustees about what to focus on for the next valuation—do you know what those comments were?

Emma King: I am afraid I don't.

Q293 Richard Graham: It would be useful, Chair, if Eversheds could come back to us with comments on that point.

In 2009, the deficit on the pension scheme had deteriorated from £61 million in 2006, but it was just the beginning of an escalation in the deficit. What was your understanding of the reasons for that?

Emma King: Again, this is more an actuarial than a legal question, but if you look at many—or all—defined benefit pension schemes in the UK, you will see that the deficit has been increasing. Some of that has been to do with yields, some to do with longevity—

Q294 Richard Graham: Indeed. But this one deteriorated at a pace unknown to most defined benefit schemes.

The actuarial adviser during this period was Towers Watson. Was it Watson Wyatt, as was, or was it Towers Perrin, as was?

Emma King: That I don't know.

Q295 Richard Graham: Again, Chair, it would be useful to know who the actuarial adviser was during this period, and for us to see them.

During that period, also, Emma, I think I am right in saying that the corporate was receiving advice from both PwC and Nabarro. Did your colleagues ever express to you some concern that the corporate was getting rather more advice than the pension scheme? What was your assessment of the competence of the trustees?

Emma King: The first part of your question I am afraid I am not really able to answer. You have cited another law firm, so the company had a law firm advising it, and the trustees had a City law firm advising them—there was that sort of parity. PwC were advising the

company, and I have mentioned the Baker Tilly advice, which would be employer covenant advice for the trustees. It would seem to me that there is parity there, in terms of the advisory piece.

On the second part of your question, about the competence of the trustees, I think it would be helpful for me to explain to the Committee the composition of the trustee board. There are three trustees, and at all times there have been two independent trustees, by which I mean—

Chair: Two of the three?

Emma King: Two of the three are independent—by which I mean, independent completely of the company. Then there is a third trustee, which is a corporate trustee, BHS Pension Trustees Ltd, and that is staffed with two member-nominated directors—individuals who are nominated by the membership to take up that role—and two employer, or company-nominated directors, but that corporate has one vote. So if—

Q296 Chair: Do they all turn up? Or can they all turn up, but have only have one vote?

Emma King: They can all turn up. The individuals who are in the BHS business can all turn up, but, ultimately, that corporate entity has one vote, so the two independents would always have the majority.

Q297 Richard Graham: Thank you. What was the relation between the pension scheme and the corporate? Of the two members you have just described—nominated by the corporate—was either of them, for example, the finance director?

Emma King: No, neither of them was the finance director. I think one of them did have a role within the finance function of the pension scheme. There will have been a change of individuals over the course of time. Would you like me to take you through the different stages of who, to my knowledge, was on the trustee board?

Q298 Richard Graham: No, but I think it would be useful to have that in writing, please.

Emma King: We could do that.

Q299 Richard Graham: The next major moment in the pension scheme, of course, was the next triennial review in 2012, which was significantly delayed. Why was that?

Emma King: My understanding is that it was delayed by three months after the deadline. There is a 15-month period within which the actuarial valuation has to be completed and all the documents have to be submitted to the Pensions Regulator. My

understanding is that that was submitted at 18 months, slightly over the deadline, but with the regulator having been informed that there would be a slight delay.

Q300 Richard Graham: What was your understanding of the key reasons why it was delayed? For example, what was the connection between that and the recovery plan, which suddenly had more than doubled from what it was at the previous triennial review?

Emma King: Before I answer that question, I should probably outline again that Eversheds was not involved in those discussions in that level of detail. My understanding, from having spoken to my clients, is that they were taking independent covenant advice, and that might have been a cause of some of the delay. There were also discussions going on with the company as to the length of the recovery period, what the company could affordably pay towards the pension scheme and, indeed, whether there was any possibility of any type of security that could be offered to the pension scheme.

Q301 Richard Graham: So what exactly was the legal advice that you were giving the trustees, especially during the period when you came in, in 2014, when the Pensions Regulator put a comprehensive request to the trustees for further information? That continued for quite a long time during 2014. A meeting was requested. However, due to trustee adviser availability, it could not be arranged until July. In June 2014, the trustees notified the Pensions Regulator of a company proposal for business reorganisation. What was your role and your advice during that period?

Emma King: Throughout that period, the trustees were conscious that there was an ongoing and open case with the regulator in relation to the valuation. We would provide advice to the trustees as to the regulatory landscape in that regard and supply the regulator with any information required. Moving into Project Thor, our role was to make sure that what was being proposed was going to be in the best interests of members taken as a whole.

Q302 Richard Graham: At what stage did you start advising them of the Pensions Regulator's ability to launch an anti-avoidance investigation?

Emma King: The trustees were given regular information from us in training sessions, as well as during the course of meetings, as to regulator powers. The trustee board at the time of Thor was composed of two professional independent trustees who were very well aware of the powers available to the regulator, and the whole Thor discussion was set against a very clear knowledge on the part of the trustees of the regulator toolkit.

Q303 Richard Graham: Deloitte earlier talked about having robust negotiations with the trustees. I am assuming that that is in 2014. How would you characterise those negotiations, and what was the negotiation?

Emma King: Our role in relation to Project Thor, with David and myself advising the trustees, was to play the sceptic—to challenge what was being put forward, to challenge the

financial propositions and to make sure that what was being proposed would actually work from a legal perspective and would give better value for members in the long run.

Q304 Richard Graham: David, as KPMG, were you providing actuarial advice or investment advice at this stage to the trustees?

David Clarke: No, I was providing advice to the trustees on the strength of the businesses that were currently supporting and would potentially in the future support the scheme. I was providing advice to the trustees about what they would recover in a hypothetical insolvency as a benchmark for the Thor proposal.

Q305 Richard Graham: Your company was previously auditors to BHS from 2001 to 2008. Is that correct?

David Clarke: I believe that is the case.

Q306 Richard Graham: And during that period, in every year that dividends were issued, they were significantly greater than the profits generated by the company. What do you think would have been the likely impact on the strength of the effective covenant with the pension scheme in that environment?

David Clarke: First, I am not an auditor; I have never been an auditor. I had no involvement with BHS at all prior to 2014, when I was appointed, so I cannot comment on the audit specifically. Companies are able to pay dividends from distributable reserves, if they have appropriate reserves and the board pass resolutions to decide to pay dividends.

Q307 Richard Graham: Let me put the question in a different way, then. The deficit had risen from £61 million to £274 million by 2011. What was your belief about the options available to the pension scheme and its members by the time you came in?

David Clarke: A fairly stark proposal had been put to the trustees. It said that if some form of restructuring of the BHS business could not be achieved, the group was suggesting that it would not be able to continue to provide support, as Mr Clare has outlined. The clear inference was that there would therefore be an insolvency, triggering the scheme's entering the PPF. Project Thor was an initial proposal to try to deliver a higher level of benefits for members. One of the main drivers of that calculation is what the scheme would recover in a hypothetical insolvency. You have to pay more, so our aim was to try to get to the bottom of that and make sure we got the best deal for members within the Project Thor proposal package.

Q308 Richard Graham: A number of people have used the phrase, "We wanted to try to get a better deal for the pensioners and members of the scheme." Is the definition of "a

better deal” one that says, “The PPF would be able to provide 90% of the benefits. Therefore, if we can provide 91%, we’ve got a better deal to offer”? Is that what it boils down to?

David Clarke: That would be an interpretation. As I said—apologies if I am repeating myself—one of the main drivers of the funding that would be offered through Project Thor was this estimated outcome analysis. If by looking at it in an evidenced way we could demonstrate that we believe that the schemes would receive materially more than the group was suggesting, you wouldn’t be at 91%; you might get 100% or 102% of PPF benefits. Clearly, the higher that number, the better the return for members.

Q309 Richard Graham: And what was your estimate on the recovery plan and its credibility?

David Clarke: In terms of the recovery plan agreed on the back of the 2012 evaluation?

Q310 Richard Graham: Yes.

David Clarke: We have never formally reviewed that. I understand that it resulted in the payment of £10 million a year for 22.8 years. Throughout the time we were appointed, those payments had been made. Certainly during 2014, they were paid by virtue of support from the Arcadia group.

Q311 Richard Graham: So how complicated was your advice? If the PPF was going to pay out 90% and you could demonstrate that there was a corporate offer that was going to pay a little—or possibly quite a lot—more, you were going to say that that was a better deal.

David Clarke: Our aim and the purpose of our advice was to work out exactly what the schemes would get. If that number were higher, the proposal that the group would have to make to the schemes would also have to rise. One of the Pensions Regulators’—and, indeed, the PPF’s—hurdles in respect of these types of transactions is that the offer of support to the scheme must be materially more than the schemes would recover in insolvency.

Q312 Richard Graham: Yes. So you were part of these robust negotiations, were you?

David Clarke: I was.

Q313 Richard Graham: And what does “robust” mean? Did the corporate effectively say to you, “Well, look, we can do you a slightly better deal. Take it or leave it”?

David Clarke: That’s not how we conduct ourselves. Deloitte were instructed to prepare a baseline estimated outcome. We asked for details of that and the assumptions on the first day we were appointed. It is fair to say that we disagreed with it. We felt that the scheme

would recover materially more. There were also areas where there was insufficient detail to enable us to conclude. We responded to the group and Deloitte with an extensive information request list explaining that we really need to get to the bottom of this. This was an absolutely fundamental proposal whereby, without wanting to sound emotive, 22,000 members of the pension scheme who were, in the main, fairly low paid with low levels of benefits were being asked to accept a reduction in their benefits again. It was something that we took extremely seriously, and the aim was to make it absolutely clear that whatever was being tabled was robust, with evidence, and gave the best possible outcome to members, in those circumstances.

Q314 Richard Graham: What did you achieve for the members by taking that stance?

David Clarke: The offer range from the group was increased as we went through those discussions. Piece by piece, various pieces of evidence—

Q315 Richard Graham: What did it increase from and to?

David Clarke: Well, the estimated outcome analysis was built on a number of assumptions, so you had individual pieces that would deliver certain value. As we went through the process, the group accepted that certain assumptions they had made in the first instance were perhaps inappropriate, and that element of the offer was increased—for instance, the value of the properties.

Q316 Richard Graham: On the value of the properties, are you aware that the Ealing store was apparently sold to Sir Philip Green's stepson for £7 million very shortly before the sale of BHS, and subsequently sold by him for £10 million very shortly afterwards?

David Clarke: There were a number of property transactions that became clear around the sale and, indeed, after the sale, to fund the business. We were consistently asking for details of those property transactions in terms of which entities had held the properties, who they were sold to, how much they were sold for and what their value was. From day one, or from very early after our engagement, we were requesting from the group professional and independent valuations of the property portfolio so that any disposals could be benchmarked against a professional agent's view.

Q317 Chair: Did you get answers?

David Clarke: During 2014, the group provided its analysis of property values, with which we engaged, but we consistently requested independent, third-party professional valuations, and they were obtained in early 2016.

Chair: Could we have copies?

Q318 Richard Graham: What was your underlying concern behind this? Was it that effectively asset-stripping was going on, which would then weaken the corporate and therefore weaken the value of the recovery plan, and that the 22,000 pensioners you have alluded to would, effectively, be stuffed that way?

David Clarke: Our initial concern was “Was an insolvency of BHS inevitable?”, which is one of the hurdles that the regulator and the PPF guidance sets out. If that wasn’t the case, there would be no need to compromise the scheme of benefits—you could continue to meet them.

Q319 Richard Graham: What was your advice to the trustees? Did you think it was inevitable?

David Clarke: The proposition put to us was that without continued group support, BHS would not be viable on a stand-alone basis. Based on the losses in recent years—both profit and loss account losses but also cash outflows, both historic and forecast—I was satisfied that, based on the information we had been provided, BHS was not viable without continued group support.

Q320 Richard Graham: Without continued group support. In your estimate and from what you knew of the finances of the group, could that support have been provided?

David Clarke: That is a matter for the Arcadia and Taveta group. What was clear from the years running up to our appointment was that BHS had been loss-making and that at that point in time the group had been willing to provide support. As for whether its circumstances had changed to an extent that it was no longer able to provide that support beyond 2014, I am afraid I have to direct you towards the directors of Taveta.

Q321 Richard Graham: Earlier, when I asked you whether you were aware that the dividends going out were greater than the profits, you said that you weren’t an auditor and that that was something for the corporate to decide on, but what you just said suggests that, actually, on behalf of the members of the pension scheme, you did not have complete confidence in the governance of the corporate.

David Clarke: If I may clarify, that is not what I said. I said that BHS had been loss-making for a number of years in the run-up to our appointment, and that the financial forecasts showed that it would continue to be loss-making and to absorb cash for a number of years, even if a turnaround plan could be successfully enacted. That meant that there were grave concerns about the ability of that business to continue to support the schemes.

Q322 Richard Graham: How would you feel if you were a member of that pension scheme?

David Clarke: As we sit here today, BHS is in administration, and the schemes are in a PPF assessment period. If the schemes end up in a PPF assessment period, members’

benefits will be reduced, and I am very cognisant that a lot of those members simply will not be able to afford reduced benefits. That said, the regulatory regime we have enables the regulator to judge or review and consider behaviour retrospectively. My understanding is that the Pensions Regulator has a live investigation open and running. Until that investigation is concluded and restitution, if any, is put in place, it is not quite clear where the schemes will end up and whether members will be at PPF level of benefits.

Q323 Richard Graham: What more could the trustees have done at the moment when it was decided to sell BHS to a completely unknown entity with an arguably disreputable background?

David Clarke: I am not going to comment on the background of the individuals, if that's okay with you. In terms of the trustee actions, I think there is a fundamental point that may be helpful for me to explain. Trustees have no power of veto over corporate activity. They are not able to stop a transaction; they are not able to dictate to a corporate who it can or cannot sell assets or a business to. Certain pension schemes have various powers, such as a unilateral winding-up power where they could call in all the debt, triggering a fairly cataclysmic event. Had that been done, it would just have triggered BHS's insolvency earlier. This scheme and these trustees do not have that power.

Q324 Mr Wright: Do you think they should have that power?

David Clarke: Had they had that power and exercised it, BHS would have entered administration in 2014 rather than 2016, so it wouldn't have solved the issue. I am very clear—

Q325 Chair: How we look to the future is a crucial part of the next stage of our inquiry. Did any of you Google Mr Chappell to see anything about him?

David Clarke: When we were told of the buy-out, which at that point in time was listed as by Swiss Rock, we did use internet searches to try to establish something about Swiss Rock. We were also given the names of four or five individuals who would be involved in Swiss Rock, which we searched. We also searched Companies House—

Q326 Chair: Could you give us a list of those individuals, David?

David Clarke: I cannot recall all of them, but—

Q327 Chair: No, but could you submit it in writing?

David Clarke: Absolutely. If I may answer your question and finish my answer to the previous question, because the acquisition vehicles were new companies set up for the purpose of the acquisition, there was very little history on them. I also suggest to you that if

you had carried out an internet search in respect of Mr Chappell in early 2015, you would have got a very different set of results than if you carried out an internet search in respect of Mr Chappell today.

Regardless, I am very confident that the trustees and their adviser team did everything they could within the regulatory framework to ask questions of the seller and buyer to try to understand the situation. They also made very clear to both the seller and the buyer the scale of the pension obligations and the fact that we had sat through the previous year with Project Thor on the table demonstrating that BHS was unable to support its scheme, and it was made very clear that we did not consider a sale to any party would solve those problems.

Q328 Richard Graham: May I turn now to Deloitte running this? Can you confirm to us that you were providing pensions advice to BHS, Arcadia or Taveta, or all three of them? From when to when?

Tony Clare: We have never provided pensions advice to BHS Ltd. We have provided pensions advice to Taveta Investments Ltd since January 2014, and we have provided pensions advice to Arcadia Ltd since—I think I will need to come back and confirm this in writing, but I think it was agreed in February or March 2016.

Q329 Richard Graham: Thank you. And did your company have any other contracts with Taveta Investments, BHS or Arcadia, apart from pensions advice? Were you auditing anything, or consulting on anything?

Tony Clare: We provide a range of professional services. Certainly, we provided some restructuring advice on the options on insolvency to Taveta in respect of BHS, and I am sure that over the years we will have provided other professional services to those entities going back, but I will have to go and check to confirm exactly what services we have provided.

Q330 Richard Graham: And the chairman of both the Taveta companies was Lord Grabiner during that period when you were appointed.

Tony Clare: I believe that is correct, yes.

Q331 Richard Graham: Weren't you the man providing that advice?

Tony Clare: To the directors overall, yes; not exclusively to the chairman.

Q332 Richard Graham: Yes, and what was your remit?

Tony Clare: We were instructed to review the pension arrangements of BHS Ltd.

Q333 Richard Graham: For the benefit of the shareholders of Taveta.

Tony Clare: On behalf of the shareholders of Taveta. Our instructions were: can we find a reconstruction of these pension schemes that will have the consent of the trustees so that we can provide a better outcome for the members than the alternative of going into the Pension Protection Fund, and to protect the Pension Protection Fund.

Q334 Richard Graham: To what extent is the Pension Protection Fund's effective remit to provide 90% of the agreed accrued benefits to members a nice cop-out for corporates who want to walk away from pension scheme obligations?

Tony Clare: I don't think it's a nice cop-out for anybody to receive 90% of their pension expectation. From the instructions we were given, it was evident that the shareholders of BHS Ltd—the owners of BHS Ltd—clearly wanted to provide a better outcome than that of going into the Pension Protection Fund. They were seeking to solve the issue and it was going to be costly. They knew it was going to be costly, and they were still willing to pursue an option to try and deliver a better outcome for those members.

Richard Graham: So those—

Q335 Chair: May I just ask about the moral hazard? If I am boss and my pension scheme has only £100 million in it, but needs £300 million in it to prevent it going to the PPF, and if I only provide £200 million, it might still go into the PPF. It has cost my company a huge amount of money, but the pensioners, bless them, would still only get 90%.

Tony Clare: That would be correct.

Q336 Chair: So the real question, which I thought was behind Richard's point, is that there is a moral hazard here, isn't there? Unless you are prepared as the employer to be very generous, you cannot make your workforce substantially better off than they would be if they were in the PPF and there was a deficit that you were going to walk away from.

Tony Clare: You can put the members in a better position than the alternative of going into the Pension Protection Fund. That is a principle we agreed in writing with the trustees early on.

Q337 Chair: Was that with no cuts?

Tony Clare: No, let us be clear. We were looking at the underpin that the members would always receive compensation from the PPF in the event of insolvency, and we wanted to offer a proposition that was better value than the alternative of the compensation. That was to cover every scenario; not just simply the straightforward 90%, but what does one receive on early retirement or late retirement?

Q338 Chair: On the generality, Tony, if they go into the scheme, those who have not yet drawn their pension will suffer 10% cuts.

Tony Clare: That over-simplifies what I think they would receive, but yes, it is one of the benefit cuts that would apply.

Q339 Chair: But you were discussing with the owners a scheme that would prevent the PPF cuts.

Tony Clare: It would not prevent them entirely. It would be a scheme that would provide somewhere between the PPF level of benefit and their full-scale expectation somewhere in between.

Chair: Brilliant. Thank you.

Q340 Richard Graham: So what exactly was the offer that you came up with?

Tony Clare: For those members who have the smaller entitlement—less than £18,000—there is a specific rule from Her Majesty's Revenue and Customs that allows that to be discharged as a cash lump sum. That rule is quite specific in terms of converting this type of pension into a capital lump sum based on factors determined by the scheme. Those conversion factors are not determined by the employer. The factors already exist, so the trustees, quite rightly, have a series of factors for reducing benefits for early retirement, and they have another series of factors to convert a pension into a tax-free lump sum. Those factors already exist. We asked the trustees about applying their scheme factors to all these members, extrapolating below the age of 55, because they normally apply only from 55 or when you retire. If you extrapolate them down to the youngest member, what are the cash lump sums that we would offer for these members in lieu? Whatever those numbers were, they were not controlled by the company; these were based on trustee schemes. Under normal operating procedures, those were the moneys we would offer to those people on the lower benefits, on a voluntary basis.

Q341 Richard Graham: Is that the £80 million offer post-sale that has been mooted?

Tony Clare: No, the two are not related.

Q342 Richard Graham: So what have you offered in total?

Tony Clare: Sorry. What have we offered to whom?

Richard Graham: To the pension scheme.

Tony Clare: To the pension scheme, my client offered at the time of Project Thor, back in July 2014, that we would go through the execution of Project Thor and my client

would underwrite the costs, which were estimated at between £50 million and £80 million. It was not certain what those costs would be, but they were underwritten by my client. That would be in addition to the inter-company loan that would also be written off by my client.

Q343 Richard Graham: Right. So the overall reduction of the pension scheme deficit would have been from what to what?

Tony Clare: The funding deficit at the time was of the order of £250 million. After the settlement of the wind-up lump sums, on the assumption that most members would prefer a capital lump sum than waiting, sometimes many years, for a relatively small pension, and the payment of the final sum from Taveta Investments Ltd, the scheme would be fully funded on the assumption that the investment return required going forward would be the return on long-dated Government stock—20-year, fixed-interest stock—plus a half per cent per annum: a very modest investment assumption. Based on that, if the trustees could invest their money—we set out an investment strategy that we were confident would deliver that level of return—they would not need any further contributions from BHS Ltd.

We also put in a loading in respect of future costs of expenses in our calculations. So, all the expenses of actually running the pension scheme for the foreseeable future would also be pre-funded as part of that final payment. Even so, BHS as a reconstituted company, having gone through its restructuring, written off the company debts and renegotiated the rental agreements, would still stand behind the pension scheme, should it need any further cash at some point in the future.

Q344 Richard Graham: Did you feel that BHS under its new ownership was ever likely to be able to stand behind anything at all?

Tony Clare: This was well before any party approached my client to purchase BHS. This was envisaged on a restructuring on a consensual basis for the creditors.

Q345 Richard Graham: Yes, but the validity of having BHS stand behind something assumes that BHS has something to stand behind it.

Tony Clare: Had BHS been restructured in accordance with Project Thor, there were, if you recall, Mr Graham, three legs to it. One is that pensions cost is reduced, with a substantial one-off payment for the shareholders. The second element is that the inter-company position is written off, and the third element is that the costs of operating BHS were substantially reduced by reducing the rental bill from the landlords. All that package together would have made BHS a viable, ongoing, profitable retailer.

Q346 Richard Graham: To what extent did the various property transactions that have been alluded to by KPMG and others in the media actually rather undermine the substance of all that, and mean that BHS was unlikely to have what it did have in terms of strength of balance sheet?

Tony Clare: I am not aware of those transactions, so I cannot comment on what impact they would have had on Project Thor. I think they occurred after Project Thor was put on the table.

Q347 Richard Graham: Do you feel that your advice and the package that you just referred to were being slightly undermined by other events going on?

Tony Clare: No, I don't believe that was the case, Mr Graham.

Q348 Richard Graham: Do you believe that the package that you presumably discussed with KPMG and Eversheds at the pension scheme was done in good conscience?

Tony Clare: I would go beyond that; I would say that it was done in absolute good faith. It was recognised that BHS was loss making, and had been for several years, and it was costing cash from Arcadia to support it. If it continued indefinitely, ultimately you could bleed cash from Arcadia to BHS and, ultimately, end up with all the house of cards coming down. Therefore, something had to be done.

Q349 Richard Graham: Yes, but that is what happens in an asset-stripping environment. Invariably the members of the pension scheme, I am afraid, do not come top of the priorities. You were employed to defend the interests of the shareholders, which is totally understandable.

Can we move to Nabarro? Mr Greenstreet, what was your role in terms of the pensions advice during the years you were advising Taveta, which I think was 2009 to 2015?

Ian Greenstreet: I can talk only in very general terms. We were the pension advisers to various entities in the Taveta group for the period from the date Taveta Investments (No. 2) acquired the BHS group. Remember that the BHS was not owned by Taveta before 2009. We gave a wide variety of advice to different entities during that period.

Q350 Richard Graham: You overlapped with Deloitte by a year, didn't you?

Ian Greenstreet: I am not sure when—

Richard Graham: It was appointed in 2014 and you carried on to 2015. Is that right?

Ian Greenstreet: I am not sure.

Tony Clare: January 2014.

Q351 Richard Graham: Did you work together on these issues?

Ian Greenstreet: Basically, if you are providing pensions advice—if I can talk in general terms—

Richard Graham: I am asking you specifically about—this is what we are here to discuss—the pension scheme.

Ian Greenstreet: You would always work with a pension lawyer. You work alongside the financial analysts.

Q352 Richard Graham: You overlapped with Deloitte as advisers to Taveta on the BHS pension scheme. Am I correct?

Ian Greenstreet: Yes, that is correct.

Q353 Richard Graham: So what sort of discussions did you have about the restructuring of the pension scheme? What was your role in that? What advice did you give?

Ian Greenstreet: I cannot actually provide details of any legal advice I did or did not give. I can give—

Q354 Richard Graham: Why not?

Ian Greenstreet: For the reasons we have discussed—that would be legally privileged and Taveta, as my former client, has not waived legal privilege.

Q355 Richard Graham: Why do you think that is?

Ian Greenstreet: Legal privilege belongs to the client and it is their prerogative to assert legal privilege. It is not for me to—

Q356 Richard Graham: Right. Thank you.

Richard Cousins, PwC was advising Taveta from 2009 to 2013 on the pension scheme. Is that correct?

Richard Cousins: On the BHS pension scheme, that is correct.

Q357 Richard Graham: So you were working alongside Nabarro during that period.

Richard Cousins: Only, if I remember rightly, when it actually came in. At the point at which BHS came into the Taveta group—

Richard Graham: Which is 2009. So was wasn't that when you started?

Richard Cousins: Correct. But with the other assignments we did from then on, we did not have any relationship with Deloitte.

Q358 Richard Graham: So what advice were you giving to Taveta?

Richard Cousins: Throughout the whole period?

Richard Graham: Throughout 2009 to 2013. That is when the first triennial review went in. There was the first recovery period that was mooted of a half period, and then the second one happened in 2012—the recovery period was doubled. The pension scheme was clearly in a mess. What was your advice to the owners?

Richard Cousins: First, we gave advice when it came in, on the implications of bringing a company into the group and the moral hazards, and then we gave advice over the 2009 evaluation, and that was in terms of what the assumptions were. We had discussions with the actuaries in the usual way—

Q359 Richard Graham: Why was it all going so badly wrong? As an actuary, you must have looked at this pension scheme and thought, “Okay, many DB pension funds have got problems. Their deficits are growing,” but this one grew from £61 million to £274 million in a period of five years. The deficit rose four and a half times. I have not got a precise league table, but I suspect that that is pretty well at the top of the underperformers. What was going wrong?

Richard Cousins: When we looked at it in 2009—when it first came in—the agreed deficit from the 2009 valuation was £160 million. My understanding was that the previous valuation in 2006 had a deficit of £10 million. There were a number of reasons for that, but the two main reasons were the lower yields—as discussed earlier—and there was, actually, in 2009, a strengthening of the basis. So with a number of the elements the actuary wanted to strengthen the basis. We had various meetings with the actuary and it was agreed that the deficit basis would be strengthened.

Q360 Richard Graham: So you had meetings with Towers Perrin, or Watson—

Richard Cousins: It was Towers Watson. It has been the same actuary all the way through the whole period.

Q361 Richard Graham: Okay. Did you feel that they were giving good advice to the trustees?

Richard Cousins: Yes, I had no reason to doubt the advice they were giving.

Q362 Richard Graham: So the investment performance of the assets was fine.

Richard Cousins: I am not sure where that comes in.

Richard Graham: They were probably advising on the strategy and the asset allocation, weren't they?

Richard Cousins: We were not advising on the investment strategy. We have never advised on the investment strategy. A third party advised the company.

Q363 Richard Graham: You were not giving any advice to Taveta on how the pension scheme was performing or what the strategy there was like?

Richard Cousins: Not in terms of the asset strategy. Towers Watson gave advice to the trustees on the actuarial matters—the valuation—and the investment strategy.

Q364 Richard Graham: But what did you think of it?

Richard Cousins: The investment strategy they put in place at the time was pretty similar to most schemes. Back in 2006 to 2009, they had 60% in equity and 40% in bonds. Their profile was something like the same: 60% non-pensioners and 40% pensioners. Although, as you look back—

Q365 Richard Graham: So it was an old-fashioned balanced portfolio with no absolute returns.

Richard Cousins: That is correct, yes.

Q366 Richard Graham: And Taveta was quite happy with that, was it? It didn't ask you any questions about what could be done to improve it?

Richard Cousins: As I understand it, when the 2012 valuation was completed, there was going to be a discussion on the investment strategy, but that was not an area that I was involved with in the 2009 valuation.

Q367 Richard Graham: Why did your appointment come to an end in 2013?

Richard Cousins: Our engagement letter allows us to do a number of things as pensions consultants. In fact, every time there is an area of advice they want, we agree a scope and a fee. The last assignment that we were asked to give a scope and a fee for, in relation to BHS, was the 2012 valuation. That was the last piece of work. It was signed off in September, although I think the last thing we really did on it was in February 2013.

Q368 Richard Graham: But, effectively, around the time you came off it, Deloitte came on.

Richard Cousins: Correct, yes.

Q369 Richard Graham: Why was that, do you think?

Richard Cousins: Well, the agreement of the 2012 valuation clearly highlighted major concern over the level of contributions going in. It was agreed that there would be a number of discussions following the valuation around liability management and the investment piece. We just were not asked to do that.

Q370 Richard Graham: How would you characterise the approach of the Taveta board to the pension scheme? What was its major concern? Was it to look after the interests of the scheme members, or to find an exit strategy that would reduce its responsibilities?

Richard Cousins: At the time, from 2009 onwards, I was not left with the impression that they were doing anything other than looking after members. One of the main reasons for bringing BHS in in the first place in 2009 was, as I understand it, that the refinancing of the debt of BHS in 2009 was causing concern. They brought it into the group for that reason, as opposed to any alternative.

Q371 Richard Graham: So during the only period that you were there, you had fairly regular meetings with the scheme's trustees and their advisers, did you?

Richard Cousins: We only had meetings with the advisers around the valuations. In the early days we did have discussions with the trustees because, in 2011-12, a large, enhanced, transvalue exercise was carried out on the schemes. That requires quite a lot of contact with the trustees, as well as the company.

Q372 Richard Graham: Did the scheme's trustees approach you or Taveta at any stage to suggest that a further injection of capital into the pension scheme would help to reduce the deficit and give members of the scheme more certainty about their pensions? Was that ever mooted by the scheme's trustees?

Richard Cousins: I will answer in a different way, if that is all right. When we were looking at the 2012 valuation, it was very clear that the £230 million deficit would need more than £10 million per annum over the 22 years to meet it. Within the schedule, the allowance was that if the group returned to profit, the schedule would be relooked at.

Q373 Richard Graham: And do you think that was a genuine offer, or do you think that there was never any particular intention to return the corporate to profit anyway, and it was more a case of selling down properties owned and withdrawing the money that way?

Richard Cousins: At the time, I have to say that it was a genuine offer.

Q374 Chair: Richard, might I bring this to a close?

One last question: were you pleased that you did not have your contract extended? From Richard's questions, you clearly had worries, didn't you?

Richard Cousins: Yes. When we were completing the 2012 valuation exercise, we would have liked to have helped the company to try to work through the problems. So, I suppose we were not pleased not to be providing further advice.

Q375 Chair: Do you think it was pleased not to have you?

Richard Cousins: Oh, I cannot answer that.

Q376 Mr Wright: Mr Clarke, my questions are directed at you. I appreciate that you are not an auditor and that this happened before your time, but I want to put these on record. If you can provide us with a written response, I would be grateful. Why did KPMG stop being an auditor to BHS?

David Clarke: I'm afraid I don't know.

Q377 Mr Wright: Going back to Richard Graham's point on the distribution of dividends in 2002 to 2004, as a firm during the audit process, were concerns about these dividend policies ever flagged up?

David Clarke: I'm afraid that I cannot answer that.

Q378 Mr Wright: But you can provide us with possible evidence.

In your experience of corporate life, is the distribution of funds that exceed profits and are not funded through free cash flow, but largely by extra borrowing, a common practice? Is that financially prudent?

David Clarke: I cannot speak about the situation of BHS in the early 2000s specifically. From my wider experience, I have seen such dividend policies before, but I have not seen them frequently.

Q379 Mr Wright: That suggests that it is somewhat unusual.

David Clarke: My personal experience would dictate that it is unusual, but not unheard of.

Q380 Mr Wright: Mr Clare, as a partner in a big four firm, may I ask you the same question? In your experience of corporate life, would this sort of policy be unusual?

Tony Clare: It would be unusual for a company to have significant assets that were illiquid that it could not use to pay out a dividend, and therefore, so as to pay a dividend and to get liquidity, it would borrow money secured against those assets to pay out to shareholders. There are very clear rules that would control the maximum dividends that can be paid. A company has to have distributable reserves.

Q381 Mr Wright: Mr Cousins, may I ask you the same question? As a partner in a big four firm, would this be an unusual practice? Would it be classed as financially prudent?

Richard Cousins: Can you repeat the question?

Mr Wright: In terms of dividend policies, if you extract cash from the business and the actual amount that you take out exceeds the profits for that year and, in order to fund it, you borrow—it is not out of free cash flow—is that a common practice? Is that a prudent practice?

Richard Cousins: It is not an area of experience for me; apologies.

Mr Wright: You have never experienced it.

Richard Cousins: It is not an area of my experience.

Q382 Mr Wright: Okay. Mr Clarke, may I come back to you? There was a sale and leaseback arrangement made in December 2001. I understand that you were not privy to this, but I would appreciate any information that KMPG has on it. The nature of the transaction was that there was a sale and leaseback of properties from BHS to Carmen Properties Ltd for £105.9 million. The profits on disposal of the assets by BHS Group that year were shown as £64.5 million. Carmen Properties Ltd is a related party of the BHS Group—it is owned by the Green family. Is that an unusual practice? You are selling something to yourself. You are unleashing a profit, and there is actually a leaseback arrangement—a rental agreement—for around £12 million a year, where you can extract that still further. Is that financially prudent?

David Clarke: I am afraid you are correct; I cannot give you any details about the particular arrangement in 2001, which I am not privy to. In terms of sale and leaseback arrangements, they are often used by large retail property groups to release value from their property portfolios. For instance, a number of the supermarkets have engaged in similar transactions over the years.

Q383 Mr Wright: Would they be sold to related parties in general?

David Clarke: I am aware of situations where that has happened. I am also aware of many situations where they have been sold to unconnected parties.

Q384 Mr Wright: I am just trying to get a sense of how common this is, in your experience. As a partner in a big four firm, you will have substantial experience. How common is this?

David Clarke: I do not personally have extensive experience of sale and leaseback arrangements. I am a restructuring person by trade. I assess employer covenants. Of the number of sale and leaseback arrangements I have seen, I would say that in my experience the majority have been conducted with third parties, rather than connected parties.

Q385 Steve McCabe: Mr Clare, I want to ask a final question about Project Thor. It sounds, as you describe it, as if it was quite a good plan with decent intentions and ambitions. When you started on the project, did you factor in a likely time to complete it? At any stage in your work and planning, did you consider or discuss with the company that it was likely to get cold feet and decide to call for a pause while it evaluated its Christmas sales?

Tony Clare: To the first part of your question, the answer is that we did put together quite a detailed timeline. We set out a project plan for engagement with all the key stakeholders, including the trustees and their advisers, reaching agreement on the key principles, and going through with the project and going to the Pensions Regulator for clearance—all that was set out in quite a detailed timeline. On the second part of your question—did we ever discuss with our client whether they would get cold feet at some point during the process—no, we did not.

Q386 Steve McCabe: I am just trying to understand whether, once you embarked on this piece of work, you were surprised when they suddenly came back to you and said, “You’ve done all this work, but actually we’re calling a halt at this stage while we investigate what happens during the Christmas period”? Is that something you would have expected to happen?

Tony Clare: I would say that I neither expected it nor otherwise. It was a statement from our client that they wanted to focus on Christmas trading, and they were a retailer. It struck me as quite a natural decision for them to take at that point in the process. They were concerned to see whether BHS could turn around its trading performance and whether it could be turned round to make the company profitable.

Chair: We are really grateful to you. Obviously we want to look carefully at the transcript. Although some of you promised us information, we may ask for other pieces. We will look carefully at your evidence during our hearing. Jeremy, did you want to ask for sets of information?

Q387 Jeremy Quin: David, in response to Frank’s question, you said that you asked a whole series of questions when you heard about the sale in relation to the ability of the new acquirers of the business to carry on funding the pension scheme. They sounded very pertinent and very prophetic—sadly, as it turns out. Did you get an answer?

David Clarke: The official response, which was provided through the group's advisers on, from memory, 25 February 2014, confirmed that the buyer would have working capital facilities of £120 million available to it and that they would be secured on the assets of the business.

Jeremy Quin: May we see a copy of that, please? Thank you.

Chair: Thank you—for now, anyway—for your help. It has been very much appreciated.

Examination of Witnesses

Witnesses: **Owen Clay**, Partner, Linklaters, **Steve Denison**, Partner, PwC, and **Anthony Gutman**, Co-Head, EMEA Investment Banking Services, Goldman Sachs, gave evidence.

Mr Wright was called to the Chair.

Q388 Chair: We will start the session with the second panel. May I ask you to introduce yourselves, for the purposes of the record, and to tell us the company you work for? We will start with you, Mr Clay.

Owen Clay: My name is Owen Clay. I am a corporate partner at Linklaters, legal advisers to Arcadia.

Steve Denison: I am Steve Denison. I am a partner at PricewaterhouseCoopers. Since 2008, I have been the auditor to Taveta and its subsidiaries, and in 2009 I assumed the same role for BHS, when it came into the Taveta group, until the point at which it was sold.

Anthony Gutman: Anthony Gutman from Goldman Sachs.

Q389 Chair: Thank you for being so patient with us. This is a question to you all, but I will start with Mr Clay. What, and to whom, was the nature of your advice regarding the sale of BHS?

Owen Clay: Our advice was given to Arcadia, and its parent company is Taveta. Our mandate was to prepare and negotiate the legal documentation to give effect to the agreed deal. There were—I think you have seen a copy of our engagement letter—a number of carve-outs to the scope of our advice that we were to give during the course of the transaction. The most notable of those exceptions was advice in relation to pensions, and obviously you had Mr Greenstreet from Nabarro, who were advising Arcadia in relation to pensions.

Steve Denison: We had no role in relation to the sale. Our role was as auditors to BHS, the company, although during the sale process we did respond to queries from the purchaser's advisers in the context of their due diligence into BHS.

Anthony Gutman: We were neither engaged nor paid as an adviser by the Arcadia group. We were asked to provide informal assistance by the Arcadia group as it related to the initial proposals received for BHS, and in particular as it related to funding and intentions.

Q390 Chair: Thank you. Mr Clay and Mr Gutman, we may come back to you and probe you further. Mr Denison, why did you sign off BHS's accounts as a going concern?

Steve Denison: I guess there were two considerations in relation to going concern. One was that, at the time the accounts were signed, no deal had been done, so in the event that a deal did not happen, then financial support would continue to be available from the Taveta group, as it had been in previous years. There is written confirmation of that from the parent company. In the event that a deal did happen, that financial support would fall away, so the factors that were brought to bear at that time were: to what extent would such a deal bring additional cash, assets and resources to BHS to allow it to continue to trade in the future?

Q391 Chair: What tests did you undertake as part of the process to satisfy yourself that it was a going concern?

Steve Denison: Just to explain, "going concern" is the ability of a company to trade for the foreseeable future, which is at least 12 months beyond the balance sheet day. It is the responsibility of the directors to form an assessment as to whether a business is a going concern or not and then for the auditors to assess that statement and decide whether it is reasonable or not. As I said, the factors that were at play in relation to any prospective deal were: what cash, assets and benefit would be brought to BHS to allow it to continue to trade in the future from any such deal?

Q392 Chair: When you are planning an audit, does having a complex group structure increase the risk?

Steve Denison: Potentially it does.

Q393 Chair: Do intra-group transactions also increase the risk?

Steve Denison: Not necessarily, because you can see both sides of those transactions. Obviously if you are the group auditor, you can see one company paying another or one company receiving from another.

Q394 Chair: Was the BHS audit—and, as an extension of that, Arcadia and Taveta—seen as a higher than average risk?

Steve Denison: No.

Q395 Chair: Why not?

Steve Denison: It is a largely UK retail business. Retailing itself is a relatively straightforward activity—it is buying and selling—and the group structure, although there are lots of entities in that structure, is not particularly complex.

Q396 Chair: Did the management charge—£252 million over five years; about 7% of turnover every year—seem excessive to you? That seems very excessive. Did you do tests on that? Did you question management and directors on that?

Steve Denison: We did do work on the management charges. Can I just explain the context of that management charge? You will recall that prior to coming into the Taveta group, BHS was a stand-alone entity, with all of the functions that you need to carry on a business as a large multiple retailer. One of the reasons for bringing BHS into the Taveta group was to achieve cost savings, and from the point at which BHS came into the group, a significant number of functions that had previously been carried on by BHS as a stand-alone entity, and paid for by BHS, were henceforth paid for by Arcadia in the first instance and then recharged to BHS. The sorts of things I am talking about are transport and logistics, HR, IT, finance. If you look at the accounts of BHS prior to it coming into the Taveta group, those costs appear separately in BHS's own profit and loss account. Subsequent to coming into the group, those costs were initially paid for by Arcadia and then recharged to BHS. In fact, across the whole of the Taveta group, those charges are incurred by Arcadia and then recharged to all the different businesses—BHS and the various Taveta brands. Importantly, 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.

Q397 Chair: The 7% of turnover for management charges seems very excessive.

Steve Denison: It depends what you mean by “management charge.” Those management charges represent payment for services that BHS needed: logistics, transport and moving goods around the country, the HR function, the IT function, et cetera. They were services that BHS was simply buying from Arcadia. Arcadia was paying for them in the first instance.

Q398 Richard Fuller: Just to quickly follow up on your point, Mr Denison, why did you not issue an emphasis of matter?

Steve Denison: An emphasis of matter is required where the going concern concept applies but where a material uncertainty exists. I guess that would be relevant in the event that there was a deal and the Taveta support fell away. So the factors that were relevant here. As I said before, if a deal was going to happen, what would it bring to BHS? I think there were three factors here to bear in mind. Firstly, the existing management team of BHS had been trying to turn the business around and had been having some success in both driving out cost and reducing the cash requirement to fund BHS as a trading entity. It is important to remember that the accounting losses shown in the profit and loss account of BHS were

significantly greater than the cash losses that it was incurring. In other words, the cash requirement that BHS had was lower than the losses shown in the profit and loss account.

In terms of the prospective deal, as I understood it and as I saw it develop over the weeks immediately prior to the accounts being finalised, there was both a package of extra cash and assets to be provided by the vendor and new cash to be provided by the purchaser. If you compared those two, additional cash and assets, with the cash requirements of the group, as shown by the plans and normal budgets—you heard earlier about the recovery plan prepared by management—there was no material uncertainty and therefore no need for an emphasis of matter.

Q399 Richard Fuller: Just for clarification, on the issue of emphasis of matter, your consideration was made on the expectation that a deal was imminent, or potentially imminent—it was six days later?

Steve Denison: Yes.

Q400 Richard Fuller: And your decision and analysis encompassed both BHS remaining as part of the Arcadia Group or being sold to Retail Acquisitions Ltd?

Steve Denison: Correct.

Q401 Richard Fuller: Did you do any assessment, other than on the financial issues, of the capabilities of the new management and leadership at Retail Acquisitions Ltd in coming to your conclusions?

Steve Denison: I think it is important to have a distinction between the management of BHS and the shareholders, because prior to any deal, under Taveta, there was an existing stand-alone management team at BHS that was running the business on behalf of its then shareholders. My understanding was that that management team would remain very substantially unchanged in the event that a deal happened. In other words, the team that had been running the business and trying to turn it around would still be doing that same role going forward.

Q402 Richard Fuller: So your concerns were mainly on a management level?

Steve Denison: Yes.

Q403 Richard Fuller: In the PwC scope of audit—I am interested in an overall assessment, not just from PwC but from others—schedule 1 states: “We will conduct our audit in accordance with international standards on auditing, issued by the Auditing Practices Board, and ethical requirements.” Are you satisfied in your work in signing off the accounts,

and in your assessment of the new acquirer, that you have met that last piece—ethical requirements—given what has subsequently happened?

Steve Denison: I am, yes, in terms of the ethical standards that apply to an audit. Absolutely.

Q404 Richard Fuller: Okay. Can I turn to Mr Clay? Again, on the individuals, there was an interesting comment on “Newsnight” on 13 May: Linklaters said that “Olswang”—the legal firm advising the acquirers—“confirmed that Olswang had carried out detailed due diligence on their client Mr Chappell and that it had not raised any concerns in relation to impropriety.” As someone who was legally advising the sale of one of our major companies, were you satisfied with that analysis?

Owen Clay: I was asked to confirm that statement. I am happy with it, yes.

Q405 Richard Fuller: So from the point of view of Linklaters, which was selling that major firm, the analysis of another legal firm, in terms of the capability of the people, is fine enough by Linklaters.

Owen Clay: Perhaps I can set some context about our role. We were effectively deal counsel. The way it works with deal counsel is that once someone has been chosen as someone to do a deal with, you are brought on by your client to get it done. That’s our job. We obviously have “know your own customer”—it is called customer due diligence—in relation to our own customers, so we are responsible for making sure we know who our client is. We obviously knew Philip Green, so that was fine.

We also have legal responsibilities in relation to the Proceeds of Crime Act 2002 and the Money Laundering Regulations 2007. Broadly, those regulations and that law require us to stay alert in relation to the transactions we are conducting to make sure there is no money laundering. There is no single legal definition of “money laundering”. In layman’s terms, it means hiding illicit money. There was no sense of that there. We are also required to stay alert to terrorist financing, and there was no question of terrorist financing here. It is not our responsibility, our duty or, indeed, our practice to do customer due diligence on other people’s customers.

Q406 Richard Fuller: You’ve given a very clear delineation of the things that you are responsible for. Let’s say that I want to buy British Home Stores and I’m a complete idiot. From your point of view, your responsibility to the vendor doesn’t require you to assess my capability of running it beyond what you’ve already mentioned. Is that correct?

Owen Clay: Businessmen do not employ deal lawyers to vet the business acumen of their counterparties.

Q407 Richard Fuller: So why did you ask Olswang to assess whether Mr Chappelle had any sense of impropriety?

Owen Clay: In the contract that we negotiated with the buyer, there were three important covenants to the seller. I will just go through them, if I may. The first one was that the buyer would retain the cash dowry in the business at completion for the sole purpose of the day-to-day running of the business. The second covenant was that they would retain in the business the proceeds of the sale of any properties for the sole purpose of the day-to-day running of the business, until such time as there was a compromise on the pension scheme. The third one was that they would take no steps that would be reasonably expected to adversely affect the BHS's ability to continue as a going concern. Those are strong covenants, but clearly the reliance that a seller can place on them depends upon the person giving them and their probity. The purpose of my conversation with my opposite number at Olswang was to establish what customer due diligence they had done on their customer and whether it had given rise to any concerns in relation to impropriety.

Q408 Richard Fuller: Looking back at what subsequently happened and what we all now know about the acquirers, are you satisfied that we have the balance right, in terms of the requirements on directors and advisers, on this issue of the competence of the people who acquire businesses?

Owen Clay: In the conversation I had, I learned that Olswang had carried out a very detailed and thorough due diligence process on their customer, that nothing in what they had done had given rise to any concerns in relation to impropriety, that their client had been open throughout and that if they had had any sense that there might have been any impropriety there, it is not something they would have been anywhere near. None of that was a great surprise to me, because they are a very respectable firm.

Richard Fuller: Thank you very much for that clarification. Chair, I am aware that the Chair of the Work and Pensions Committee wants to ask a question.

Q409 Frank Field: Owen, we have got people like Sir Philip Green and Lord Grabiner—very busy people who paid professionals to do work for them. If two pukka legal firms checked up on the abilities and proper nature of the person they were selling to, and it turns out that this person was twice or three times bankrupt, where do you think it puts the firms that told those key people in this whole arrangement that this was a good person to sell to?

Owen Clay: I have tried to explain what the role of a deal lawyer is in this context.

Q410 Frank Field: Don't you feel any responsibility? There were people paying you, presumably, very good fees, there were two lots of firms involved and neither of the firms discovered the most obvious thing about this person.

Owen Clay: I can only speak for myself, obviously. I have explained that our duty in relation to those matters that I have described does not extend to inquiries about other people's customers. I have also explained that in this particular case, given the particular

terms of the contract, we did something that was, in my experience, unusual by asking another firm of solicitors what customer due diligence they had done. I was assured that they had done very detailed due diligence on that person.

Q411 Frank Field: Do you think it would be fair for other companies that might be looking at selling all or part of their holdings not to use either of your two firms in this due diligence process, given that you failed so sadly on it?

Owen Clay: That would be a matter you would need to ask them.

Q412 Frank Field: What would your advice be?

Owen Clay: I never advise myself.

Q413 Frank Field: You are replying to me.

Owen Clay: Again, clients choose lawyers, so it would be down to you.

Q414 Richard Fuller: If I could bring in Mr Gutman from Goldman Sachs, you said regarding initial proposals on funding that Goldman Sachs was providing informal advice. “Informal advice” is an interesting phrase. What does it mean?

Anthony Gutman: At the initial stages of this transaction in October, we were asked whether we wanted to be engaged as an adviser. We declined for commercial reasons.

Q415 Chair: Why was that?

Anthony Gutman: That was largely related to the size of the deal. It was prior to our knowledge of the identity of the buyer. It is ordinary course for us to largely not be involved in deals of this scale, so we turned it down for those reasons.

Q416 Chair: It just wasn’t worth your while? It was too small?

Anthony Gutman: We do not traditionally advise clients with deals of this scale.

Q417 Richard Fuller: I just want to clarify: is that because it was too small or too big?

Anthony Gutman: It was too small.

Q418 Chair: But you do some work for free?

Anthony Gutman: Again, it is perfectly normal for us to provide informal assistance to long-standing clients of the firm, consistent with the relationship that we have with those long-standing clients.

Q419 Richard Fuller: You provide advice; “informal advice” means you don’t get paid for it. Can I ask broadly, is that the key difference between formal and informal advice? There is no structured engagement letter or fees attached.

Anthony Gutman: No, I would say that what we did here and what we do quite regularly is that if a client is considering their options, we will provide informal assistance. If we intend to provide advice, then we will be signed up to an engagement letter. Under the terms of those letters and under the scope of that duty, we will carry out the duties associated with that. We will conduct full due diligence on the buyer and seller, do valuation work, do financial analysis and assess funding arrangements. In this scenario, as I said, we did not do that. We chose not to do that. We were clear with Arcadia Group that we were not doing that, nor did they ask us to do that. Our role was therefore limited to providing preliminary observations on the proposals received, nothing more.

Q420 Richard Fuller: So they asked your judgment on things.

Anthony Gutman: They asked us to provide our observations on the proposals received from Retail Acquisitions Ltd; they did not ask us to make judgments or provide recommendations, and nor could we in the light of the very limited access we had and the nature of our role.

Q421 Frank Field: What was the informal advice, Anthony? If you couldn’t really give any gutsy advice about what they should do, what does informal advice mean?

Anthony Gutman: I would characterise it as observations on the proposals received. When we initially had sight of the proposals received, we went back to Arcadia Group and we gave them some observations on those proposals. We indicated to them that clearly the potential buyer did not have retail experience. We indicated that the proposal was highly preliminary and lacking in detail. We also indicated that the bidder had a history of bankruptcy.

Q422 Frank Field: You told them informally what the lawyers could not find—that he was a bankrupt.

Anthony Gutman: We were notified of that by RiverRock, who were advising at that time.

Q423 Chair: Forgive me, I'm going to bring Richard back in, but when was that and how was that advice, informal or otherwise, provided? Was it through verbal communication? In a letter? How did you give it to your client?

Anthony Gutman: Again, Chairman, to be clear, we did not provide advice, we provided observations. Those observations related to the nature of the proposal, and all we did was convey them. The initial proposal was received in early December—I can provide you with exact details.

Q424 Frank Field: Was that by telephone call to Sir Philip or Lord Grabiner? Did you give them a note?

Anthony Gutman: No, we received their proposal in early December—in fact, Arcadia Group received the proposal. We subsequently attended a meeting with RiverRock, which was at that time an adviser to Retail Acquisitions Ltd—or Swiss Rock, as it was then called. At that meeting, they tabled a written proposal and we then conveyed the observations I gave at that meeting to Paul Budge and to Arcadia Group.

Q425 Frank Field: So for no cost at all you told Sir Philip and/or Lord Grabiner, whereas other people charged and could not tell them that information.

Anthony Gutman: We did not have conversations with either Sir Philip or Lord Grabiner; our conversations following that meeting were with Paul Budge, at his request. The identity of the bidder as a bankrupt was made known to us by the adviser.

Q426 Chair: And that was done verbally, as opposed to in any written observation.

Anthony Gutman: Correct.

Q427 Chair: At a meeting in December 2014.

Anthony Gutman: Yes.

Q428 Richard Fuller: December: Mr Budge was driving the process of the potential sale of British Home Stores. That transaction was eventually completed in March 2015. Three months ahead of the date of the sale, you, as an informal provider of observations, said that the potential acquirers had no retail experience, a highly preliminary business plan—I think that's what you said—and that they were led by a bankrupt. Those were the core observations you provided.

Anthony Gutman: Yes, although, if I may, I should make a few corrections to that. At the point in time that that initial proposal was received, of course neither we nor anyone had any idea as to the point in time at which a deal might close. The proposal was, of course, therefore highly preliminary, but that would not be unusual for any bid at this potential stage

in a process as we subsequently understood it. So yes, it was preliminary, and yes, it was lacking in detail, but I wouldn't characterise that as unusual relative to the timeframe as we subsequently understood it. There were clearly risks attached to the proposal, given the other factors you have referenced.

Q429 Richard Fuller: If you looked at other deals where you had been providing that formal advice and you came to a similar series of early observations that this potential acquirer has no experience in your field or the field of the company they are going to buy; that they have a very patchy history in terms of personal bankruptcies and they haven't really worked out what they are going to do; and you were asked for your advice and recommendations, just on those factors—what sort of advice and recommendations might you give? Proceed, not proceed, proceed with great caution—run for your life?

Anthony Gutman: Again, in this scenario we did not have access to information or give directions.

Q430 Richard Fuller: I am talking about in general; you are a very experienced banker, aren't you?

Anthony Gutman: In general, as I mentioned, when proposals are received at a very early stage in a transaction it is not unusual for them to be as preliminary as this one was; and therefore we would say that it is preliminary; it is lacking in detail; there are risks attached to the proposal but there could be a basis for proceeding.

Q431 Richard Fuller: So let me understand; in a formal situation where Goldman Sachs, one of the premier advisers in the world on M and A transactions, is presented to its client with a potential purchaser who is at an early stage of building their business plan, who has got absolutely no experience in the industry that they are going to take over, and has a history of being bankrupt not once but twice or three times, your advice is, "Hey, these are risks; let's just carry on"?

Anthony Gutman: In every situation it is different. We would identify the risks attached, but—

Q432 Richard Fuller: But you wouldn't say there are substantial problems selling a major business to someone who has no experience of that industry and who has a history of personal bankruptcy. Goldman Sachs's name means a lot, so I think it is important for you to explain; in a similar situation would you not be waving the red flag? *[Interruption.]* Not your one, Chair. Would you not be waving a red flag to say "This is a walking disaster; don't touch it. Goldman Sachs says don't go there"?

Anthony Gutman: In a situation at an early stage in a transaction with many months to follow before the deal could hypothetically close, we would identify the risks and say "These risks need to be assessed and considered in the round."

Q433 Chair: Mr Gutman, do you mind me asking, what is the nature of your relationship in terms of the client basis with Philip Green? Is it on a monthly retainer call-off contract? Is it a sort of deal-by-deal transaction? Would he phone you up and say “We’re putting the band back together; I’m going to try and buy Marks and Spencer’s—third time lucky. Are you in with me?” What is the nature of the relationship with Philip Green?

Anthony Gutman: Yes, sure. As with the vast majority of our client relationships we do not have retained relationships where we are paid on a retained basis. This is no different to that. On a case-by-case basis a client will call us and ask us to provide advice, and we will make a decision based on those circumstances at the time.

Q434 Frank Field: Before Richard comes in; Anthony, I read that Sir Philip does lots of his business by the phone. How many times were you in contact with him over this deal?

Anthony Gutman: The vast majority of my interactions and those of my team were with Paul Budge. I’d say throughout the course of a five-month process there may have been one or two phone calls with Sir Philip. None of them related to the detail of this transaction, and he was not involved in any of the meetings that we attended.

Q435 Richard Graham: Just very briefly, Mr Gutman, if I might; you are co-head of UK investment banking.

Anthony Gutman: Yes, that’s correct.

Q436 Richard Graham: And you were personally involved in this.

Anthony Gutman: Yes, that’s correct.

Q437 Richard Graham: And so on the press release, or on the email correspondence with the Committee, it described the purpose of your involvement as “to get an informal perspective on whether the consortium’s proposal warranted further consideration”. Did it?

Anthony Gutman: We provided a view that there were risks attached to the proposal.

Q438 Richard Graham: You said that; I understand that. The advice—you have spelt it out in your email: did it warrant further consideration? The answers, presumably, would fundamentally boil down to yes, no or maybe.

Anthony Gutman: We felt that subject to the limited information we had that at that preliminary stage it was something that they could have progressed—Arcadia Group—if they wished to.

Q439 Richard Graham: So it was a maybe.

Anthony Gutman: We weren't asked to provide a recommendation, if I may. We were simply asked to provide our observations on it, and then—

Q440 Richard Graham: “The purpose was to get an informal perspective on whether the consortium's proposal warranted further consideration”. It sounds like a maybe. Is that a correct analysis?

Anthony Gutman: I would say to you that we outlined the risks attached to the proposal, and other factors related to it, and we then—

Q441 Richard Graham: But you didn't rule it out.

Anthony Gutman: We did not rule it out, no.

Q442 Richard Graham: What would be your own interpretation of the lawyers' analysis that they had carried out detailed due diligence and hadn't raised any concerns? Would you be surprised at that sort of analysis?

Q443 Frank Field: Before we go on, Anthony, we talked about the considerable amount of informal advice over a five-month period. Might you at some stage give us an audit—a log—of each of those occasions on which you were informally in touch with Mr Budge, Lord Grabiner or Sir Philip?

Anthony Gutman: Yes sure. I will go back and check with Brian Hewitt.

Q444 Amanda Solloway: We have heard about other third parties being interested in making a purchase and ultimately Retail Acquisitions was the preferred buyer. I am intrigued about what, given its lack of experience and the fact that it was paying £1, made it the preferred buyer? *[Interruption.]* No answer. Anybody?

Q445 Chair: Anybody?

Steve Denison: I have no knowledge from my conversations and information during the period of the deal as to why that was the case.

Q446 Craig Mackinlay: I will probably leave Mr Gutman out of this one. Given the informal advice, which seemed to be out there, that this character who was involved with the potential company had no retail experience and no background, and did not seem to have any

financial backing, with your professional experience as accountants and lawyers, do you think that was a sensible decision to have taken forward? Can you see how Olswang came to its conclusion that due diligence was appropriately ticked off and that this was a robust deal considering everything in the round, the requirement to look after pensioners, and all that was involved?

Owen Clay: I want to make it very clear that my conversation with Olswang was limited to the propriety of the buyer. It was nothing to do with his business acumen. One way that business acumen is assessed—talking generically—is through the business plan and whether the parties collectively believe there is a business plan or turnaround plan that is viable. That is the first point.

The second point is that it wasn't the case and it would be wrong to leave you with the impression that somehow this business was being handed over to someone without retail experience and no one else. In many ways it was characterised as a management buy-out, so many of the existing retail team of BHS—the management people who actually ran the business—were going with the business. It wasn't a case of going off with some guy who knew nothing about retail. That is an important distinction.

Q447 Craig Mackinlay: That team had managed to accumulate losses over six years. That doesn't seem like a very good place to start.

Owen Clay: The business was clearly facing challenges, obviously—

Q448 Chair: That's a good understatement.

Owen Clay: Lots of businesses face challenges from time to time—markets change and so on—but these people were good people. One thing I can show you from the contract is that there was an obligation on the buyer to put in place new management incentivisation arrangements with the management team to keep them.

Q449 Craig Mackinlay: Mr Denison, you knew this business well. Could you see anything new is what was being proposed that gave you confidence that there would be a bright future?

Steve Denison: Picking up on Owen's point, there was a business plan in place. The existing management team had been driving that business plan. The cash requirements for the business were lower than the losses and had been coming down, and were projected to continue coming down. There was an action plan—a turnaround plan—in place in an attempt to do that. What the envisaged deal brought was, as I said, significant additional cash into the BHS business through a number of different routes and further assets into BHS which weren't there before and would provide both cash cost savings going forward and a potential upside opportunity to realise further cash. There was a credible plan in place from the management team that had been running the business before and would be running it going forward, and there were extra cash and assets coming into BHS in the event of a deal to help to fund the business going forward.

Q450 Craig Mackinlay: In your view, having audited the old entity for all those years and the accumulating pension problems and the deficit accumulating—it is not just a normal business any more, but one that has to do well plus to finance and get out of the hole that the pension fund was getting into—did you perceive that the plan was so good that it could plug all those holes and get the pension fund out of the difficulties it had got itself into over a number of years?

Steve Denison: The plan, in terms of contributions, was the one that was set back in 2012, which was £10 million a year. Part of the additional cash that was coming with the deal was that for the first three years after any deal there would be £5 million of pension contributions directly from Taveta, as had been the case prior to that. That cash was obviously envisaged to be there.

The agreement of that recovery plan—that long recovery plan and the £10 million a year—was the responsibility, as we have heard, of the trustees, the management team and shareholders to agree, using the regulator as appropriate. All I can say is that once that had been agreed and £10 million was set as the contribution level, that is what was paid into the pension scheme, in accordance with that plan.

Q451 Craig Mackinlay: Mr Gutman, I know you gave initial—I do not know how you described it—not advice, but observations. Were those sort of things on the table in these casual meetings when you gave observations—about this extra money going into the pension fund, about the team going over, about new money being available? Or what emerged? Was it distinctively different from what you initially commented upon those months before?

Anthony Gutman: The first thing I would say is we are not aware of what emerged, because we weren't involved subsequently. What was initially provided in the proposals was very light on detail. There were no financials, there was no business plan and there were no indications as to cash flows and how this would be funded. It was simply a proposal to buy the business, with some very broad parameters related to it.

Q452 Chair: And that didn't develop? It didn't evolve over that five-month process that you were involved in?

Anthony Gutman: We were not involved in any of those developments. We were involved in a subsequent proposal, following the initial proposal in early December, that came in at the end of January. That proposal, again, was broadly the same as the proposal received in early December. In between, we had no involvements with the bidder. Those were being carried out directly between Arcadia Group and the bidder.

Q453 Craig Mackinlay: In terms of the time that you did spend with them, how many hours do you think you personally pored over what was on the table from Arcadia Group and discussions with Sir Philip? I am just trying to get when does an observation become advice, really? Is this commonplace to say, “Yeah, we've dealt with you before”? I

can't see it's unusual that you're asked for some initial observations. When do they become a little bit more formal? How much would you be willing to invest of your time and your team's time on what might just run into the sand regularly?

Anthony Gutman: Well, it would be commonplace for a client to ask for some perspectives. It would also be commonplace for a client to ask for those perspectives in the context of the client determining that they were actually going to manage an execution—execute the transaction in-house, i.e. using their own resources, as indeed they did here. And it would be common for us to be clear, therefore, as to the limits of what we would do, and that was the case here.

As to the exact hours, I can come back to you with that information, but we attended three meetings and that was the sum of it. And there was a small, single-digit number of phone calls. So a very small amount of time.

Q454 Craig Mackinlay: What was your assessment of the management team—the existing one—that was looking after BHS? I ask that because we heard earlier on from discussions that were more in-depth about the pension that they seemed to be incapable of doing two things at once. There were discussions about the Thor plan, to try and get the pension back on track, but that process seemed to be suspended because they were very concerned about or getting active into what fashions and articles they were going to be selling in their shops later on that year. Do you think they were capable of doing these things in parallel? Just adding into the mix a potential sale, I'm wondering about their ability to do three things at once.

Anthony Gutman: Again, given our limited role, we never met BHS management. I have never met the BHS management team. I had no engagement or interaction because of the position we took on this, so I cannot give you a comment on it.

Q455 Craig Mackinlay: Mr Denison, you would have had to do assessments of management structure and how good they are at managing risk, at looking forward and at putting business plans together. We heard earlier that it seemed very difficult to do two things at once. Is that a fair assessment of the state of management at the Arcadia Group and BHS?

Steve Denison: In terms of what I saw, it was not so much doing two things at once; it was two different groups doing separate things. You had the BHS management team running BHS on a day-to-day basis—taking decisions in consultation with Taveta and, no doubt, members of that management team, but running the business on a day-to-day basis in terms of strategy around what to buy, what price to sell at and all of those normal things in a trading business. Those individuals in that management team, as far I was aware, were not involved at all in the negotiations in terms of the pension scheme.

Q456 Richard Fuller: Mr Gutman, did you have any discussions or observations about Paul Sutton?

Anthony Gutman: No. We had no engagement with Paul Sutton and no involvement. We were not aware of Paul Sutton. There was one reference at one stage to Dominic Chappell being associated with Paul Sutton.

Q457 Richard Fuller: But prior to giving observations about Retail Acquisitions, there was nothing to do with Paul Sutton?

Anthony Gutman: No.

Q458 Jeremy Quin: Steve, there is the £40 million that was offered to go into the BHS pension scheme after the sale. Was that something you had any involvement in at all?

Steve Denison: No.

Q459 Jeremy Quin: This is a curious thing, in some ways. It is good that an offer was made subsequent to the event, but that is not something on which you advised.

Steve Denison: No.

Q460 Jeremy Quin: More generally—others may have comments on this—there must be many transactions on which you advised in which the pension scheme is a concern. Do you have concerns about moral hazard and the role that the pension scheme plays in people's deliberations? In what stage of a typical transaction do people get involved in the pension scheme? Do directors focus on that as having a significant impact on value, as part of the transaction?

Steve Denison: Not in terms of the role as an auditor, which was the role we were fulfilling in relation to this transaction. We were not advising on the sale in any capacity at all.

Q461 Jeremy Quin: I should say, Chairman, that I have known Mr Gutman in my past life. Anthony, looking at pension schemes in general and not this one in particular, what role do you think they play in the transactions you have seen and the way clients look at them? Do you think there is an issue with moral hazard that needs to be confronted, regarding the PPF?

Anthony Gutman: I would say generally, on both the buyer side and the seller side, that clients tend to be very focused on pension liability as part of their overall assessment of a transaction. Much more than that, it would be very difficult for me to give you a view on.

Q462 Jeremy Quin: But there is a focus and an appreciation—they have all had specialist advisers.

Anthony Gutman: Absolutely.

Q463 Jeremy Quin: Our concern is that the PPF is there. It fulfils a valuable role, but no one wants to see a situation where it is an incentive for bad things to happen and provides moral hazard. Have you seen examples, in your experience, where that concern has been flagged?

Anthony Gutman: No, I have not.

Q464 Steve McCabe: Mr Denison, you talked about two different teams, with one team concerned with the day-to-day retail and running the BHS stores and another team engaged in the Project Thor exercise. Who took the decision to pull the plug on Project Thor or to pause it because they needed to take account of the Christmas sales? Do you know which team or which person or persons would have called that? I am trying to figure out how that decision got taken if there were two different teams.

Steve Denison: I am afraid I have no knowledge at all.

Q465 Steve McCabe: Who would know that?

Steve Denison: I would think that Taveta management would know.

Q466 Michelle Thomson: Picking up on a question that Richard asked about Paul Sutton, Mr Gutman, you said you heard him informally mentioned. In what context was that, in relation to the deal? Who was that? What were the circumstances?

Anthony Gutman: The only awareness we had was that at one stage early on we were notified that there had been an association between Paul Sutton and Dominic Chappell.

Q467 Michelle Thomson: Who notified you of that? Was that part of your informal observations? Did you feed that in or was that given to you? What were the circumstances around that?

Anthony Gutman: We were notified by RiverRock at the time. They advised us that there had been an historic association there. Subsequent to that, we were told that that association no longer existed. That was the limit of what we were told about Paul Sutton.

Q468 Michelle Thomson: Did you then relay that as part of your informal observations?

Anthony Gutman: I think that communication was made direct to Arcadia Group as well as to us.

Q469 Chair: A final question from me for Mr Clay. On the phone call that you had with Olswang on 10 March 2015, was that the only interaction that you had? You said a number of times in front of the Committee that you were confident that Olswang had done very detailed due diligence. Did you ask for any copies or correspondence to confirm the telephone call, or was that the single point of contact?

Owen Clay: That was the single call I had with my opposite number in relation to that particular issue. It was clear they carried out very detailed due diligence on someone who was a new client.

Q470 Chair: How do you take that conclusion from the phone call? How can you say, “Yeah, they carried out very detailed due diligence.”?

Owen Clay: Because they told me the process they had gone through with him. They said they had had statutory declarations from him. He had been very open. They had given him a grilling. They had done some digging. It was a very detailed explanation of the process they had gone through. I had no reason to doubt it, and I still have no reason to doubt what he said to me.

Q471 Frank Field: They were wrong, though, weren't they?

Owen Clay: Hindsight, of course, is a wonderful thing. At the time, they had clearly been given a lot of information. They had done a lot of work and they came away with the impression he had been very open. They clearly had no sense at any time that there was any bad faith or dishonesty or anything like that that would have concerned them.

Chair: Amanda, do you want to come in on the final part?

Q472 Amanda Milling: Let me get this clear. Mr Gutman, you provide informal advice. You say, “We have got some reservations: retail experience, history of bankruptcy and the level of detail.” At any point, Mr Clay, did anyone say to you, “We have got these concerns. Can you look into this in more detail?”? Does your client ever have that conversation and go, “You are getting this advice, but we are getting these noises.”?

Owen Clay: You can see I have been helpful with what I have given. I have been as open as I can. In terms of discussions with my client and the advice I have given my client, that is something I am not able to disclose for reasons of privilege. If I may, there was a question earlier about privilege. Privilege is a fundamental legal right, long established in the common law and long established by the European convention on human rights. Given all the other investigations that are going on at the moment, it is completely appropriate that our client should exercise that legal right that he has.

Q473 Chair: But your concern was as a deal lawyer; you just wanted to get this through as quickly as possible.

Owen Clay: Why do you say that?

Q474 Chair: Because that is what you have told us.

Owen Clay: I haven't said that at all.

Q475 Chair: Well, I'll look back over the transcript, but you want to get this transaction through with the minimum of fuss and as rapidly as possible. That doesn't seem unreasonable.

Owen Clay: I didn't say that at all. I never said anything that could give any impression that that was my intention. If I did, I apologise, because I did not mean to.

Chair: Well, I apologise, too, if I have misunderstood you. Gentlemen, thank you very much for your time. It has been very helpful.

Examination of Witnesses

Witnesses: **Ian Grabiner**, Chief Executive Officer, Arcadia, **Lord Grabiner**, Board member, Taveta Investments Ltd, **Paul Budge**, Finance Director, Arcadia Group, Director Taveta Investments Ltd, **Gillian Hague**, Director, Arcadia Group and Taveta Investments (No. 2) Ltd, and **Chris Harris**, Group Property Director, Arcadia Group, gave evidence.

Q476 Chair: I welcome you to the Committee and also apologise for keeping you. You have been extraordinarily patient. For the record, I ask the panel to introduce themselves and tell us what role they played in the sale of BHS. Let's start with you, Lord Grabiner.

Lord Grabiner: I am Tony Grabiner. I am the non-exec chairman of Taveta Investments Ltd and Taveta Investments (No.2) Ltd. I have provided the Committees with a written statement that I am sure accurately summarises my involvement in the exercise.

Ian Grabiner: My name is Ian Grabiner and I am the chief executive officer of Arcadia Group. I run the day-to-day business of the Arcadia Group and all the brands within it. We have eight brands.

Paul Budge: I am Paul Budge, group finance director, also the Arcadia finance director. I was on the BHS board as well.

Gillian Hague: My name is Gillian Hague. I am the group financial controller at Arcadia and I was part of the team that was carrying out the work with Grant Thornton and such people during the sale.

Chris Harris: My name is Chris Harris. I am the Arcadia Group property director. I was also responsible for BHS and our ownership.

Q477 Chair: May I ask you all who was responsible for the sale of BHS?

Lord Grabiner: The sale was obviously by the vendor, which was TIL (No.2), because that was the immediate holding company—so that board, effectively.

Q478 Chair: Anything else to add, in terms of that statement? The Companies Act 2006 states that directors need to exercise independent judgment. Lord Grabiner, how did you demonstrate that independent judgment with BHS?

Lord Grabiner: We appointed a sub-group of the board of executive officers of the board. Apart from Ian sitting immediately next to me, the other three persons in front of you, along with Sir Philip Green, represented that sub-group. We appointed that sub-group to look at the question of the possible disposal of BHS, and they discharged that exercise throughout, which is the real reason why my own knowledge of the various events, as described in my statement, is rather limited.

Q479 Chair: But you can't abdicate responsibility, can you?

Lord Grabiner: No, I wouldn't dream of doing that.

Q480 Chair: You may have delegated to a sub-group, but you needed to be kept informed of what was going on, in terms of what could be a major divestment of a business.

Lord Grabiner: Yes. I am not trying to get rid of any obligations that I may have had. Obviously, the sub-group was full of the relevant expertise. It had pensions expertise; it had real estate or property expertise; and it had detailed financial information about BHS. I had never been a director of BHS at any time. It was entirely appropriate that that group of persons should be responsible for that exercise. At the end of the day, it was necessary for the deal to be done, if it was going to be done, by TIL (No.2) as the vendor. That is perfectly true. In relation to that, I believe that the responsibilities were properly discharged.

Q481 Chair: How did you keep yourself up to date with developments regarding the sale?

Lord Grabiner: I can take you through the timeline very briefly. We as a board were told near the end of January 2015 that there had been some expressions of interest from third parties in the purchase of BHS.

Q482 Chair: But you weren't told who they were.

Lord Grabiner: No. At no stage was I told who they were.

Q483 Chair: And you did not see fit to ask?

Lord Grabiner: No. There is certainly no point asking at a time when there are preliminary negotiations, which may result in nothing at all, as happened five or six times, I think—I acquired this information subsequently—but I don't believe that any of those came to a serious fruition stage, for whatever reason. I think Mr Budge will be in a position to tell you something about those matters.

On 4 March 2015, which was shortly prior to the deal being done on 11 March, the board of AGL—as it then was, namely Arcadia Group Ltd—resolved that it would no longer provide any more cash for BHS, unless it was secured. The report to the board essentially was, “We're losing a huge amount of money here”—we had lost a huge amount of money over the six-year period since 2009, when BHS had been acquired under the Arcadia umbrella. On 10 March, there was a night-time board meeting to which I was not invited, but it was quorate—

Q484 Chair: The board of which company?

Lord Grabiner: TIL—the top board.

Q485 Chair: And you were not invited?

Lord Grabiner: No, I was not invited, and I saw no papers, but it was a quorate board. The quorate board consisted of the people in the executive team, as I have described, so it was entirely appropriate that those people should be making that judgment—

Q486 Chair: Forgive me, Lord Grabiner, but there is a complex structure here, and I am getting confused. In terms of the board of TIL, who is chair of that company?

Lord Grabiner: I am.

Q487 Chair: And you were not invited to that board meeting?

Lord Grabiner: That is quite right.

Q488 Chair: Do you feel aggrieved by that?

Lord Grabiner: No, because—

Chair: I am Chair of the Select Committee on Business, Innovation and Skills. If there was a meeting of the Committee and I was not invited, I would be really angry.

Lord Grabiner: The point is that we had appointed this sub-group to investigate the possibility of disposing of BHS, and it was that sub-group that formed itself into the board meeting on the night of 10 March. They approved the proposed sale. On 11 March, the transaction was done. On 16 March—this was the first time that I came into the story—

Q489 Chair: So five days after it happened?

Lord Grabiner: Yes. On 16 March, the Taveta 2 board meeting records, in effect, a technical resolution to ratify the transaction done on 11 March. So that is a technical resolution, which retrospectively authorises the transaction. Then the report, which was in due course made, came to the TIL board on 25 March. At the 25 March board meeting, broadly speaking, in big picture terms, the terms of the deal were described to the full board. As I think I have explained in my note, it was on that occasion Sir Philip Green—I think—described the terms of the deal, and one of the points he made was that the purchaser had produced what I think he called a credible business plan, and the business plan had been examined by the team. I then asked him—it is recorded in the board minutes, as I have set out in my note—what the credible business plan consisted of. The answer was given and is recorded in the notes. It is also recorded in my submission to you.

Q490 Jeremy Quin: Lord Grabiner, I totally understand the appointment of a sub-committee of a board to advance the technical detail of the transaction, but did you give them a bracket in which they could do a deal? Was there an understanding? I don't know what the notice was for that board meeting they held to agree the deal—or whether no notice was given, and they just held the board meeting—but had you given them a circumference within which they could execute?

Lord Grabiner: No, we had not, but that was included, in my view, implicitly, if not explicitly, in the remit that was given to that sub-group. We are talking about very sophisticated people, as you will see as you develop your questioning today, and with Sir Philip Green dealing with the matter as well. We are talking about very sophisticated people, who had a very good understanding indeed of the nature of BHS.

Q491 Jeremy Quin: This is not a criticism, but, basically, the board decided that they wished to dispose of BHS. They formed a sub-committee and gave that sub-committee full remit to proceed to execute a sale.

Lord Grabiner: One of the problems with this case is that it is extremely complicated and there are lots of complicated angles. It is not a simple thing and I cannot overstress that. We did not simply give instructions to the sub-group to sell the business. The reality was that we had reached the stage when the whole board had decided that BHS was going to have to go into some insolvency process or, alternatively, it should be sold. Finding a buyer was the most desirable outcome because it would protect the jobs and the position of the business as a

going concern. If we could not find an acceptable buyer and could not do that deal, I have no doubt whatever that the business would have gone into administration.

What we are discussing is, in my view, for what it's worth, the most fundamental point in the story. If this deal had not been done with this particular buyer, the BHS business would have gone into administration 12 or 13 months—or whatever the period was—earlier than, in fact, it did. That is my personal view. I do not know whether others will agree with that. That was my understanding of the position we were in as of March last year.

Q492 Jeremy Quin: So you were a distressed seller at this point.

Lord Grabiner: Essentially, yes. But one has to recognise that, in order to achieve the sale, the Arcadia Group or TIL was actually investing a huge amount of money in this asset with all these problems. We had made £250 million or so of interest-free loan over a series of years, certainly running since 2009. Every time you come to the meeting and look at the accounts, you can see that the TIL business is very successful, but you are carrying this huge burden on the accounts of the group in the form of BHS losing money. There is only so long that you can do that. I think we did pretty well to try as we did for six years.

Jeremy Quin: I am sure we will come back to the cash flows.

Q493 Frank Field: My apologies for being late, Lord Grabiner.

Lord Grabiner: Not at all.

Frank Field: I have heard you twice say that you had, in your mind's eye, an acceptable buyer. What do you mean by an acceptable buyer?

Lord Grabiner: All I would say about an acceptable buyer is that it is a buyer that—the sub-group were looking at this as carefully as they could reasonably have looked at it. I know and trust these people, and they are very astute. If they found a buyer that they were prepared to sell to on suitable terms, that would be a solution to the problem. That is all I mean by that. I am not suggesting for a moment that I was in a position to do the sort of exercise that I have been listening to in your deliberations today. I certainly did not do it.

Q494 Frank Field: But would you trust that same group again, given what they came up with?

Lord Grabiner: I would. You'll hear, in particular, what Mr Budge has to say and, no doubt in due course, what Sir Philip Green has to say. I believe that they believed that their business plan that was provided to them by the buyer was a plausible, credible business plan. They may have some views as to why that plan failed. My own view is that there is nothing that I have heard or seen that would suggest that they failed to discharge their duties as they should have done.

Q495 Frank Field: Do you feel let down by those lawyers who checked on the character reference of the person to whom the business was going to be sold?

Lord Grabiner: Well, I sat in on your earlier hearing and heard the evidence that was given by the Linklaters partner. It seemed to me that he was being assured by his opposite number at Olswang that they had done some suitable due diligence on their client, and that the Linklaters lawyer was actually going beyond what one would normally do in that sort of situation. As I think he rightly pointed out, ordinarily the solicitor acting for the buyer would not be concerned with such an exercise, as it would always be a responsibility of the solicitor on the other side. He was satisfied by what he was told and left it at that. As to what happened at the Olswang end of the story, it is, as was pointed out, a highly reputable law firm. One assumes that it did their job properly.

Frank Field: One assumes.

Lord Grabiner: One assumes. I am not in a position to second-guess that, I'm afraid.

Q496 Chair: Can I just ask, m'lord, whether you think that, as chairman of the company, you have provided enough leadership, effective scrutiny and questioning of the strategy going on regarding the sale of BHS?

Lord Grabiner: Yes, I think I have. I was entirely satisfied that we would have to put this company into administration if we could not find a buyer. That was my view, and it was actually the view of the whole board. I was entirely satisfied that the sub-group had found a suitable buyer, and if that had not been the case, I would not have done the things that I did in order to achieve—

Q497 Chair: But how do you know that? In your written statement to the Committee you said: "it was not until the press publicity after the transaction was concluded that I learned of his history as having been made bankrupt, possibly on more than one occasion." You did not know whether it was a reputable buyer, did you?

Lord Grabiner: No, I did not, but we do know that the sub-group did know that he had a bad history in terms of previous bankruptcy—or bankruptcies, as may be a possibility. I have never done the Google exercise myself, but I am assuming that there were three bankruptcies, as I think I have read in some of the press reports. My view is—again, Mr Budge will be able to say something about this—that they must have taken that into account in coming to a judgment about whether this was a suitable buyer. If they did not, they failed in their duty. But we do know that they did know that fact, and if they knew that fact, the next question is: what was the impact of that fact on their overall view about the quality of the deal and the quality of the individual with whom they were dealing for the purposes of the sale?

Q498 Richard Graham: Lord Grabiner, thank you for the written statement that you submitted to this Joint Committee. May I just ask a few questions relating to that?

Lord Grabiner: Please do.

Q499 Richard Graham: First, you say you are one of several minority shareholders in TIL. How did that come to be?

Lord Grabiner: I originally met Philip Green when advising him in relation to the acquisition of Arcadia. This is back in 2002.

Q500 Richard Graham: Did he invite you to be a shareholder, or did he gift you some shares?

Lord Grabiner: Oh no, I paid for them. What happened was that I was advising him in relation to some legal point that had arisen in relation to the takeover panel on the acquisition and he invited me to become the non-exec chairman; part of that arrangement involved my buying some shares, yes.

Q501 Richard Graham: Right. Why was the company structured in the way that it is? You were originally chairman of Arcadia Group Ltd but then you became non-exec chairman of TIL. What is the purpose of TIL and TIL (No. 2)? Why were they created? Was this fundamentally a tax wheeze through Jersey?

Lord Grabiner: No, I think they are both UK companies.

Paul Budge: Some 95% of our profits are taxed in the UK. They are UK companies—BHS and Arcadia. What is important for the Committee to understand is that Taveta is at the top of the group, and BHS and Arcadia are totally separate entities.

Richard Graham: Yes, thank you. That is very kind, but I was just trying to ask Lord Grabiner why—

Lord Grabiner: First, I know that they are UK companies.

Q502 Richard Graham: What did you think was the purpose of having Taveta Investments Ltd and the TIL (No. 2) company?

Lord Grabiner: Whatever structure they had adopted, no doubt there were good reasons for it, but I am not aware of what the reasons were.

Richard Graham: They being the Green family.

Lord Grabiner: Yes. But I can tell you about Arcadia Group Ltd because originally that was the holding company and then—*[Interruption.]* I can answer the question if you would like.

Richard Graham: No, I just wanted to ask you—

Lord Grabiner: I can explain what happened to that company because I was a director of the company, but ceased to be because it then took on a purely FCA function, I think dealing with the credit card business.

Q503 Richard Graham: Yes, thank you. You said you were sure that they had good reasons, but you, as chairman of Arcadia Group Ltd, and subsequently of TIL, were not aware of what they were.

Lord Grabiner: No, I have no idea, but I am sure that Paul Budge can explain the history of that.

Richard Graham: Right. You then say—

Lord Grabiner: It is perfectly normal, may I say—perfectly usual—for any group of companies. This is a large business. This is a business that, before the sale of BHS, had something like 40,000 employees. It is perfectly normal to have a series of companies within the group structure. There is nothing surprising about that.

Q504 Richard Graham: What qualities did you bring to the party as chairman of both these companies? What did you see your main role as?

Lord Grabiner: Well, I was chairing meetings and I regularly did over the long years that I've been there.

Q505 Richard Graham: Yes, you said the key feature of your role was that you chaired the monthly board meetings, although not, apparently, the crucial one where the decision to sell BHS was made. Isn't it rather odd to have as your key role the chairing of board meetings, but not actually the crucial one, where you were not invited and did not receive the papers?

Lord Grabiner: It might be odd until you understand what the circumstances were, and once you understand what the circumstances were, by which I mean in relation to the function of the sub-committee and the fact that it was done by way of after-the-event ratification, it doesn't become odd at all.

Q506 Richard Graham: To what extent do you think that during that process you were able to fulfil the general duties of a director, let alone a chairman, under the Companies Act?

Lord Grabiner: I believe I discharged them properly. My duties in relation to a solvent business, which fortunately this is and always has been, were, first of all, a fiduciary duty to the company and, secondly, a duty to take account of the position of the shareholders. That was my responsibility, and I believe I fully discharged it.

Q507 Richard Graham: You said in your statement that Sir Philip Green's view, which was supported by the TIL board—that is, I assume, you—was that, if possible, BHS should be sold as a going concern, but how could it survive given that you describe the deterioration in the business as so great that the only practical alternative was to place the company into administration?

Lord Grabiner: That would depend upon the quality of the business plan that was being proffered by the buyer, and the assessment of that business plan by the people on my left.

Q508 Richard Graham: With which you were not involved at all.

Lord Grabiner: That is exactly right.

Q509 Richard Graham: So how could the TIL board take that view, given that you did not know what was going on?

Lord Grabiner: You are suggesting— It's true, I did not know, but the appropriate persons on the board whose task it was to know what was going on did know what was going on, and we relied upon their judgment and their skill.

Q510 Richard Graham: Do you think it is unusual that a chairman does not know what is going on in his board?

Lord Grabiner: Well, you're putting that in a rather loaded way and I don't accept the way you have put it.

Q511 Richard Graham: So your answer is no, it is perfectly usual for a chairman not to be invited to a board meeting, not to receive the papers and not to know who is the buyer of the company, of which ultimately he is the chairman, being sold?

Lord Grabiner: I think in the particular context of this transaction, bearing in mind the expertise of the people whose task it was to do the exercise on behalf of the board, it is entirely an unsurprising result. This is a private company.

Q512 Richard Graham: You have said that you do not believe you are in a position to provide the Committees with any facts or matters that would improve their knowledge or understanding of the facts. Why did you say that? For the chairman of the company that was ultimately the holding company for the company that has gone bankrupt, isn't that rather curious?

Lord Grabiner: Well, because it's true. If you are interested in looking, for example, at the dividend position in 2002 to 2004, I was not around and I had nothing whatever to do with it. If you are looking at the negotiations which resulted in the sale, I did not participate

in that process. I assume that those are the matters that these Committees are interested in getting to the bottom of, and I am not in a position to give you any factual information about any of those matters, I'm afraid.

Q513 Richard Graham: So from 2009 to 2015, which was when the position of the company deteriorated sharply, the pension deficit ballooned, and the company was ultimately sold without your knowledge or understanding—

Lord Grabiner: That's not true. It was sold with my knowledge.

Richard Graham: Ah.

Lord Grabiner: I just told you that.

Richard Graham: Yes, you have said that—

Lord Grabiner: I was a party to the ratification decision. Of course I knew about the sale. What I did not know was anything about the negotiation process that resulted in the sale, as I have explained.

Q514 Richard Graham: And you believe that that demonstrates independent judgment and reasonable care, skill and diligence?

Lord Grabiner: Yes, I do, because of the structure of the negotiating team—a decision that was adopted by the board at the outset.

Q515 Michelle Thomson: Just to finish up this point, perhaps we are dancing around accountability and responsibly, so who, in your view, has overarching governance responsibility for Taveta Investments?

Lord Grabiner: Well, the board—the board of the company undoubtedly has responsibility.

Q516 Michelle Thomson: And who within the board has overarching accountability for governance?

Lord Grabiner: I am not quite sure what you mean, I am afraid.

Michelle Thomson: My knowledge, based on business life, is that it is usually the chair of the board who has overarching accountability for governance and there may be separate groups that have responsibility. Is that a clear statement?

Lord Grabiner: Well, I am not sure that I understand the definition. My understanding is that we had a perfectly good corporate governance structure, which I have been describing, and that is the structure that we adopted.

Q517 Richard Fuller: Lord Grabiner, you have done lot of heavy lifting for the team, so, if I may, I would like to open up a question that perhaps—

Lord Grabiner: I was beginning to wonder why all the others were here.

Q518 Richard Fuller: As Members of Parliament, we go home and meet our constituents, and we have to answer for when we mess up—and, occasionally, for when we do the right things. Since the company went into voluntary administration, have any of you had an opportunity to meet and talk to any of the employees of British Home Stores?

Paul Budge: Yes. We are still in touch with a number of the head office people.

Q519 Richard Fuller: I meant the people in the stores—the people who are worried today about whether they will carry on having a job and their pensions. Have any of you gone and had a chat to them?

Ian Grabiner: Yes. I speak to regional managers who worked with me for 15, 20 years in the past.

Q520 Richard Fuller: What do they tell you?

Ian Grabiner: They are disappointed. Some of the store managers worked there for a long time. A lot of the staff are more transient—as I think was mentioned earlier, turnover was quite high. They are hoping, obviously, that it can be saved, through administration, by another buyer.

Q521 Richard Fuller: Are you personally confident? Do you think that is going to happen?

Ian Grabiner: I do not know enough about the buying process but, as I say, hopefully they it will go as a going concern.

Q522 Richard Fuller: Mr Budge, can I ask you some questions? Tell me a bit about whether you had any discussions with Paul Sutton regarding the sale of British Home Stores, and what they were.

Paul Budge: Yes, I met Paul Sutton back in April 2013. He was put in touch with us via a banker friend of Sir Philip's. He wanted to invest in BHS at that time. We talked on and off for many months without really going anywhere. He worked up a business plan—it was called Project Albion—and the idea was to turn BHS around to profitability. However, we were always lukewarm about these discussions and, indeed, come early 2014—by my recollection I have got the date 27 March 2014—we discontinued any dealings with him. We

had heard from a third party who discredited him that he was using Sir Philip's name, so we decided no longer to do any work or talk with him.

Q523 Richard Fuller: How, then, did you get in touch with Mr Chappell?

Paul Budge: Mr Chappell came to see me with a gentleman called Peter Graf, a Swiss retailer. Again, in terms of dates, he came forward on 16 July 2014. The first question obviously was: is Mr Sutton involved with this? He gave us his assurances that he was not. We—

Q524 Richard Fuller: Why was that your first question?

Paul Budge: Because earlier Mr Sutton had been discredited and, therefore, that was one of our first questions.

Q525 Chair: So in terms of Paul Sutton's involvement, was Dominic Chappell coming to meetings alongside you and Mr Sutton?

Paul Budge: I think he did on one occasion.

Q526 Chair: So you knew there was a connection.

Paul Budge: Yes, but Mr Sutton had actually dealt with a guy called John Forsyth, who was his finance person, and we had seen those two people on and off during the period of April 2013 to March 2014.

Q527 Richard Fuller: So you were aware that there was a connection between Mr Sutton and Mr Chappell.

Paul Budge: Yes.

Q528 Richard Fuller: But one of your first things was to ensure that Mr Sutton was not connected—

Paul Budge: That was one of my first questions, yes.

Q529 Richard Fuller: Was the plan that Mr Chappell presented to you materially different from the proposals that Mr Sutton had had?

Paul Budge: He started from a clean sheet of paper. He came and discussed in July 2014 whether we would be interested in selling BHS to him and the people he was associated with. I make the point at this stage—this is important—that when we sold the business it was

to RAL. We were dealing with a company called Swiss Rock at the time, which changed its name to RAL on completion. Dominic Chappell had other people who he was working with. It was a board of four people. The other three people were all businessmen who seemed to check out fine—Stephen Bourne, Edward Parladorio and Mark Tasker. As we moved forward to talking seriously with Mr Chappell—this is coming up to the early part of 2015—other people were also involved with Mr Chappell in putting the business proposal together, including: Kevin Lyon, the chairman of 3i and a non-executive director of Booker; Alan Jacobs, who I believe is an esteemed finance man; and Mark Sherwood, a partner at property consultant Vail Williams.

This was not one man on his own. Mr Chappell had a number of people he was dealing with. He had a good team of six to eight people around him, as well as—we will talk about this—engaging Grant Thornton, who did an enormous amount of due diligence. They were working with our BHS management team to put together a business plan over the course of about four weeks after we signed heads of terms with RAL, which was about mid-February 2015. There was then four weeks of due diligence—the most heavy due diligence I have seen. Grant Thornton and an army of people came in and put a business plan together, working with our BHS management team to come up with a turnaround plan that had the ownership of the BHS management team and that was also drawing on the experience at that time of people such as Kevin Lyon and Alan Jacobs.

Q530 Richard Fuller: At that time, did you know about Mr Chappell's previous corporate experience?

Paul Budge: We knew of his bankruptcy—one bankruptcy at the time.

Q531 Richard Fuller: You did not know about the others.

Paul Budge: Not at the time, no. We were cautious, and that is one of the reasons why we took informal advice from Goldman Sachs back in December 2014.

Q532 Richard Fuller: So they did not give you advice. You said that he gave you his observations.

Paul Budge: He gave us observations. For clarity, as far as we were concerned, the observations were that they had ability proof that they had lines of funding for £120 million through Farallon. That was very important.

Q533 Richard Fuller: Through who?

Paul Budge: Farallon Capital. That was a very important point, because that means that they were actually able to get funding to run the business. It also meant that their intentions were serious in that they wanted to run the business as a going concern. Those were the observations. The other key observation coming out was on their lack of retail experience, which we took on board.

Q534 Richard Fuller: Just on that retail experience, I certainly put a lot of weight on it, as others may have done. You mentioned the existing British Home Stores management as being a point of comfort, in that they would carry on and fill any gap in retail experience.

Paul Budge: That was a comfort, because—perhaps Mr Grabiner can pick up—

Ian Grabiner: Perhaps I can pick up on that point. When we took over the business in 2009, the BHS operating board was struggling a little bit. Over 2011 and 2012, we brought in a new management team. We brought in a new CEO from one of our biggest competitors. We had a COO. We brought in a new finance director and a new HR director.

We put together a recovery plan, and that started off with us making an investment into the portfolio of all the stores. We spent just over £100 million in Capex on modernising the stores and trying to get them looking more competitive. We inserted into BHS hundreds of inserts from Arcadia. We have a number of brands that we felt would enhance BHS's offering and increase customer flow. We did some trials on revamping some restaurants, which were very successful, and we trialled some food in our stores, which they had had many years before, in 1990. We also put the BHS e-commerce platform on to our WebSphere 7 and 8 platform, which is very robust. On top of that, we invested in marketing and did a lot more investment in TV.

The year before we sold BHS, we saw some traction. The management team brought in some new product people, a lot from high street competitors. Where did it go wrong? I suppose that market conditions were really, really tough, but in the last year we achieved something like a 3.7% like-for-like increase, predominantly through the e-commerce platform, and we saw some signs of things getting better. I think a lot of it was that the fixed costs of BHS, which were alluded to earlier, were dragging it down. We couldn't deal with some of the property costs. To take your point about the management team, it was a very, very good management team, so there were a lot of very good retailers within the organisation.

Q535 Richard Fuller: So you brought in new management, and they were doing a pretty good job, making lots of changes and moving forward, but then you decided to sell. Why, after you brought all those people in and made all those changes, would you decide to do that after a year?

Ian Grabiner: It wasn't after a year. We brought the people in around about 2012, so it was two or three years. The first one was 2011.

Q536 Richard Fuller: Okay, so they had a chance to prove it to you. I am trying to work out why, if you had such faith and comfort in the management team, you passed it on to people who had no retail experience. You had lots of retail experience. Why would you do that? Why would that give you comfort?

Ian Grabiner: Maybe Paul can articulate—

Paul Budge: Let me take you through it. First of all, the background, as Lord Grabiner said earlier, is that BHS had run up an intercompany debt with Arcadia of up to £256 million at the time of sale. The good thing about the new management team is that it plateaued the losses. We were losing about £35 million per annum on an EBITDAR cash basis between 2012 and 2014. The new management team had actually achieved a plateau for that.

Q537 Richard Fuller: How much was that?

Paul Budge: We were losing £35 million a year on average in 2012, 2013 and 2014. The new management team plateaued the losses.

One of the key issues here is the cost base. There is this perception that BHS has the covenant strength of the group, so if we were to go to the landlords to renegotiate terms as Taveta, associated with Arcadia and BHS, the landlords, who also dealt with Arcadia, wouldn't really take us seriously. However assertively we wanted to negotiate, we would not be taken seriously because there was always this perception—wrong legally, but it was in people's minds, such as the landlords'—that there was always the covenant strength of the wider Taveta group, which didn't allow us to be able to make the kinds of changes to our cost base that we actually required.

The one feature as far as RAL was concerned—Vail Williams were very important, and Mark Sherwood was hugely important—was that their business turnaround plan was mainly predicated on property improvements. There was a situation where they could take the forecast loss—in the last year of ownership I recall the period 5 accounts of 2015 as being of the order of £40 million-plus. They could see £26 million-worth of property restructuring benefits, which was a huge building block not predicated on trade but predicated on tackling that cost base. They were confident about that, and they had taken advice regarding it. Grant Thornton were all over it like a rash. Vail Williams put a credible plan that said that £26 million of profit improvement could come from property.

Q538 Chair: Why hadn't you done that?

Paul Budge: As I said before, what we found—

Chris Harris: Perhaps I should come in here and get on the property ladder. Obviously, I had numerous conversations with landlords over the years to try to deal with what I guess was an aged portfolio. By that I mean that it was a department store business and they tend to be on very long leases—not just 25-year leases, but sometimes 100-year leases. They had five-yearly rent reviews that were upward only. What you found is that, since the financial crisis of 2008, the rental values had dropped away but BHS was up here and continuing to pay non-market rents.

Q539 Chair: Was that included? You were talking about fixed costs and the pressures on the property portfolio, was that exacerbated by the sale and leaseback arrangement?

Chris Harris: No. The sale and leaseback arrangement—I think you are talking about Carmen; is that the reference?

Q540 Chair: Yes.

Chris Harris: A sale and leaseback was carried out in 2001. Carmen was not part of the BHS group at the time; it was a company controlled by the Green family. They paid £106 million for 10 properties. They paid market price for them—I have seen the valuation from the time, and I am satisfied that they paid market price—and they paid market rent. Interestingly, what happened over time is that there were rent reviews every five years. So in 2006, there was an open market rent review, and in 2011 there was another one, but the rents didn't rise at that time. I had a fairly interesting conversation with Sir Philip in 2012 in which I agreed with him that we would reduce rents on three of those properties by a total of £700,000 to bring them back in line with market value.

I would say, actually, that Carmen was probably the only landlord—in fact, was the only landlord—that did support what we were trying to do. Back to the other landlords, the more institutional landlords, I guess, thought that they had, as Paul said, the support and covenant strength of the wider group, which was not the case. Clearly, in selling BHS, what we were giving the buyers the ability to do was have what was, I guess, perceived as weaker covenant strength and much more robust conversations with all the landlords, which it was vitally important for them to do at the very start of the process, when they bought the company.

Q541 Richard Fuller: On the sale, Mr Budge, did you leave cash in the business when you sold it?

Paul Budge: Yes, substantial amounts of cash. I should also step back to one further point. Goldmans, in their observations, had shown that Farallon would give £120 million worth of funding to RAL. That was very, very important to us, as you can imagine, because they had the ability to access funds.

Q542 Richard Fuller: Did you confirm that directly with Farallon, or did you just take the observation as sufficient?

Paul Budge: I had worked with Mr Gutman before; I will take his word on that as an observation. That was fine.

Q543 Richard Fuller: So you didn't actually get any confirmation that there would be funding available, when you sold, from Farallon Capital.

Paul Budge: Can I perhaps move on? As we—

Q544 Richard Fuller: If you would answer the question.

Paul Budge: No, I did not.

Q545 Richard Fuller: You did not.

Paul Budge: Not personally. But I think it is very important, again, to just set the scene. Mr Gutman and Goldman Sachs were informally looking at the RAL business plan for us during the course of December to late January, but actually, we took the decision to open this up to more than one buyer, and saw that a number of other buyers came forward because BHS went on the market. Six people came forward. Four would only be interested if they put it through some kind of process; two were actually interested in running it as a solvent business.

RAL were very keen to pursue this deal, and they demonstrated that because when we signed heads of terms in mid-February, we asked them to make sure that they deposited £35 million with Olswang in the Olswang client account to confirm their intention. If we were going to go forward, sign up to some heads of terms and give them a period of exclusivity, they had to do that, so they put £35 million into an escrow.

In terms of what we left with the business, I think it is substantial. First of all, we had the £256 million inter-company loan. Of that, £216 million was written off, and £40 million was then set aside as a fixed and floating charge which, in principle, was going to be to the benefit of the pension scheme. That is quite important. We also covenanted to pay £15 million over the next three years, at £5 million a year, into the pension scheme, so £55 million was earmarked for the pension scheme. RAL had £94.5 million worth of cash availability to run the business at the time of completion.

Put this into the context of it being a business that had recently lost in the region of £35 million per annum, although the recent forecast was closer to £45 million in EBITDAR cash loss. They had £94.5 million. Of that, around £70 million was true cash or availability to cash. The other £25 million was actually an HSBC working capital facility that we were guaranteeing. We also did further guarantees. In fact, overall, Arcadia was going to give £110 million worth of guarantees to various financial mortgages and loans that RAL had. I think that is sort of proof that a lot of money actually was put into the business. There was no want on our part for the business to go under as it has done.

Q546 Richard Fuller: So essentially your fingers were on this business in lots of different ways to try to hold it together for many, many months after the sale.

Paul Budge: We wanted it to be a thriving business. What has happened is very disappointing, but we wanted it to be a thriving business. We seriously believe there was a credible business plan. We seriously believe that RAL—Mr Chappell—was surrounded by competent people. As I said earlier, names such as Kevin Lyon and Alan Jacobs are credible people. Grant Thornton are credible. Vail Williams are credible.

Q547 Richard Fuller: But they were all going to go away, weren't they? The advisers are there for the transaction, but then they might stay or they might go away. People who have been hanging around a deal may get involved or may not. The person who is going to become the owner is Mr Chappell, and you knew that at that time he was at least one-time bankrupt, maybe two—if you had done the research, maybe twice or three times. You had given him some cash and you had fingers all around it. Didn't it just strike you that Mr Chappell was the wrong sort of person to take on British Home Stores, particularly as you had been introduced to him by someone you thought was totally inappropriate to purchase the company?

Gillian Hague: Clearly, as Paul has already said, we didn't sell to Dominic Chappell; we sold to RAL.

Q548 Richard Fuller: Who was the major shareholder of RAL?

Gillian Hague: Probably Mr Chappell.

Q549 Richard Fuller: So you were selling to Mr Chappell.

Gillian Hague: No. The point is that it was a credible board—

Q550 Richard Fuller: Two out of five of them resigned within two weeks of the sale.

Gillian Hague: You are saying that with the benefit of hindsight, but at the time there was a credible board there. Vail Williams, the property consultants, were at that time engaged on an ongoing basis to assist them on the very important property part of the plan.

Q551 Richard Fuller: But Ms Hague, when the principal shareholder in the company you are selling to has advisers who are professional employees of advisory firms, one might anticipate that they were there just to facilitate a transaction. Does it not sound extremely naive for you to put so much weight on the fact that you were selling to a company rather than to a three-time bankrupt?

Gillian Hague: At the time we did not know that he was a three-time bankrupt.

Q552 Richard Fuller: Okay: a one-time bankrupt.

Gillian Hague: A one-time bankrupt, and we had had a very plausible explanation of the background of that bankruptcy.

Richard Fuller: From Linklaters.

Chris Harris: If I could come in, it is the package of everything. You are focusing on the fact that he was a bankrupt, and we were aware of that.

Q553 Richard Fuller: But you also didn't know about his financing. You had just taken it on trust from someone to whom you weren't prepared to pay any fees.

Chris Harris: We were aware that he was bankrupt. We had taken some soundings and observations from Goldman Sachs

Richard Fuller: You didn't bother to get a letter.

Chris Harris: Around that, he had managed to put £35 million in a bank within about three days—I think it was something like that—which showed credibility. He had good advisers around him in Olswang and Goldman Sachs. He put together a credible business plan, which we bought into. He injected £10 million of equity into the business at the time of sale. So there were many things—a package of things—that made us comfortable that RAL was a credible buyer.

Richard Fuller: Okay.

Q554 Chair: Just following on from that, Richard Fuller was saying that you still had a lot of involvement, Mr Budge, and were trying to hold it together to ensure that BHS was going to be a successful, viable business for the long term. That included helping to secure credit lines for the new company, didn't it?

Paul Budge: We secured a £25 million overdraft, as far as HSBC was concerned, because it was at 1.6% LIBOR, so that was good for the business. I think and I hope it shows that, first of all, we acted honourably, because—as Lord Grabiner said—the business could have been put into administration three years leading up to the sale. Arcadia actually backed it to the sum of £255 million. We did not need to do these things but we wanted to make sure that it would have a future. It had a credible business plan and we wanted them to deliver that. We were certainly putting ourselves on the line in terms of assisting that to happen.

Q555 Chair: Were you trying to help in terms of providing assistance with suppliers? Arcadia is well known within retail as having good arrangements with suppliers. Were you trying to help the new company by saying, “We'll help you with that supplier”?

Paul Budge: No. We would have no involvement in that. Again, the BHS management were experts in the supply chain. As Mr Grabiner said earlier, there were good people there, and we would leave them to carry on and do that.

Q556 Chair: Over the 13-month period from when you sold it to when it went into administration, when was the support that you provided withdrawn? You said you had provided a degree of help and assistance to ensure that it could be held together. When did you withdraw from that?

Paul Budge: The majority of those guarantees were still in place when it went into administration. I believe the figure is that £85 million of the initial £120 million of guarantees were still in place at the time of sale.

Q557 Michelle Thomson: Chris, just a quick question, for my own understanding—on the sale and leaseback arrangement in 2001, you said that the value in the accounts was £106 million for the property portfolio. After the sale and leaseback to Carmen Properties, it was then repurchased prior to the sale of BHS. Is that right?

Chris Harris: Carmen sold it back to BHS.

Q558 Michelle Thomson: Yes. What was that for?

Chris Harris: Seventy million.

Q559 Michelle Thomson: So between 2001 and 2015, it had gone down from £106 million to £70 million. Was there any kind of purchase option in place to buy back at a much cheaper rate at some point in the future?

Chris Harris: No.

Q560 Michelle Thomson: Was it just incredibly bad luck that it dropped by so much between 2001 and 2015?

Chris Harris: Yes. There was no buy-back—it was sold for £70 million.

Q561 Michelle Thomson: Were you surprised, then, at future sales of some of the properties—for example, the sale of Ealing BHS at a profit?

Chris Harris: Actually, let me just correct myself. Nine properties were sold back under Carmen at £70 million. There were 10 properties bought out, so there was one property that was not sold back, which was a head lease that had been previously surrendered. That was the difference, but that would not have been all the difference; it would have been a decline in value over that time as well.

Q562 Frank Field: May I ask all of you one question? A lot of people worry about their jobs, and even more about their pensions. When was the last time you walked through a BHS store and talked to staff?

Chris Harris: I walked through the Oxford Street store one day last week, and I spoke to two people in the menswear department.

Gillian Hague: I visited the Kingston store probably two weeks ago.

Paul Budge: I visited the Oxford Street store a couple of weeks ago.

Ian Grabiner: I visit the Oxford Street store regularly. I travel extensively around the UK. I still talk to the regional directors. I visit the team, and I talk to the staff.

Q563 Frank Field: In the stores?

Ian Grabiner: Yes.

Lord Grabiner: I have not visited a BHS store.

Q564 Craig Mackinlay: Mr Budge, it very helpful to hear about what you tried to do to make this entity look quite appealing to a new buyer. From 2009 onwards, no profits were being earned. They were gradually accumulating bigger and bigger losses. On the pension fund, every time there was a triennial valuation, there was a bigger and bigger black hole. I am surprised there was not more of an attempt to get rid of this thing some time earlier.

It seems that once you did find a new buyer—there were a lot of sweeteners for them: you left them a fair bit of cash, you wrote off a big inter-company loan and there was a suggestion that some of the inter-company loan would go to the pension fund. It seemed that the losses you were sustaining in those very bad years, post 2008, when we were in a recession—I have not seen the accounts, but on the face of it, in this last year it managed to lose even more money more quickly than when it was being run in the post-recession years. Does that seem fair and reasonable, given that it had a load of cash and has now gone into administration?

Paul Budge: I think it is fair to say that in the autumn of 2015, the Christmas trading for all retailers was very tough. I do not have the exact details, but it was also tough for BHS. That is their peak period of profitability for the year.

Q565 Craig Mackinlay: Given that it was not that long ago that a due diligence report was done and Olswang was involved, how could it have gone so wrong so very quickly? I bet that whatever business plan they put together did not forecast such a dreadful loss so very quickly. I am bit confused about that.

Paul Budge: I do not know the exact detail. The disappointment we had was that they did not execute the business plan quick enough. In terms of the property savings that I talked about earlier, that needed to be done literally in the first quarter of their ownership. Unfortunately that was not done in a timely fashion, and that is one of the key factors.

Q566 Craig Mackinlay: May I take you way back now, to 2002? We had the valuation of Taveta No. 1, as it were; let's go on to Taveta 2—I'll call them 1 and 2, if I may. Taveta 1 had a balance sheet value of £866 million in 2002. When Taveta Investments (No. 2) was created, there was an exchange of shares and it ended up with 2.3 billion £1 shares in the balance sheet of Taveta 2, I believe. Then there was a reorganisation through a High

Court-approved method, approved by the creditors, by which the share capital reduced to just £10 million, so £2.29 billion of share capital was converted into some type of distributable reserve. Casting your mind back—I know it's a fair way back—what was the reason for that? Was there a commerciality decision behind that? I know PwC was involved.

Paul Budge: I'm afraid that goes back so far that I would have to take that question away and come back to the Committee in writing.

Q567 Craig Mackinlay: I think I'd remember a £2.29 billion change of share capital into something else. Were you with the group, Miss Hague?

Gillian Hague: I was with the group, but I wasn't closely connected with that.

Q568 Craig Mackinlay: Okay. What do you think the reasons were for that? It was quite an unusual transaction, of a very large size.

Paul Budge: Sorry, just to be clear, I was with the group at the time. Arcadia was the company I was working for. I was not party to that. That's why I think we need to take it away, if we may, and come back with a written explanation.

Chris Harris: Was this in 2001?

Q569 Craig Mackinlay: 2002, I believe. If you can come back, that would be very useful.

Paul Budge: Okay. I will be happy to do that.

Q570 Jeremy Quin: Paul, I understand the rationale for why a new buyer could potentially do better and strike better property deals, because you didn't have the group standing behind you and it makes sense. It's unfortunate, of course, that the covenant was much worse for the pensioners as well as your property counter-parties.

Chris Harris: That is interesting because obviously Arcadia had written off £200-and-something million at that time, and we also left £200 million-worth of property in the business when it was sold, so I might dispute that the covenant strength of BHS was weaker at the time it was sold.

Q571 Jeremy Quin: BHS, yes, but it depends what reliance is present elsewhere in the group, but let's not go there. What I am interested in, in terms of the property transaction, is this: is that the real reason why Project Thor fell apart? Was it that you realised that you wouldn't be able to renegotiate your property agreements and therefore that was the leg that wouldn't work with Project Thor? What was the rationale between Project Thor having difficulties—

Paul Budge: Well, we never thought that Project Thor would fall apart. Tony Clare gave a very good presentation of Project Thor earlier, but actually the reason it was paused before Christmas was that we knew that both suppliers and landlords would have to take some kind of impairment, and it wasn't going to be the right time to be talking to suppliers and landlords coming up to the peak trading time at Christmas. We didn't want to disrupt that. That was one of the reasons it was actually paused until January 2015, and we were confident that we would get some traction and some—

Q572 Jeremy Quin: That is more credible. So it wasn't that you were worrying about what was going to go in your stores; you didn't feel comfortable about going to suppliers at that moment—

Paul Budge: No, I think whoever made the comment earlier was completely right. A range had been bought; we were set for Christmas. It was more around the landlords and the suppliers, and we didn't want to disrupt those at that particular point in time.

Q573 Jeremy Quin: So had you not had a buyer, you would have come back to Project Thor in January?

Paul Budge: Yes, we were running towards Thor—I would like you please to take that away today. Project Thor was very much seen to us as a collaborative solution to the pension scheme.

I was party to the time we were selling the business and we met the Pensions Regulator I believe on 4 March, and Tony Clare was there and Chris Martin was there, and the project team and Sir Philip were there; indeed, Mr Clay was there as well. We really are running towards this: we wanted at that meeting, talking about the sale of the business, to put in place something like Project Thor. It was very important to do. It was the way that we were going to sort out the pension scheme; it seemed the fairest way to sort out the pension scheme. Please remember also that although the actual deficit did increase over the years, again going back to the 2008 financial crisis, it is as much down to gilt yields—15-year gilt yields, if I recall, have gone from 5% down to sub-2%. I think there is a 3.2 percentage point movement. People are living longer.

It didn't just happen: there were reasons behind why ours—in terms of BHS—and indeed why many other pension schemes' deficits ballooned; but as a management team, we were fully behind Project Thor and wanted to make that happen. Indeed, I think the frustration, or rather the sad thing, is, come when we actually sold the business in early March, we had had a meeting with the Pensions Regulator on 4 March and we would have very much liked to sit round the table and sort out some kind of Project Thor to sort out the pension going forward. Unfortunately the way that things are—I don't think it's anybody's fault—but the way the Pensions Regulator and the inter-relation with the PPF and the way they inter-relate with the companies: it just was not able to be done.

Q574 Chair: Mr Budge, why did Project Thor fail? Was it the regulator's fault?

Paul Budge: I don't think it is; I think in some ways—personal view—it is probably the system's fault. We were going to get into a situation where we were going to actually sell BHS; we had the Pensions Regulator in the room; we had the PPF in the room; and yet there was no easy way—and the way that the Pensions Regulator is geared at the moment—that we could sit round the table and sort out Project Thor.

Q575 Jeremy Quin: Did you have all the information to give to them, though? Because they weren't convinced they had the information they needed back in the summer; so sitting there on 4 March with a deal to be accepted on 8 March is quite tough.

Paul Budge: By that time the estimated outcome statement between KPMG and the trustees, Christopher Martin, and between Deloitte and ourselves, had been agreed. There was a meeting of minds regarding that statement at that time, as I recall.

Q576 Jeremy Quin: Right. You don't have any blame for the regulator at all? You believe that you could have—

Paul Budge: I don't want to come here and put blame all around. I think it is as much the system that—and I don't want this to be a criticism, but Project Thor existed. We worked very hard with the trustees over a number of years—since January 2014—to actually collaboratively put something together with the trustees. Yes, it was paused, but when the Pensions Regulator came to see us, the night of 4 March, I think it was very aware that there had been Project Thor. It was on the table. It was something that could be discussed, but then it was taken off the table because the whole thing then became a moral hazard investigation. And as I think all of us are aware—and we are in the middle of a moral hazard investigation at the moment—that can take anything up to two years. Unfortunately for the BHS pensioners, to know that that is going to take two years when something, with the benefit of hindsight and if we were regulated slightly differently, could be done—

Q577 Jeremy Quin: There are means you can do to get out of that investigation, aren't there, if you are able to make an agreement with the regulator, even at this stage?

Chris Harris: We haven't been able to reach an agreement.

Paul Budge: We have been in contact with them since that time. We haven't been able to come to an agreement. I think, also, a worry, and again the way we are configured, as I understand it; one of the key things is that we want the benefit of whatever money goes, to go to the BHS pensioners. And at the moment my understanding—and, forgive me, I am not a pensions expert—but the way the PPF is configured, if money is paid in now, it goes into the PPF, but our pensioners, or BHS pensioners who are our pensioners, will not get the benefit of that. I think that would be quite sad, and from our perspective it is very important that the BHS pensioners, if there was a project-type Thor, would actually get the benefits of it.

Q578 Jeremy Quin: Chairman, if I could have one last question, off Project Thor, in fact. Lord Grabiner, back to you, if I may: there were some comments made earlier in the session about related-party transactions, so perhaps we could just be reassured that in those circumstances—that it is brought to the board’s attention—it is discussed at a board meeting, not a sub-committee.

Lord Grabiner: When you say “related-party transactions”, what are you talking about?

Jeremy Quin: When it is a sale of group assets to people who are directors of the company or who have got a close relationship with them.

Lord Grabiner: In principle, yes. I mean, if it was a matter of substance, yes.

Q579 Chair: Mr Budge, you said there were failings to the system. What recommendations would you be giving us in terms of what improvements to the system could be made?

Paul Budge: For a company it is unclear in terms of PPF and TPR and that relationship. I am sure they have clear terms of reference, but many times we have met, particularly such as on 4 March or in meetings since then, and both were in the room and both seemed to have quite different agendas, so I do not think there is consensus there. Business moves quite quickly. Again, this is not meant to be a criticism; it is just a fact of life. Commercial deals move quite quickly, so in an ideal world, with Thor-type schemes being out there, if there is a transaction like the BHS-RAL one, it would be very good within a very short time period. People have come to us and said, “In two weeks we can get round the table and sort this out prior to the sale being made.” That would be a good improvement to the system.

Chris Harris: In support of that, we signed heads of terms with RAL on 16 February 2015; we sold the business on 11 March 2015. We met with the regulator on 4 March 2015 and we were keen to do everything we could to resolve the pension proper. If there was an ability to do that—I appreciate it was a short period of time, but we were trying to resolve it. We were there to try and do a deal to resolve this issue and not to be investigated for two years, which is where we now find ourselves.

Q580 Steve McCabe: Mr Budge, may I ask you two quick points? First, can you tell us what was the tax impact on Arcadia of the £215 million loan that was written off?

Paul Budge: No impact.

Q581 Steve McCabe: None whatsoever?

Paul Budge: No, we have not got a tax deduction as a result of that.

Q582 Steve McCabe: Anyone listening to you today would hear about a picture of pretty good stewardship of a company: people who were trying to do the right thing right up to the point where you sold it. But you must have read and heard the other version that is doing the rounds, which is not a penny was invested in the company from the day it was bought in 2000. Dividends were paid out in excess of profits, you ran it into the ground and then flogged it to someone who was not fit to receive it. You must have spent a bit of time thinking about that. What would you say now?

Paul Budge: I can't comment prior to 2009 because I was not a BHS director.

Q583 Steve McCabe: But wasn't the company part of the group?

Paul Budge: No, not until 2009. Mr Goldman, on behalf of Arcadia, sent a good letter to the Committee about some of the pensions issues. He covered the dividend point in quite a lot of detail as the last point in that letter. The reality was, back in the early 2000s, BHS was making significant cash profits. Dividends were declared in the early years—again, I was not there at the time; I would have to go to Mr Goldman's letter—through to about 2004. Substantial amounts of capital were also invested over that period. Again, Mr Goldman's letter gives you the exact numbers.

Since BHS came under the Taveta umbrella in 2009, £100 million was spent in capital in some of the things that Mr Grabiner talked about earlier, putting Arcadia concession inserts into the business. It was not as if capital was not being spent. Indeed, the £255 million inter-company loan deficit was not just the losses the business was making; it also took into account the £100 million capital that was being invested in the business over that period of time.

Q584 Amanda Solloway: On Project Thor, it seemed like a good idea as a solid rescue plan. Within the negotiation that was made with RAL or whoever the potential buyer was, was there any consideration that Project Thor could be part of that negotiation?

Paul Budge: A lot of that. Grant Thornton's advisers spent a lot of time with Tony Clare going through the Thor papers. Indeed, they took forward something that they called Project Vera, which was basically Project Thor for them to take forward.

Chris Harris: As Owen Clay said earlier, there was a commitment in the contract for them to try and come up with a solution similar to Thor.

Q585 Jeremy Quin: So they gave you an undertaking that they would be looking after the pensioners.

Chris Harris: Correct.

Q586 Jeremy Quin: So it was a similar scheme to Thor.

Chris Harris: Correct.

Q587 Richard Graham: Lord Grabiner, at the beginning you said, critically, that the reason you were so confident that everything could be handled effectively without your being involved or, indeed, even there at the relevant board meeting where the decision was made was that you had such a strong team of people to handle these very sophisticated matters. Well, it now appears as if Mr Budge put his faith in your informal adviser from Goldman Sachs, who, if I get it right, gave you wrong advice about the amount of capital that would be available to the new buyer. The lawyers involved did not do any due diligence on the buyer.

Paul Budge: Can I just correct you? Sorry, but £120 million was available from Farallon.

Q588 Richard Graham: It was available.

Paul Budge: Yes. In terms of how the deal ended up being constructed, there was £93.5 million, if I recall, of cash or working capital facilities available on completion. Therefore, there was no need for that Farallon loan actually to be called upon.

Q589 Richard Graham: I see. Well, my apologies if I got that bit wrong. The faith that the team had in the well-known retail names—which look, at least in retrospect, as if they were there to pad out a bid by someone with no track record or credibility himself—either appears like a well-organised scam or remarkable naivety on behalf of Taveta investments. Which is it?

Lord Grabiner: I don't think it was either. I am sure the Committees have formed a judgment about the calibre of people in front of you today.

Q590 Richard Graham: We might have formed a view on the quality of the decision making, but that is a slightly separate issue. I am looking through a letter from the Pensions Regulator, which describes a meeting with Sir Philip Green on 4 March: "Sir Philip Green gave an overview of the possible sale". It says that, on 5 March, "Sir Philip Green telephoned the Pensions Regulator to discuss the regulated apportionment arrangement, and clearance process and timings."

In your note to the Committee, you said that you understand there was a board meeting of TIL on 10 March. That is the one at which the sale was approved, but you were not present and did not receive any papers. It looks as if Sir Philip Green was operating entirely without your knowledge. Would that be a fair conclusion?

Lord Grabiner: I think we are going round in circles, with respect. I said, a long time ago today, that the board had appointed a sub-group of people in whom it reposed significant trust, and I certainly did.

Q591 Richard Graham: So you as chairman would not expect to know that the major shareholder was discussing a possible sale a week before a board meeting that you were not even aware of?

Lord Grabiner: I do not believe that it was necessary for me to know that, given the structure that we had put in place. We had appointed a team to do the negotiation. In my view, and from what I have been hearing, they were doing a perfectly good job.

Richard Graham: Even to the extent where the board meeting was held—

Chair: Richard, I'm going to move on because I am conscious of the time.

Richard Graham: May I just ask one last question?

Chair: Very briefly.

Q592 Richard Graham: If I understood Paul Budge correctly, the structure of Taveta Investments and so on actually did not work well financially for the real estate part of BHS, which was quite a big part of the business. Presumably the whole structure of Taveta, which I asked its chairman about earlier, was really designed for the benefits of the shareholders of Taveta, rather than for the business of BHS. Would that be a fair conclusion, Mr Budge?

Paul Budge: The point that I was making earlier was about the way that businesses are organised. You have Taveta at the top, BHS and Arcadia. In terms of covenants, the landlord would always think that they had the benefit of the Arcadia covenant and the Taveta covenant, and never appreciated that BHS was as loss-making as it was, and they did not actually have the benefit of that covenant. When it got to negotiations regarding property matters, it was difficult for us to make cost savings that were required by the business.

Richard Graham: Yes, I understand that. The conclusion that some people might make, listening to that, is that the structure was beneficial to the shareholders, but not necessarily beneficial to the good health of the company. We'll leave it at that.

Q593 Chair: A final question to you, Lord Grabiner. I want to clarify something that I think is quite important. Earlier, you said that Taveta had stopped giving support to BHS on 4 March. Was it definitely 4 March?

Lord Grabiner: No. That is almost right, but not quite. What was decided on that occasion was that Taveta would not supply further support without security. I may not have added that bit, in which case I apologise. You will see from the transcript. From memory, that was the decision—I may be corrected from my left—that was taken on 4 March.

Q594 Chair: And then 48 hours later, Mr Budge, you signed off the accounts, and they were signed off by the auditors as a going concern. Given what happened on 4 March, that didn't change the going-concern nature of BHS at all.

Paul Budge: Those were the historical accounts.

Q595 Chair: Well, going concern is actually looking forward in terms of whether it is able to pay its debts.

Gillian Hague: I think there were plenty of assets within BHS on which security could have been taken so I don't think there was any suggestion it was not a going concern at that point.

Chris Harris: £200 million of property, for example.

Q596 Richard Graham: Even though the chairman said himself the deterioration in the business was such that the only practical alternative was to place the company into administration. Your words, sir.

Lord Grabiner: Indeed.

Q597 Richard Fuller: You try and sell the business; it's losing a shedload of money; you have a massive pension deficit; you have been supporting it for years and you are now no longer prepared to support it without security; and you can sign off and say, "It's a going concern." Who are you trying to fool?

Paul Budge: I don't think anyone. In fact, in terms of the 4 March minute and taking security on assets, there were many unencumbered assets that the loan could be secured against. If we were losing at that time £35 million per annum and putting in another £20 million so it was £55 million cash a year required for that business, there were £200 million of unencumbered property assets that could satisfy the requirement of that board meeting.

Q598 Richard Fuller: Okay, so what you are saying is that you have been giving the money on the basis of, "We'll maybe get it back later on, but from now on we want to make sure it is physically secured against either property or"—

Paul Budge: I think after £255 million that was the right decision because there would come a time when it would impact on the rest of the group. I go back to the business having been supported for many, many years while we looked for a solution to improving its profitability.

Q599 Richard Fuller: Did the auditor comment that that was a change from the past and perhaps they ought to make a note about it in terms of a going concern?

Paul Budge: I don't recall that they did. No.

Q600 Richard Fuller: But they were aware of it.

Paul Budge: I am not even sure whether they would have seen that board minute. To be fair, I would need to check and come back to you.

Q601 Richard Fuller: Will you let us know?

Paul Budge: Yes.

Chair: Thank you very much for your time. We are very grateful for the answers you have given us. They have been very helpful to our inquiry.