The Pensions Regulator	**Standard Procedure** **DETERMINATION NOTICE** **under Section 96(2)(d) of the Pensions Act 2004 (the "Act")** **(1) BHS Pension Scheme (the "Main Scheme")** **(2) BHS Senior Management Scheme (the "Senior Scheme")** **(together the "Schemes")**	**The Pensions Regulator case ref:** **C22263848**

1. The Determinations Panel (the "Panel"), on behalf of the Pensions Regulator (the "Regulator"), met on 6 December 2017 to decide whether to exercise a reserved regulatory function in relation to the issues raised in the Warning Notice dated 2 November 2016 (the "Warning Notice") in respect of Mr Dominic Chappell, referred to below as the "Respondent".

Matters to be determined

2. The Panel was asked to determine whether to issue two contribution notices ("CNs") under section 38 of the Act[1] to the Respondent.

Directly Affected Parties

3. The Panel considers the following parties to be directly affected by this determination:

   3.1. Mr Dominic Chappell, the Respondent;

   3.2. The statutory and participating employer in relation to the Schemes – BHS Limited (now known as SHB Realisations Limited (Company No: 00229606) but referred to hereafter as "BHS");

   3.3. BHS Pension Trustees Limited (Company No: 04002330), as Trustee of the Schemes;

   3.4. Independent Trustee Services Limited (Company No: 02567540) as independent Trustee of the Schemes;

   3.5. MGL Corporate Services Limited (Company No: 075333520) as independent Trustee of the Schemes;

3.6. The Board of the Pension Protection Fund (“PPF”).

Contents

4. The remainder of this Determination Notice is divided into the following main sections:

Introduction

5. By the Warning Notice, the Case Team[2], on behalf of the Regulator, gave notice that it considered it appropriate for two CNs under section 38 (one in relation to each of the Schemes) to be issued to each of the Respondent and one other target, namely Retail Acquisitions Limited (“RAL”). The action against RAL (which entered liquidation on 1 June 2017) has been stayed XXXXXXXXXXXXXX. This determination, therefore, only relates to the Respondent (Mr Chappell). The Case Team has also confirmed, following the stay of the action against RAL, that CNs are now only sought on a sole liability basis rather than on the basis of joint and several liability which had previously been sought in the Warning Notice as an alternative form of relief.

6. Pursuant to section 10(1)(a), the Panel exercises on behalf of the Regulator the power to determine whether to exercise reserved regulatory functions. Reserved regulatory functions include the power to issue a CN under section 38 (see paragraph 30 of Schedule 2).

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[1] References to statutory provisions hereafter are to provisions of the Pensions Act 2004 unless otherwise stated.

[2] The “Case Team” refers to the team at the Regulator which handles the case, including preparation of the Warning Notice and the presentation of the case to the Panel.

7. In response to the Warning Notice, representations were made on behalf of the Trustees[3] of the Schemes who support the issue of CNs to the Respondent. Whilst correspondence was exchanged between the Respondent's legal representatives and the Case Team and time was extended for the Respondent to provide representations in response to the Warning Notice, ultimately the Respondent did not provide any representations.

8. As part of its process of determining whether to issue CNs to the Respondent, the Panel convened an oral hearing on 6 December 2017. The Respondent did not appear and was not represented at the oral hearing. At the oral hearing, the Panel heard submissions made on behalf of the Case Team. No oral evidence was heard.

9. In arriving at its determination, the Panel has considered the evidence to which it has been directed by the Case Team, the written representations and the oral submissions made to it. Notwithstanding that the Respondent has not actively challenged the issue of CNs to him by participating in the proceedings before the Panel, it remains for the Case Team to persuade the Panel that CNs should be issued to the Respondent. In relation to uncontested evidence submitted by the Case Team to the Panel, the Panel considers that it should be accepted save to the extent that any such evidence is either inconsistent or manifestly incredible.

Representation

10. The Case Team was represented at the oral hearing by Mr Fenner Moeran QC. The Panel is grateful for counsel's submissions.

11. Representatives of the liquidator of BHS attended the oral hearing as observers and did not make representations.

12. No other parties were represented at the oral hearing.

Background Facts

13. Set out below is a summary of the salient background facts drawing heavily on the material set out in the Warning Notice and the submissions made on behalf of the Case Team at the oral hearing.

[3] References to the "Trustees" hereafter are to the trustees of the Schemes in office from time to time.

BHS

14. BHS was a well-known British department store chain originally founded in 1928. It operated at many locations across the UK including a large department store on Oxford Street in London. Its primary activity was the retail of clothing, homeware, lighting and furniture.

15. The BHS group of companies was first purchased by a company ultimately owned by the wife of Sir Philip Green ("SPG"[4]), Lady Christina Green, and therefore within the control of the family of SPG in 2000. SPG sold the BHS group to RAL in March 2015. The Respondent was a director and 90% shareholder of RAL. In April 2016 the BHS group entered administration and then liquidation in December 2016.

The Schemes

16. Both Schemes are final salary occupational pension schemes, the principal employer and sole statutory employer of which is and has always been BHS.

17. The Schemes were established on 1 July 2000, arising out of the purchase by SPG of the BHS group. Both Schemes are closed to future accrual.

18. As at 31 March 2015, the Main Scheme had a total of 20,462 members and the Senior Scheme a total of 233 members.

19. At the time of their establishment, both Schemes were in surplus in the order of £43m (calculated on an ongoing basis). However, that surplus reduced and, by 2006, there was a combined deficit across the Schemes.

20. The funding position of the two Schemes over the period 2009 to 2015 was summarised in the Warning Notice as follows.

Year	**Main Scheme Deficit (£m)**		**Senior Scheme Deficit (£m)**	
	Ongoing	*Buyout*	*Ongoing*	*Buyout*
2009	(148)	(354)	(18)	(48)
2010	(110)	(328)	(7)	(39)

4 The term "SPG" shall be used hereafter to include the family of Sir Philip Green as well as entities in which he or a member or members of his family was or were interested. Accordingly, at some points in this document "SPG" refers to Sir Philip Green, on other occasions it refers to a member or members of his family or entities in which Sir Philip Green or a member or members of his family was or were interested.

2011	(112)	(344)	(7)	(44)
2012	(211)	(452)	(22)	(62)
2013	(222)	(529)	(21)	(72)
2014	(194)	(480)	(17)	(63)
2015	(231) – (300)	(516)	(20) – (32)	(55)

21. As at 11 March 2015, the Regulator’s actuarial team have estimated that the joint deficit of the Schemes was £531m calculated on the buy-out basis, consisting of £478m in respect of the Main Scheme and £53m in respect of the Senior Scheme.

22. The most recent recovery plans for the Schemes were agreed in September 2013 in relation to a valuation date of 31 March 2012. These provided for £10m annual contributions (£9.5m to the Main Scheme and £0.5m to the Senior Scheme) over the period to April 2036 (i.e. for 24 years 1 month from the valuation date of 31 March 2012).

History prior to the Sale

23. Whilst the Warning Notice contains a great deal of factual background, the Panel understands that this was provided as historical context and Mr Moeran QC confirmed at the oral hearing that the Case Team does not seek to make its case against the Respondent in reliance upon events prior to 2014. Accordingly, the events prior to 2014 can be stated briefly.

    23.1. In May 2000, SPG purchased the BHS group XXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXX.

    23.2. Subsequently, a number of properties within the BHS group were sold to subsidiaries of Carmen Properties Limited (“Carmen” a company owned by SPG) as part of a sale and leaseback arrangement.

    23.3. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.

    23.4. In July 2009, SPG transferred BHS into the Taveta group which held the Arcadia group of companies (another well-known business of SPG’s which included brands such as TopShop / Top Man, Dorothy Perkins, Burton and Evans). One consequence of this transaction was that Arcadia brand concessions were rolled out in BHS stores.

23.5. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXX.

23.6. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXX.

24. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXX.

25. In January 2014, a proposal named “Project Thor” was put forward on behalf of BHS/SPG to the Trustees under which the Schemes would be restructured by compromising their liabilities (as outlined below) and the BHS business would also be restructured. In essence, the proposal sought to deliver a better outcome for the Schemes than would have been achieved in the event of BHS’s insolvency. An important premise of the proposal was that, in the absence of some form of restructuring, BHS’s insolvency was inevitable. This premise reflected the fact that the restructuring was envisaged to take the form of a “regulated apportionment arrangement” (available under Regulation 7A of The Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 678 of 2005)) which would only be approved by the Regulator if insolvency was considered to be inevitable.

26. Deloitte, who had been appointed to advise SPG in relation to Project Thor, carried out extensive work which recognised that BHS was a loss-making business which depended on wider support from its parent’s group and that without a solvent restructuring, BHS would enter administration and the Schemes would enter the PPF.

27. The Project Thor proposal was, broadly speaking, as follows:

27.1. BHS would establish a new scheme, paying lower benefits, through lower annual increases on pensions, than under the Schemes but at a level at least as generous as PPF compensation.

27.2. Members with benefit values in excess of £18,000 would be offered a transfer of their benefits into the new scheme.

27.3. Members with benefits of a value of £18,000 or less would be offered the option of commuting their benefits into a lump sum payment or of transferring their benefits into the new scheme.

27.4. The Schemes' assets and liabilities in respect of the transferring members would be transferred into the new scheme.

27.5. There would be a payment of a lump sum (the amount of which had not been agreed) into the new scheme, equal to the amount that the Schemes were estimated to receive in an insolvency scenario.

The intention was that the new scheme would be well funded on a "self-sufficiency" basis.

28. Discussions in relation to Project Thor took place during 2014 between the Trustees and SPG and his representatives. The Trustees were, in principle, receptive to a Project Thor style proposal, recognising that BHS did not offer a viable long-term funding solution for the Schemes if they continued unchanged. The Trustees instructed KPMG who advised them in relation to the estimated outcomes on insolvency.

29. The Regulator also became involved in the discussions about the proposal and a draft clearance application was submitted to the Regulator on 17 July 2014. However, ultimately no agreement was reached, not least because of differing views over the amount that the Schemes were likely to receive in an insolvency and accordingly the amount of the lump sum that should be paid into the new scheme. By September 2014, the Project Thor proposals were "paused" by SPG (as communicated to the Trustees during a telephone call on 5 September 2014) and the draft clearance application was formally withdrawn on 3 October 2014. Whilst discussions were later resumed, no agreement to implement Project Thor was ever reached.

Build up to the Sale

30. It appears that the Respondent became aware of the potential opportunity to purchase BHS through Mr Paul Sutton who had been in discussions with SPG about a possible sale. By some point in the first half of 2014, those discussions had broken down due (so it seems) to

concerns about Mr Sutton's background (he had apparently been declared bankrupt and convicted of fraud in France).

31. The Respondent, who knew Mr Sutton, took over the sale negotiations, renaming as Swiss Rock plc a company that he already owned (the name 'SwissRock' had also been used by Mr Sutton as a potential purchasing vehicle during his own discussions). Other features of the bid that the Respondent later put forward were also the same as those that Mr Sutton had been promoting.

32. On 19 September 2014, the Respondent spoke with Adam Goldman (the Arcadia Company Secretary) concerning a potential bid for the BHS business. Mr Goldman provided the Respondent with a draft Non-Disclosure Agreement on the same day. On 23 September 2014, the Respondent then spoke with Paul Budge (the BHS and Arcadia Finance Director) in what the Respondent described as a "*straight no BS discussion*". This period appears to have marked the start of the Respondent's direct involvement with those on the BHS/SPG side that ultimately led to the sale of BHS in March 2015 (the "Sale").

33. On 31 October 2014, the Respondent met with Mr Budge along with Lennart Henningson. Mr Henningson was then of RiverRock Securities Limited ("RiverRock"), who were being lined up as the lead buy-side advisers for the transaction providing strategic and financial advice. Following this meeting, Mr Budge indicated that any approach should be made through Goldman Sachs whom it appears that SPG had appointed to act as a "*gatekeeper*" in order to vet possible purchasers. This process was referred to amongst those involved on the purchasing side as the "*Goldman Sachs test*".

34. On 20 November 2014, Swiss Rock Ventures Limited ("Swiss Rock"[5]) was incorporated. It was this company that ultimately purchased BHS (having changed its name to RAL on 3 March 2015).

35. In addition to the Respondent, who was described as a "*serial entrepreneur*", the key individuals involved within Swiss Rock were:

    35.1. Edward Parladorio. Mr Parladorio is a solicitor whose clients included the Respondent and (at least formerly) Paul Sutton. The Panel understands that Mr Parladorio's primary role was intended to be in relation to PR and media.

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5 The term "Swiss Rock" shall be used to refer to Swiss Rock plc and/or Swiss Rock Ventures Limited.

35.2. Stephen Bourne. Mr Bourne is an accountant who was intended to provide expertise in finance and accounting.

35.3. Mark Tasker. Mr Tasker is also a solicitor and appeared to be involved in the process to provide legal expertise.

36. Also on 20 November 2014, RiverRock were formally engaged to act as lead advisers on the transaction. Around the same time, Grant Thornton LLP, Olswang LLP and Bell Pottinger were also instructed. Each of them was working on a contingency fee basis until the signing of a lock-out agreement.

37. Representatives of RiverRock met with Goldman Sachs on 11 December 2014. RiverRock had prepared a written proposal which, amongst other things, provided for a purchase price of £1 and stated that the purchaser would invest £120m into BHS and implement a management sponsored restructuring plan for the business. The heads of terms that were proposed included the provision of a "*pension solution satisfactory to* [the purchaser]" and a "*call option on Arcadia*". The proposal also recorded that the Respondent personally was to provide working capital in the form of a shareholder loan of £5m.

38. Whilst it is not clear exactly what Goldman Sachs told SPG following their meeting with RiverRock, the outcome was that SPG declined the initial proposal that had been put forward. Michael Casey who attended the meeting on behalf of Goldman Sachs commented afterwards that, "[t]*he people in the room appear credible but it's a high beta plan*". He also noted that the Respondent did not have "*retail background / expertise*" and had himself previously been bankrupted which RiverRock recognised created a "*PR risk*". Accordingly, it appears that the Respondent and his colleagues had failed the "*Goldman Sachs test*".

39. This failure appears to have prompted some dissatisfaction between RiverRock and Swiss Rock. As a result, on 15 December 2014, RiverRock sent notice to the Respondent terminating its engagement with Swiss Rock. However, notwithstanding the parting of the ways between RiverRock and Swiss Rock, Mr Henningson remained involved as part of the purchaser's team.

40. At around this time, the Respondent took steps to progress matters more directly. It appears that he planned to meet personally with SPG over one weekend in mid-December 2014 (although, it is unclear whether in fact this meeting took place).

41. On 8 January 2015, the Respondent emailed Anthony Gutman (of Goldman Sachs) with a revised proposal for the purchase of BHS, Carmen and Marylebone House (which was used by BHS as a headquarters). Amongst other things, this proposal included that:

41.1. The purchase price would be £1.

41.2. Swiss Rock would obtain £100m to inject as senior debt.

41.3. Swiss Rock would invest £35m clear, unencumbered equity into BHS.

41.4. A recognised retail specialist would be appointed as CEO/chairman.

42. Although the Respondent was optimistic that a deal was about to be reached (as is evident from the emails to the Swiss Rock team sent at the time), this proposal was also not acceptable to SPG.

43. Despite this setback, the Respondent continued to pursue the purchase of BHS, trying again to reach out to SPG personally. On 18 January 2015, Mr Budge emailed SPG attaching the offer proposal that Swiss Rock had made to Goldman Sachs and stated that, "…*they have now said they would be flexible on, improve on* [the offer] …*Dominic stresses that he and his investor team are prepared to* [pursue] *any opportunity necessary to reach an agreement*".

44. In the hope of seeking to persuade SPG to agree to a deal, it appears that the Respondent informed Mr Budge that Swiss Rock would be prepared "*to contribute towards the pension recovery position*" (as recorded by Mr Budge in an email to SPG on 20 January 2015). It also appears that Respondent believed this would require c.£50m which was a figure that he had been informed of during the previous year when assisting with Mr Sutton's failed approach. The Respondent did not appear to have access to any more up to date information about the Schemes.

45. On 21 January 2015, Grant Thornton commented in an internal email amongst its deal team that SPG and the Respondent remained in discussion and that the Respondent was "*desperate*" to get a deal done. It is clear that those involved on the BHS/SPG side also recognised the Respondent's "*persistence*".

46. However, with no deal reached with Swiss Rock, on 25 January 2015, it was announced in the news media that SPG had put BHS up for sale. This was the first time that the Trustees learned that a sale was being sought. Notwithstanding this development, the Respondent still considered himself to be at the front of the queue in terms of potential purchasers.

47. Whilst it appears that several other parties expressed initial interest in a potential purchase of BHS, in the end, Swiss Rock was the only party who remained interested.

48. On 27 January 2015, Mr Parladorio emailed Mr Tasker and Mr Bourne and stated that:

"*SPG has agreed terms with DC this morning and his key concern is a very firm promise to run the business for three years minimum. The stick for that is he sorts out pension issues on 3 yearly instalments and if business busts before end of year three then he will not pay the third tranche…*".

49. Further meetings between Swiss Rock and Goldman Sachs appear to have taken place at the end of January 2015 which led to some optimism amongst the Swiss Rock deal team that a transaction would soon be concluded.

50. On 30 January 2015, Allied Commercial Exporters Limited ("ACE") wrote to the Respondent offering to purchase Marylebone House for £45m. As an initial payment, ACE agreed to transfer £35m into Olswang's client account to be held to ACE's order, which it duly paid on 2 February 2015. ACE was to receive a fee of £1m for doing so at the time of completion. It appears that SPG's team may have been given the impression that this money was equity on the part of Swiss Rock that could be invested in the BHS business when that was not in fact the case.

51. On 5 February 2015, draft points of principle were provisionally agreed between Swiss Rock and SPG. Whilst these points of principle were revised over the next week, on 12 February 2015, SPG and the Respondent "*shook hands*" on a deal (as the Respondent reported in an email sent to his team on that day). Although it was pointed out to the Respondent by David Roberts of Olswang that the current draft points of principle were "*imperfect*", the Respondent appeared willing to sign them because "*the goodwill that has developed between SPG and* [Swiss Rock] *means that Dominic is confident they will happen notwithstanding*".

52. Accordingly, on 16 February 2015, points of principle were signed by SPG and the Respondent. Completion was envisaged to take place on 9 March 2015 (until which time Swiss Rock was to have exclusivity to complete the purchase). Amongst other things, those points of principle included:

52.1. Swiss Rock was to demonstrate that it had £35m of provisional funding to acquire Marylebone House and a £120m three year working capital facility.

52.2. Swiss Rock was to use all reasonable endeavours to continue to trade the BHS group for at least 3 years.

52.3. Swiss Rock was to inject £10m of new equity into the BHS group on completion.

52.4. Arcadia group would make contributions to the Schemes of £5m per annum for the next three years.

52.5. Swiss Rock was to use reasonable endeavours to reach a settlement, as soon as reasonably practicable, with the Trustees as envisaged under Project Thor (or similar). Arcadia group was to contribute the balance of any unpaid annual contributions (as referred to above) to any settlement up to a maximum of £15m.

53. The reference to reaching a settlement with the Trustees clearly reflected an awareness on the part of the Respondent that a pensions solution for the Schemes and BHS was required. Indeed, the need for this was obvious. In the year ending 30 August 2014, BHS had suffered a loss before tax and extraordinary items of £69m. Accordingly, the funding position of the Schemes (as summarised in paragraphs 20 to 21 above) had to be viewed in the context of the poor financial performance of their sponsoring employer. Further, despite the combined deficits running into the hundreds of millions of pounds, under the existing 2012 recovery plans, only £10m per annum contributions were being made. According to the Schemes' investment committee, contributions at that level only covered interest on the deficits plus expenses and not even the PPF levies. By early 2015, it was estimated that additional annual contributions of a further £20m to £30m would be required. Accordingly, it was abundantly clear that BHS on its own could not support the Schemes in their then state.

Due Diligence

54. Given the proposed completion date, there was only a short window in which to carry out due diligence. As the Case Team has described it, the due diligence exercise was subject to significant problems.

    54.1. Swiss Rock could not afford to pay its professional advisers, who threatened to "down tools" on a number of occasions despite the proximity to the completion date. The Respondent ended up agreeing to significant success fees on the completion of the purchase in order to keep the advisers working. However, this was a recurring problem right up until the time of completion.

    54.2. On account of the expedited nature of the exercise, important due diligence areas remained incomplete at the time of completion. In particular, little disclosure was provided in respect of the Schemes.

55. The limited due diligence in relation to the Schemes is of most relevance for present purposes. It is clear that, long before the points of principle were signed on 16 February 2015, those involved in the bid team were made aware of the importance of addressing the issue of the Schemes. For example:

    55.1. As far back as 11 November 2014, Grant Thornton had raised questions about how the Schemes were to be dealt with. In particular, they advised that, "[t]*he key issue is to ensure that any restructuring of funding proposals in respect of the schemes are both legally binding and avoids any future funding requirement arising in respect of 'Swiss Rock*'".

    55.2. On 1 December 2014, XXXXXXXXXXXXXX RiverRock raised the following query in an email to the bid team, "[c]*an we get a bit more info on the Pension situation – how is SPG planning to address that point and please confirm we can have access to the PwC working papers asap?*"

56. Despite the Respondent's advisers raising concerns about the pensions position, it appears that the Respondent did little to investigate the matter and in fact positively agreed to limited disclosure being given in relation to the Schemes. At the same time, assurances were given by the Respondent to the Trustees that a solution would be reached.

    56.1. On 16 February 2015, Stephen Bourne emailed Mr Paul Martin (of Grant Thornton) setting out a list of points that needed to be considered as part of the "*very focussed*" due diligence. That list did not specifically include reference to the Schemes, although Mr Bourne recognised at the end of his email that, "*of course we all have to gain an appreciation of our options and exposures on pensions*".

56.2. On 19 February 2015, the Respondent met with the Chairman of the Trustees, Chris Martin, during which meeting the need for a solution for the Schemes was discussed. Mr Martin informed the Respondent that the 2015 valuations for the Schemes would produce deficit contributions that were "*unaffordable*". The minutes of that meeting (recorded by Mr Martin) include a statement by Swiss Rock that "[t]*hey are clear that they will only proceed with a purchase if they believe that a pensions solution can be agreed (pensions are the elephant in the room in all their conversations…)*". The Respondent also informed Mr Martin that "*they would recapitalise the business (£120m) and that the funding is lined up*". That meeting was concluded on the basis that "*reaching a high level understanding on pensions should be an objective pre-9th March (without it they won't complete)*". Mr Moeran QC (in the Panel's view, quite fairly) described the Respondent's approach as saying "*one thing to the Trustees*" but then not actually caring to do anything in order to reach a pensions solution.

56.3. Although the points of principle referred to Project Thor, it does not appear that the purchasing team in fact had much information at all about Project Thor and were required to sign a "hold harmless" letter before receiving further information. This is clear from an email of 20 February 2015 between Tony Clare (of Deloitte) and Gillian Hague (of Arcadia) in which Mr Clare stated:

"*We now have a signed HH and bidder wants Thor pension docs. I think they need them in order to get the lenders comfortable etc. It is unrealistic to think a deal of this scale will go thru without full due diligence. SPG was adamant that pensions would be dealt with at high level only between Principals. He did not want due diligence. It will look as tho there is something to be hidden here. That is not the case of course*".

56.4. Ms Hague responded to Mr Clare on 23 February 2015. In her email, she stated, "*this seems a reasonable request as you say BUT we think that Dominic would be best to ask for the DD from Sir Philip himself – I believe that Dominic is seeing SPG tonight so* *that might be the opportunity to do so*". Mr Clare's response later on the same day stated, "*I think we are all agreed it is reasonable and almost certainly necessary. I am happy for DC to speak with SPG…*" Also on 23 February 2015, XXXXXXXXXXXX Grant ThorntonX emailed Ms Hague with a list of requests from his pensions colleagues which included requests for basic information such as the latest scheme actuarial valuations, copies of the Schemes' deed and rules and "*an evaluation of opportunity and prospects for implementing project Thor and the costs of its implementation and a summary outline of it*".

56.5. Despite the recognition (including even on the part of those involved with the vendor) that due diligence in relation to the Schemes was important and necessary, it appears that the Respondent specifically agreed with SPG that limited information in relation to pensions would be provided during the due diligence exercise. This can be seen from an email from Mr Budge sent to Deloitte on 24 February 2015, in which Mr Budge stated:

"*Spoke to SPG. He is happy that the Thor report goes to Dominic, but does not agree to release all the other request on pensions. On the basis that Thor will include an element of scene setting, Dominic has pragmatically agreed to this approach*".

56.6. It is clear that the lack of due diligence in relation to the Schemes was of concern to Grant Thornton. On 25 February 2015, Paul Martin emailed the Respondent stating that: "*I understand that you have been having principal to principal discussions with SPG on pensions…GT and Olswang pensions teams are encountering significant resistance to their efforts to progress work*".

56.7. Despite the concern expressed by the purchaser's professional advisers, it appears that the Respondent was anxious for the deal to be completed. On 25 February 2015, David Roberts of Olswang emailed XXXXXXXXXXX Linklaters (who were acting for the vendor) concerning the progress of the drafting of the Sale and Purchase Agreement and stated, "*the principals on both sides appear adamant that the deal has to sign or complete on or before 9 March and we are being forced to short circuit our diligence efforts accordingly*".

56.8. It was not in fact until 26 February 2015 that the Project Thor documents were released to the bid team. On receipt, perhaps unsurprisingly, Olswang sought further information from Ms

Hague. That request appears to have been rebuffed. In an email sent later on 26 February 2015, which was copied to the Respondent, Mr Budge stated that "[v]*ery specifically SPG and Dominic had agreed limited paperwork regarding pensions*".

56.9. Only a day later, on 27 February 2015, Grant Thornton produced an interim report on their due diligence. The summary in relation to pensions recorded that:

"*Substantial deficit on any measure likely to have increased since the last valuation.*

Normal treatment of a pension deficit would give rise to a negotiated deduction from the purchase price for 'debt'.

Size of the Schemes' gross assets and liabilities relative to earnings of the business mean that any volatility can have a material impact on the future funding requirement and therefore potentially on free cash flow even if Project Thor is delivered.

Attitude of the Trustees and possibly the Pensions Regulator critical."

Later in the report, the point was made that "*Project Thor details received 26 February. No other information received or meetings held to date*".

56.10. The concern on the part of the professional advisers, and the view that the Respondent was following an abnormal course, is clear from an email from Keith Hinds (of Grant Thornton) to Ron Burgess (of Olswang) dated 1 March 2015:

"*Dominic is no fool and must be aware that this does not bode well and is hardly "normal" or particularly helpful in coming to anything other than a cautious or even more conservative conclusion about the issues that might be presented by the scheme. Nevertheless I get the strong impression that he had a desire to proceed come what may. Ultimately he is a sophisticated buyer of our combined services and we can only advise on the information we are allowed to have access to and flag our concerns at the risks presented by the pension scheme to the business post acquisition.*"

56.11. The Respondent met for a second time with Chris Martin (as well as SPG and others) on 4 March 2015. According to Chris Martin, who has provided a witness statement, he recalls, "*explaining again to* [the Respondent] *the likely scale of the deficits in the Schemes and the contributions that would be required to fund these deficits*".

56.12. It appears that Mr Hinds (of Grant Thornton) spoke with Tony Clare of Deloitte on 5 March 2015 to gain some understanding of the current position with Project Thor. In Mr Hinds' email reporting on his conversation, he noted that "[Mr Clare] *confirmed that all parties (SPG/Deloitte/Trustee/KPMG/tPR) considered the scheme was too big for the company and needed 'rightsizing' his words not mine and that they could see that insolvency was inevitable unless something was done…I said that one of the areas that we needed comfort on was to understand tPR's and Trustees appetite for Thor since if the transaction was going to proceed as currently planned all execution risk re Thor would rest with the Buyer. He agreed*".

56.13. Grant Thornton produced an updated draft due diligence report on the Schemes on 6 March 2015. The report noted Grant Thornton's "*extremely limited access to essential base data regarding the Schemes and Project Thor*" and that all execution risk on Project Thor lay with RAL/BHS.

56.14. On 6 March 2015, Olswang prepared an "issues list". In relation to pensions, it recorded the seller's position to be that:

"*Seller sells the group with the potential £500m hole in the pension funds but will gift £5m over three years towards annual contributions. On and from completion, Seller's position is that the Buyer should assume full risk in respect of the existing pension deficit including risk of winding up, risk that Project Thor cannot be funded, the risk that Project Thor is not agreed by the pensioners and the risk of regulatory action by the Pensions regulator regarding moral hazard, contributions notices etc… Seller's position is that the Buyer should find the funds to execute Project Thor post completion*".

In the same document, the buyer's position was stated to be (or should have been) that:

"*The buyer is unable to buy the business without its board and lenders having clarity and certainty about the views and powers of the trustees of the schemes now and post completion and without seeking comfort and input from the Pensions Regulator regarding this deal and Project Thor. Normally in a transaction of this nature a defined benefit scheme's funding deficit would be treated as a debt-like instrument, with an appropriate adjustment made to the purchase price to take account of the future funding liability*".

56.15. Also on 6 March 2015, Mr Hinds emailed Paul Martin stating that, "*in simple terms all execution re Thor rests with our client as will all scheme risk volatility until Thor is delivered*".

56.16. Whilst the Respondent and the rest of his team were given only limited access to the Trustees, in the run up to the Sale, SPG continued discussions with the Trustees over a possible pension solution. However, no agreement was reached.

57. In his oral submissions, Mr Moeran QC placed particular emphasis on three important factors which he said were evident from the build up to the Sale.

57.1. First, the Schemes were clearly a defining issue for BHS from a commercial perspective.

57.2. Second, the Respondent knew (at least in principle) that the Schemes were a defining issue for BHS before the Sale.

57.3. Third, despite both of the points made above, the Respondent did nothing seriously to investigate the position, ignored the advice of his professional advisers and appeared not to care about resolving the issues presented by the Schemes.

In the Panel's view, each of these points is a fair conclusion to reach based on the evidence to which the Panel has been referred.

Last minute changes

58. In the days immediately prior to completion, the terms of the deal continued to change. It appears that RAL was having difficulty reaching agreement with a funder. On 6 March 2015, XXXXXXXXXXX Grant ThorntonX stated in an email to XX colleagues, "*DC just threatened to walk away now as the penny has finally dropped that the deal on offer makes BHS insolvent on Day 1. DC and SB to meet SPG at 3. 50/50*

whether there will be a deal on Monday am. 130m dowry needed from SPG or the deal can't happen".

59. An "all parties" meeting took place later that day following which a revised agreement appeared to have been reached. The precise terms reached at that time are not particularly clear but it included SPG providing a bridging loan of £50m. As Mr Hinds (of Grant Thornton) admitted in an email on 9 March 2015, "*the funding arrangements between SPG and DC keep moving around and I am forever nervous that they want to keep some of them or the transaction steps surrounding them as confidential as possible*". In relation to pensions, XXXXXXXXXX XX Grant ThorntonX commented that "*I don't really get the pensions solutions but it looks like they're parking it until afterwards*".

60. It also appears that the Respondent had now agreed with SPG that Marylebone House would not be sold to RAL but instead to a third party for £52.055m. As a result, the Respondent proposed to sell another BHS property, North West House (instead of Marylebone House) to ACE for £32m. Accordingly, RAL returned to ACE £3m of the original £35m down payment that ACE had made and was being held pending completion of the sale (as described in paragraph 50 above).

61. Immediately before the Sale, ACE and RAL also entered into a loan agreement by which a £5m facility was provided to RAL, for the purpose of subscribing for shares in BHS Group Limited ("BGL") (which was BHS's parent company). £2m of the loan was to be repaid by 18 March 2015, with the balance due on 11 May 2015. There was a £1m "exit fee" payable in addition.

62. Grant Thornton's final due diligence report, dated 11 March 2015, recorded that, "*there are important areas of our work (particularly pensions, tax and separation) where we are unable to reach definitive conclusions*". It went on to note that "[a]*ll execution risk in Project Thor will lie with the Employer/Buyer*" and that "[a]*s things stand the Buyer should assume it is acquiring a business that is struggling to fund a pension scheme with a funding deficit of c.£300m (subject to imminent review at upcoming triennial valuation) and a buy out deficit in excess of £500m and which is under the close scrutiny of the Pension Regulator*".

Completion of the Sale

63. On 11 March 2015, the Sale of BHS's parent company, BGL, from the Taveta group to RAL was completed by a Sale and Purchase Agreement. The main terms were as follows:

63.1. The purchase price was £1.

63.2. At completion, the vendor was to procure that the Group Cash Account was £23,660,000 and that a loan be made to BGL of £3.5m.

63.3. Arcadia had written off £200m of a £240m unsecured intercompany debt owed by BHS by a deed of release; the remaining £40m of intercompany debt was to be secured by a fixed charge over the Cribbs Causeway store in Bristol (as to £15m) and a floating charge over the non-property assets of the BHS group.

63.4. At completion, RAL was to procure a £10m capital injection.

63.5. The purchaser was to use all monies available to the group for the sole purpose of running the group's business, and use all proceeds of sale of properties for the same purpose until a pension compromise had been reached.

63.6. RAL was to use its reasonable endeavours to reach agreement with the Trustees for the compromise of the liabilities of the Schemes and implement such a compromise as soon as reasonably practicable following completion.

63.7. BHS was to pay £5m per annum contributions to the Schemes, which would be matched by the Taveta group (up to a maximum payment of £15m each over a 3 year period).

63.8. RAL undertook to use its best endeavours to ensure that BHS continued to trade for three years.

64. By a side letter of the same date, Arcadia wrote to the Respondent to confirm that (i) the floating charge of £25m over the stock and debtors of BHS and (ii) the £15m fixed charge over the BHS Cribbs Causeway store were held to BHS's order to secure the ongoing £10m per annum contributions to the Schemes and in the event of a compromise or winding up. The floating charge was to reduce pro-rata as contributions to the Schemes were made. The side letter also said that if the Cribbs Causeway store were to be sold, it had to be replaced with £15m cash or a suitable asset to be mutually agreed. In an internal Olswang email sent several months after the Sale, it was explained in relation to the side letter that:

"*[t]his was drafted during the SPA negotiations between SPG and our client without any lawyer input. I understand…that the commercial intention is that RAL and Bhs have the right to request that SPG transfers the secured loan to the pension trustees as part of a compromise with the pensions trustees or if there is an insolvency process*."

65. A further side agreement also appears to have been reached between the Respondent and SPG concerning the apportionment of the sale proceeds of Marylebone House.

66. At the time of the Sale, RAL's shareholders were:

66.1. the Respondent – 90%;
66.2. Mr Parladorio – 5%;
66.3. Mr Tasker – 2.5%;
66.4. Mr Bourne – 2.5%.

67. The formal decision by the board of RAL (consisting of the Respondent (as chairman), and Messrs Parladorio, Bourne, Tasker and Henningson) to enter into the Sale transaction was recorded in board minutes of 11 March 2015. Those minutes reflected some of the deficiencies in the due diligence process and indicated that significant reliance appeared to be placed on assurances given by SPG. In relation to the Schemes, it was accepted that, "*the Trustees consider the proposed acquisition as materially detrimental and were seeking mitigation with the involvement of the Pensions Regulator*". It was also recognised that "[t]*o implement Project Thor will be expensive and time consuming and there are structural problems that may arise…There is currently uncertainty about exactly what stage of agreement the parties have reached with Project Thor…Post-Completion, all of the implementation risk and cost will be the Buyer's*".

68. It appears that RAL held a separate board meeting on 11 March 2015 specifically to consider the issue of the Schemes. The minutes of that meeting recorded:

"*In summary: (i) very limited information was disclosed to the directors in respect of the Schemes and all the financial information came from Deloitte who were acting for the Seller group in relation to Project Thor (broadly, a proposed partial solution to the significant funding issues in relation to the Schemes)…*

…The directors noted that as a condition of entering into the Transaction, they had no choice but to grant…a fixed charge over certain property of the group in favour of the Seller's group…

…Given that the directors have no choice in order to enter into the Transaction, the directors have taken advice regarding the granting of security…and will have a better view of the finances after Completion and as the business turnaround plan starts to be implemented".

69. On 13 March 2015, a Sale and Purchase Agreement was also entered into in respect of Carmen. Under this, the shares in Carmen were sold to BHS Properties Limited (which was part of the group that RAL had acquired) for £1. The sale of Carmen had followed a refinancing of its debt by which HSBC provided a £70m facility with security over various properties and Arcadia providing a guarantee.

Taking stock

70. Taking stock of the position at the time of the Sale, the Case Team relies on the fact that it appears from the material evidencing the course of the negotiations that SPG originally had three main requirements for a buyer of BHS:

70.1. A person with retail experience should be appointed as CEO.

70.2. There should be an equity investment of £35m by the buyer.

70.3. An additional £120m of debt funding should be provided as working capital.

These original requirements appear to have been made known to the Respondent during the negotiations and were reflected in various of the proposals and earlier in principle agreements.

71. In fact, by the time that the Sale was concluded, none of these original requirements was met.

71.1. Despite the Respondent initially claiming to have in place an experienced retailer (Mr Peter Graff) who would become CEO following the purchase, in the end Mr Graff played no role with BHS. Instead, RAL's board had no retail experience and no experienced CEO was found to head up the BHS board.

71.2. RAL had no equity to inject. At one point during the build up to the sale, it appears to have been suggested that RAL had £35m to inject but this was (as explained in paragraph 50 above) in fact the advance purchase consideration from ACE for Marylebone House, the freehold of which RAL anticipated would be transferred into the BHS Group prior to the Sale but which in fact did not take place.

71.3. Despite early claims to have funding in place, it became apparent before the Sale that RAL had no proper or sustainable funding arrangement in place.

72. Two days after the Sale (on 13 March 2015), Mr Bourne emailed Messrs Parladorio and Tasker explaining why the fees of Grant Thornton and Olswang must be paid (and, therefore, must have still been outstanding at that time):

"*Lots of reasons for this*

Volatile owner who changes his mind, poor track record on fees and has little respect for professionals – until cash moves all fees are at severe risk of not being paid
We cannot pretend that this is not damaging all of our reputations.
We need total commitment from GT and O going forward.
We have to draw a line with Dominic who seemed to have had the time to make some sort of payment to himself!"

Conduct post-Sale

73. The fortunes of BHS did not improve following the Sale. The Case Team referred the Panel to various matters which are set out below.

74. The most obvious point was that, by running a business that continued to be loss-making, this inevitably worsened the position of BHS to the detriment of its unsecured creditors, including the Schemes.

75. In addition to the sheer passage of time, BHS's fortunes were also damaged by the following:

75.1. Inexperienced personnel were appointed to the boards of BHS and its parent company BGL. On the Sale, all of the BHS and BGL directors had resigned. In their place, came the Respondent and others who had no or little retail or relevant management experience. The only director of BHS with any prior retail experience was Darren Topp who had previously worked for BHS before the Purchase but at a position below board level. This deficiency appears to have constituted a major flaw in the implementation of the Respondent's plans since he had previously informed Mr Budge (on 6 February 2015) that "[t]*he extent of costs savings and the timescale required to implement them will depend upon the ability of the existing BHS management team, who will be central to our plan, and our intention to supplement them wherever necessary with senior retail talent*".

75.2. No realistic business turn-around plan was ever developed prior to the Sale or then put into action. A business plan called "Project Albion" which had originally been prepared back in 2013 as part of the Paul Sutton proposal was still in circulation in the run up to the Sale. There was also an Arcadia produced business plan dated March 2015 which appeared to envisage a dramatic reversal in fortunes for BHS over only a 2 year period so as to turn the business into profit by making £27m of property savings and £24m from trade initiatives. Grant Thornton appears to have treated this plan with some scepticism and noted in their due diligence report that "[t]*he numerous initiatives across the business will have inter-dependencies and potential contradictions between them, especially in terms of timing and resource requirements*". The Arcadia plan also required significant investment to be made in order to achieve the turnaround envisaged.

75.3. A key aspect of any turn-around for the BHS business was to achieve cost saving on BHS's rent liabilities. This could be done either through negotiation with landlords or via an insolvency process. Following the Sale, these measures were not implemented. In particular, rent renegotiations in relation to the BHS stores were not achieved until March 2016 when a CVA was finally entered into with landlords (as described below). This was far too late, meaning that a year had gone by without the savings that had been hoped for.

75.4. At the time of the Sale, it had been envisaged that the BHS Oxford Street store would be sold by September 2015 in order to generate £50m of working capital. As Grant Thornton noted in its 11 March 2015 due diligence report, "[f]*ailure to deliver this cash flow (or some other form of financing) will mean the business runs out of headroom at the end of September 2015*". In fact, the Oxford Street store was not sold until April 2016 thereby failing to generate £50m of working capital that was vitally needed.

75.5. The Case Team claims that a number of other properties not only took longer to sell than had been envisaged but were sold at an undervalue. These are dealt with in a report by Lambert Smith Hampton and included Northwest House which (as explained in paragraph 60 above) was sold to a subsidiary of ACE for £32m on 11 March 2015 but then sold on two months later for £38.5m. It is also notable that £5m of the £32m proceeds of sale received by BHS was in fact paid on to RAL ostensibly as an interest free loan. The result was that the property sales failed to produce the value for BHS that was needed.

76. The removal of BHS from the same ownership group as Arcadia caused suppliers to lose confidence in BHS. This led to the withdrawal of credit insurance which immediately impacted negatively on BHS's cash-flow.

76.1. Whilst BHS was associated with SPG and the Arcadia group, credit insurers were generally willing to extend insurance to BHS's suppliers against the risk of BHS defaulting. However, it was clear that once BHS was sold, this position would change: even before the Sale was completed, credit insurance limits were being reduced on the basis of press reports of an impending sale. Grant Thornton had identified the issue as an important one in its pre-sale due diligence.

76.2. With the withdrawal of credit insurance, BHS would instead have to provide letters of credit backed with cash collateral. The financial impact of this change was substantial. By 16 May 2015, £14m of letters of credit had been agreed and it was estimated by Grant Thornton that a total of £31m of cash collateral was needed to place the orders for Autumn/Winter 2015 and that if that proved correct, BHS would be unable to meet the June quarter rent repayments. Whilst BHS survived for a while longer than feared at that time, the withdrawal of credit insurance caused a major drain on its working capital.

76.3. The Case Team also relies on this issue as an illustration of SPG's ongoing involvement in the BHS business after the Sale and thus evidencing the unusual (or "non-commercial") nature of the Sale. It appears that SPG negotiated with suppliers and insurers in an attempt to ameliorate the position for BHS. HSBC were prepared to extend credit insurance to BHS when other insurers were not based on SPG's intervention and long-term relationship with HSBC. At one point, SPG appears to have offered to put up a

£20m guarantee to stand behind the credit insurance. HSBC aside, all other insurers withdrew or reduced their insurance cover.

77. RAL injected no equity into BHS and no sustainable or long-term funding arrangement was ever put in place. It had been envisaged that £120m of debt finance would be obtained, however, this was never arranged. Instead, resort was had to expensive, short term piecemeal funding arrangements, the cost of which was borne by the BHS business. In total, RAL used four sources to finance its purchase of BHS and for BHS's working capital requirements.

77.1. A series of loans were taken from ACE. In addition to the £35m (see paragraphs 50 and 60 above), the £5m (see paragraph 61 above) and loan notes in connection with the purchase of Northwest House, ACE extended BHS a further multiple tranche loan facility in June 2015.

77.2. Two loan facilities were entered into with HSBC. The first was the £70m Carmen facility (referred to in paragraph 67 above) and the second was a £40m facility entered into on 26 March 2015. It is clear that SPG and Arcadia were instrumental in procuring this financing given their existing relationship with HSBC and that Arcadia also provided HSBC with a guarantee. In one email, HSBC commented that "[w]*ithout this support there would be no transaction*". It also appears that RAL was unable to draw down the HSBC facility without the written consent of SPG. XXXXXXXX XX Grant ThorntonX noted at the time that "*we cannot draw down the [full] facility without written consent from SPG – clearly something RAL team are nervous of but think their hands are tied*". Further, a part of the HSBC debt was only repaid by SPG providing a £10m loan to BHS/RAL.

77.3. A £62m secured loan from Grovepoint Funding 2 Limited was entered into in September 2015 and used to discharge the ACE facilities. This was only expected to be a short-term measure and did not provide a long-term solution.

77.4. A 60 day £9.4m loan was entered into with Gordon Brothers in February 2016 which, with SPG's consent, was secured against the Cribbs Causeway store (despite the previous understanding that this security had been intended to benefit the Schemes, although, in the event it had never been assigned to the Trustees). Although discussions over obtaining further funds from Gordon Brothers took place, by 20 April 2016, the BHS board recognised that "[t]*he funds from Gordon Brothers would still be insufficient and leave a capital requirement of between £20-25m*".

77.5. Overall, it is clear that the attempts to provide financing for the BHS business were desperate. As HSBC commented at one point, the conduct was "*classic activity of a business that is going to run out of cash imminently. As soon as one thing is agreed, there is a new request*".

78. Despite the fundamental importance of the challenge brought about by the Schemes, the Respondent and his RAL colleagues failed to take adequate action to progress a solution.

78.1. The Respondent and RAL did not enter into any serious discussions with the Trustees until November 2015 (despite an initial meeting on 18 March 2015 and then high level proposals made in July 2015). Furthermore, it also appears that the motivation for engaging with the Trustees in November 2015 was because it was necessary to do so to assist with refinancing discussions. At a meeting between BHS representatives and the Trustees on 9 November 2015, it was recorded that in order to obtain a refinancing, "*the company needs to demonstrate to the lenders that there is a credible pension solution*". Mr Topp (of BHS) was also recorded to have acknowledged that "*the revised deficit repair contributions were unaffordable and indeed that save for a successful refinancing the company would run out of cash in March and become insolvent*".

78.2. Even with the delayed engagement with the Trustees, RAL abdicated responsibility to SPG. The new proposal, called Project Vera which was an updated version of Project Thor, was subject to the involvement of SPG who it was also envisaged would be the source of any funds to put the proposal into effect (which might require something in the order of £120m).

78.3. Although the Respondent appeared at one stage in January 2016 to suggest to Chris Martin that the business could stand alone without support from its previous owner and that the Respondent "*could raise £120m and if necessary would sell off the businesses 'crown jewels'*", the Respondent later that month recognised that BHS could not "*trade their way out of the current position without additional finance and agreeing a pension solution*".

78.4. However, it appears that SPG refused to commit to reaching a solution with the Schemes unless the Regulator agreed to discontinue its moral hazard investigations against SPG. It is clear from, amongst other things, the minutes of a meeting between BHS/RAL, the Trustees, the Regulator and the PPF dated 26 January 2016 that the Respondent was well aware of this condition. Furthermore, on 17 February 2016, Deloitte confirmed to the Trustees that SPG was unwilling to meet the level of lump sum that would be required to achieve a Project Vera settlement. Although discussions involving SPG continued, no solution was reached.

79. In the period following the Sale, significant value was taken from the BHS business through a series of payments to the Respondent and those colleagues he had brought into the business. These payments are addressed separately in paragraphs 84 to 86 below.

CVA and Administration

80. On 23 March 2016, a CVA was eventually approved, the principal objective of which was stated in the CVA proposal to be, "*to rationalise BHS Limited's leasehold obligations, facilitate operational improvements and restore the viability of BHS Limited's business*". The CVA did not serve to compromise the pension liabilities.

81. The CVA did little to delay BHS's demise. Despite the CVA, the business failed to raise the finance that it needed to meet its cash flow requirements. It appears that, at a meeting on 18 April 2016 between BHS and Arcadia, SPG concluded that Arcadia was unable any longer to support the BHS business.

82. At a BHS board meeting held on 21 April 2016, the board resolved to put the company into administration. The minutes of that meeting recorded that:

"[The Respondent, Mr Chandler and Mr Topp] *had attended a meeting with* [Arcadia], *the qualifying floating charge holder…whereby Arcadia reviewed the future cash flow forecast of the Company and concluded that they were not prepared to support the business going forward whether by the provision of letters of credit facilities for delivering essential supply in September 2016 or otherwise. Additionally, the facilities offered by Gordon Brothers, which the Directors had worked hard to put in place, were inadequate given the cashflow requirements of the Company.*

…additionally the Company had received a seven day winding up notice from HMRC on 15 April 2016, the balance of which outstanding was £2,671,808 which the Company could not meet. Given this, together with the fact that there was no likelihood of future financing being available to the Company, there appeared to be no reasonable prospect of the Company avoiding insolvent liquidation."

83. Administrators were appointed on 25 April 2016 and BHS ceased trading in August 2016.

Extraction of fees and other payments

84. During the period between the Sale and BHS's entry into administration, a substantial amount of fees and other payments were "*extracted*" (to use the Case Team's term) from the BHS business. The Case Team set out these fees in Appendix 4 to the Warning Notice. The contents of Appendix 4 were corrected during the oral hearing and a revised version circulated to the parties thereafter. In summary:

84.1. A net total of £4,310,900 was paid to the Respondent or (so it appears) for his benefit, consisting of:

(a) £2,913,967 (paid either to the Respondent personally or to Swiss Rock plc);
(b) £1,500,000 paid by RAL to JDM Islands Properties Limited by way of a purported "loan" secured originally by way of charge over the Chappell family home (since purportedly satisfied);
(c) a net amount of £103,067 <u>paid by</u> companies associated with the Respondent's father (Joseph Chappell).

84.2. A net total of £2,832,085 was paid to other BHS, BGL or RAL directors (or, in Mr Bourne's case, the wife of a RAL director) either directly or indirectly during the period between the Sale and the Administration consisting of:

(a) £1,447,212 paid to Mr Edward Parladorio;
(b) £465,000 paid to Mr Mark Tasker;
(c) £258,630 paid to Mr Stephen Bourne;
(d) £294,634 paid to Ms Zoe Bourne (the wife of Mr Bourne);

(e) £157,757 paid to Mr Dominic Chandler[6];
(f) £125,902 paid to Mr Lennart Henningson;
(g) £82,950 paid to Mr Keith Smith (who is also the Respondent's uncle).

84.3. A combined total of £2,400,000 was paid to Olswang and Grant Thornton for advice in relation to the Sale. This was funded by part of the proceeds of the sale of Northwest House.

85. The overall total of the figures set out in paragraphs 84.1 to 84.3 amounts to £9,542,985. This represents the combined total of the two CNs that are now sought by the Case Team, in the ratio 99:1 between the Main Scheme and the Senior Scheme.

86. It appears that further amounts totalling £1.8m were also transferred away (£1.4m to Mr Henningson's company named "BHS Sweden" and £400,000 of "fees" to RAL) before the appointment of administrators. These sums were repaid but only upon Mr Chappell being challenged about them by Mr Topp and the BHS board demanding repayment.

Regulatory action against SPG

87. At the same time that the Warning Notice was issued in the present action, a Warning Notice was also issued against SPG (and others).

88. On 28 February 2017, the regulatory action against SPG was settled. The terms of the settlement are confidential between the parties and the Panel has not seen a copy of the settlement agreement (or a copy of the Warning Notice issued against SPG). However, information about that action and the settlement (the "SPG Settlement") is contained in a report issued by the Regulator under section 89. The Case Team also made submissions in relation to the SPG Settlement at the oral hearing.

89. The Case Team's summary of the SPG Settlement taken from its position paper is as follows:

"*In summary, the Settlement provided for a new scheme to be set up ("BHS2") which would offer benefits that were higher than those provided for by PPF compensation and as close as possible to those promised under the BHS schemes in that:*
(i) BHS2 will provide starting pensions the same as the original Schemes, albeit that for members under 60 those pensions will not

6 Mr Chandler was a former criminal barrister who had known and worked with Mr

be subject to the 10% PPF reduction or nil-increases for pre-April 1997 pensionable service benefits.

(ii) *Members of the original Schemes would then be offered the option to:*

(a) Remain in the original Schemes;

(b) In certain cases where eligible (those with pension pots of up to £18,000), take a lump sum payment; or

(c) Transfer to BHS2.

(iii) *In order to fund these arrangements £343m was paid, together with up to £20m for expenses and costs of implementation*."

90. According to the section 89 report, "[o]*n average, the new scheme will offer members benefits of around 88% of the value of their full BHS scheme benefits*".

91. The post-transfer funding positions of the Schemes have been estimated by the Scheme Actuary as follows:

Basis	**Main Scheme (£m)**	**Senior Scheme (£m)**
Section 143 as at 2.3.16	(9.07)	(0.04)
Buyout as at 2.3.16	(44.28)	(0.64)
Section 143 as at 31.10.17	(4.07)	0.28
Buyout (assuming BHS2 level benefits) as at 31.10.17	(24.65)	(0.10)

92. The impact of the SPG Settlement is that only 2,192 members are expected to remain in the Main Scheme and just 5 members are expected to remain in the Senior Scheme. This change in membership numbers has had a consequential impact on the proportion of the outstanding liabilities across the two Schemes. Accordingly, the Case Team now seeks a split of the total sum sought under the two CNs in the ratio of 99:1 (Main Scheme: Senior Scheme) rather than the ratio of 90:10 (Main Scheme: Senior Scheme) which had been sought in the Warning Notice.

Statutory Tests under section 38

93. Section 38 imposes five tests or conditions for the issue of a CN to a target. They are:

Parladorio and was brought into the business as a director of BHS and BGL.

93.1. That the scheme in question is an occupational pension scheme other than a money purchase scheme or a prescribed scheme or a scheme of a prescribed description (section 38(1)), the "Scheme test".

93.2. That the target was at any time during the relevant period[7] either the employer or a person connected with, or an associate of, the employer (section 38(3)(b)(ii)), the "Connection test".

93.3. That the Regulator is of the opinion that the target was a party to an act or a deliberate failure to act which falls within section 38(5) (section 38(3)(a)), the "Party test".

93.4. That the act or failure to act falls within section 38(5), the "Act test". As explained below, this requires either the "material detriment test" or the "main purpose test" to be satisfied as well as that the act or failure to act occurred within certain time limits.

93.5. That the Regulator is of the opinion that it is reasonable to impose liability on the target to pay the sum specified in the CN (section 38(3)(d)), the "Reasonableness test".

94. The Case Team submitted to the Panel that each of these five tests is satisfied in the present case. The amount sought by way of CNs are:

94.1. £9,447,555 in relation to the Main Scheme; and

94.2. £95,430 in relation to the Senior Scheme.

The Scheme test

95. Both the Schemes are occupational pension schemes within the definition provided by section 1 of the Pension Schemes Act 1993 given that they were established by BHS as employer and have also had at all material times their main administration in the UK. Neither of the Schemes is a money purchase scheme or a scheme of a prescribed description in accordance with section 38(1). Accordingly, the Schemes clearly satisfy the Scheme test.

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[7] The "relevant period" begins with the time when the act or failure to act falling within section 38(5) first occurs and ends with the giving of a warning notice (section 38(6)).

The Connection test

96. Immediately after the Sale, Mr Chappell was appointed as a director of BHS. Accordingly, he was connected with BHS under section 249(a) of the Insolvency Act 1986 and the Connection test under Section 38(3)(b)(ii) is thus satisfied.

The Party test and the Act test

97. It is convenient to deal with the Party test and the Act test together.

98. In order for a CN to be issued, section 38(3)(a) requires that:

"*the Regulator is of the opinion that the* [target] *was a party to an act or a deliberate failure to act which falls within subsection (5)*".

99. This can conveniently be broken down into three stages:

99.1. identifying the "act" or "deliberate failure to act" relied upon;

99.2. establishing that the Respondent is "a party" to that act or deliberate failure to act; and

99.3. satisfying the requirements of section 38(5) (which, as explained below, in the present case means meeting the "material detriment test").

100. However, before considering each of those three stages, it should be noted that section 38(5)(b) and (c) also provide for certain timing requirements. The Panel mentions these mainly for completeness because they clearly do not give rise to any difficulties in the present case. First, under section 38(5)(b), the act or failure to act relied upon must have occurred on or after 27 April 2004 and before the assumption of responsibility for the relevant scheme by the PPF. This is satisfied in the present case. Second, the act or failure to act must have occurred within six years of the giving of the Warning Notice. Again, this is clearly met in the present case.

<u>Identifying the acts or failures relied upon</u>

101. The Case Team puts this aspect of its case in two ways, turning on whether reliance is placed on the Sale alone or the Sale is taken together with subsequent events as forming a "*series of acts or failures to act*". Reliance upon a series is a permissible approach given that section

38(12) and (13) expressly provide that a "*series of acts or failures to act*" may be relied upon to satisfy section 38(5) so long as the target is a party to that series (and the other requirements of subsection (5) are satisfied in relation to the series).

102. Accordingly, the Case Team's primary way of putting its case is that the act of the purchase by RAL of the BHS group pursuant to the Sale is a single act that falls within section 38(5). On this approach, the Case Team has explained the interaction between the Sale and the events which took place after the Sale in the following way:

102.1. For the reasons addressed below, the "material detriment" test is met in relation to this single act because the Sale itself detrimentally affected in a material way the likelihood of accrued scheme benefits being received.

102.2. The Sale also created the risk of the events which took place after the Sale and therefore those later events are part of the detrimental effect of the Sale.

For convenience, this shall be referred to hereafter as "the single act approach".

103. The alternative way in which the Case Team puts its case is that there was a series of acts or failures which fall within section 38(5). The series of acts or failures relied upon by the Case Team consists of the following:

103.1. the Sale itself;

103.2. the events following on subsequent to the Sale, and leading up to the ultimate administration of BHS within 13 months of the Sale:

(a) the appointment of inexperienced management to the BHS board;[8]
(b) the adoption by that BHS board, without proper or adequate due diligence, of the speculative, sensitive and risky BHS "*turnaround*" business plan (and thereby a failure adequately to prepare a realistic "*turnaround*" business plan);

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8 In its submissions to the Panel, the Case Team had also relied upon "*the immediate impact this inexperienced Board had on supplier confidence, resulting in the removal of credit insurance and impact on cash flow*" as forming part of the series of acts or failures. Whilst the Panel accepts that the impact on supplier confidence could be considered as an "act", the Panel considers it better to view this event as a consequence of the Sale and the appointment of an inexperienced board rather than as, in itself, forming part of the series of acts. Accordingly, the Panel has excluded this from the description of the series of acts or failures.

(c) the continued operation of BHS by that inexperienced board in such a way that, during their stewardship, failed to deal with the clear need for financial "*turnaround*" in a timely manner, resulting in further deterioration and/or removal of value from the business whether for their own profit or to enable the business to continue to operate, in particular:

(i) delays and failure to realise value from property disposals, both to refinance existing loan facilities and to generate cash;

(ii) obtaining repeated rounds of interim funding and securing finance for BHS;

(d) the late and minimal attempts to pursue the essential issue of a pension restructuring in the context of the required business "*turnaround*" and the inability to recognise the need for, and secure (whether from the former owner or otherwise), the necessary funding for a pensions restructuring solution, be that Project Vera or otherwise;

(e) the failure meaningfully to engage with the Trustees on the issue of pensions;

(f) the failure to commence essential negotiations with landlords in a timely manner, culminating in the administration of BHS only one month after the eventual CVA was agreed with landlords.

103.3. the extractions of monies directly or indirectly from BHS to the benefit of the Respondent, his family, associates and advisers, through RAL, without reasonable basis (thus reducing the sums available to the Schemes on BHS's insolvency in a material way).

For convenience, this shall be referred to hereafter as "the series of acts approach".

104. As addressed below, the Case Team again argues that the material detriment test is met in relation to the series of acts approach.

105. In the Panel's view, both the Case Team's primary approach and its alternative approach as set out above are justified. The Sale itself is clearly a single act. Alternatively, the Sale and subsequent conduct identified above can fairly be described as a "*series of acts or failures to act*" given their interconnection.

Whether the Respondent is a "party" to those acts or failures

106. Under the single act approach, the Case Team submits that the Respondent was a "party to" this act. The Panel agrees with this submission. This follows because:

106.1. section 38(6)(a) expressly states that "*parties to an act or a deliberate failure include those persons who knowingly assist in the act or failure*";

106.2. whilst the Respondent was not the named purchaser under the Sale, he was the majority (90%) shareholder of RAL and a director;

106.3. as the Case Team submits, it is clear from the evidence that the Respondent was the driving force behind the purchase process and the negotiation carried out on the buy side, indeed often negotiating directly with SPG;

106.4. accordingly, the Respondent clearly falls within the wide meaning given to the term "party to" under the statute.

107. Similarly, on the series of acts approach, the Respondent was quite clearly a party to that series of acts or failures to act given his position as director of BHS, BGL and RAL and his personal involvement in the series relied upon (especially when considered in light of the wide meaning given to the term in section 38).

The material detriment test

108. There are two alternative ways of falling within section 38(5)(a), namely by satisfying either the "material detriment test" or the "main purpose test". Since, in the present case, the Case Team relies only upon the material detriment test, no further consideration will be given to the main purpose test.

109. The material detriment test is elaborated upon in section 38A. Section 38A(1) provides that:

"*For the purposes of section 38 the material detriment test is met in relation to an act or failure if the Regulator is of the opinion that the act or failure has detrimentally affected in a material way the likelihood of accrued scheme benefits being received (whether the benefits are to be received as benefits under the scheme or otherwise)*".

110. Section 38A(2) and (3) provides that:

"*(2) In this section any reference to accrued scheme benefits being received is a reference to benefits the rights to which have accrued by the relevant time being received by, or in respect of, the persons who were members of the scheme before that time.*

*(3) In this section "**the relevant time**" means –*
(a) in the case of an act, the time of the act, or
(b) in the case of a failure –
(i) the time when the failure occurred, or
(ii) where the failure continued for a period of time, the time which the Regulator determines and which falls within that period:
and, in the case of acts or failures to act forming part of a series, any reference in this subsection to an act or failure to act is a reference to the last of the acts or failures in that series."

111. Section 38A(4) provides that:

"*In deciding for the purposes of section 38 whether the material detriment test is met in relation to an act or failure, the Regulator must have regard to such matters as it considers relevant, including (where relevant) –*

(a) the value of the assets or liabilities of the scheme or of any relevant transferee scheme,
(b) the effect of the act or failure on the value of those assets or liabilities,
(c) the scheme obligations of any person,
(d) the effect of the act or failure on any of those obligations (including whether the act or failure causes the country or territory in which any of those obligations would fall to be enforced to be different),
(e) the extent to which any person is likely to be able to discharge any scheme obligation in any circumstances (including in the event of insolvency or bankruptcy),
(f) the extent to which the act or failure has affected, or might affect, the extent to which any person is likely to be able to do as mentioned in paragraph (e)...".

112. The Case Team submits that (whether under the single act approach or the series of acts approach) the material detriment test is satisfied. In brief, this is because:

112.1. if the Sale had not gone ahead then there would either have been a pensions solution put in place or an imminent insolvency and on either basis the Schemes would have been in a materially better position than they in fact were in as a result of the period of RAL ownership;

112.2. further, the fees and other monies extracted from BHS have served to reduce the sums available to the Schemes on BHS's insolvency to a material extent.

113. The main way in which the Case Team seeks to illustrate that the material detriment test is met is by reliance upon an estimated outcome analysis of the dividend to the Schemes on the insolvency of BHS. In summary, the figures that the Case Team has provided (based on analysis performed by KPMG and taking into account the likely dividend to creditors as updated by the liquidator of BHS on 17 November 2017) are set out in the table below.

Reference date	**Marshalling scenario 1 outcome**[9]	**Marshalling scenario 2 outcome**	**Detriment as against pre-sale position**
Pre-sale of BHS	£78-98m	£77-91m	n/a
Immediately post-sale	£41-61m	£28-41m	£36-39m or £49-51m
As at January 2016	£8-20m	£8-20m	£71-78m or £67-73m
As at date of WN	£14m	£14m	£64-84m or £63-77m
As at 17 November 2017	£42m	£42m	£36-56m or £35-49m

114. As Mr Moeran QC explained, the Case Team says that the Sale resulted in ultimately less being recoverable for the Schemes in the liquidation that eventually happened than would have been the case had BHS entered an insolvency process at the time of the Sale. Whichever of the above alternative dates is taken, the financial outcome for the Schemes was materially worse following the Sale when compared with the pre-Sale position. Hence, there has been a detrimental effect in a material way on the likelihood of accrued scheme benefits being received.

115. If a pensions solution (along the lines of Project Thor) had been concluded rather than the Sale taking place, then, the Case Team submits that *ex hypothesi*, the outcome for the Schemes would have

9 Two alternative approaches have been adopted depending upon how secured claims are marshalled.

been better than the position on BHS's insolvency. As explained in paragraph 25 above, delivering a better outcome for the Schemes was one of the proposal's objectives and it is hard to see how the Trustees (or the Regulator) would have agreed to something that was worse for the Schemes than the outcome on BHS's insolvency.

116. By way of further reality check, it is notable that, at the time of the Sale, it appeared to be recognised by those involved in the Sale that its effect would be to cause material detriment to the Schemes. This arose primarily because of the increased borrowing and new security that was granted as a consequence of the Sale, thus acting to the detriment of the liabilities owed to the Trustees which were unsecured claims. At the time of the Sale, Deloitte had provisionally agreed with Chris Martin on behalf of the Trustees that a security package worth at least £55m would need to be put in place in favour of the Schemes so as to enable the Trustees to conclude that the Sale was not materially detrimental to the Schemes. In fact, none of that security was put in place. As stated in paragraph 68 above, the RAL board minutes which approved the entry into of the Sale transaction specifically noted the Trustees' view that the transaction was materially detrimental to the Schemes.

117. The Panel considers it important to note that the question whether material detriment has been suffered does not have to be answered solely by reliance upon a quantitative analysis. Detriment may be caused even if that detriment is not capable of an easy or direct translation into a quantitative outcome. Thus, in the present case, the replacement of an experienced BHS board with individuals with no or limited retail experience (certainly, at board level) can be seen as causing material detriment even though that detriment may not be capable of easy or direct quantification.

118. Accordingly, aside from looking purely at the quantitative analysis that the Case Team relies upon, the Panel considers that the following factors also support a conclusion that the material detriment test is met in the present case.

    118.1. As stated above, the appointment of persons to the boards of BHS and RAL who had insufficient experience and expertise and who then failed to implement a turnaround plan (including through property disposals and renegotiation with landlords).

    118.2. The removal of SPG/Arcadia's (at least perceived) support for BHS caused suppliers to lose confidence, demand more onerous terms and insurers to withdraw credit insurance.

118.3. The failure to raise the funding required to supply the working capital needs of the business.

118.4. The failure to engage with the problems presented by the Schemes in a remotely timely or appropriate manner.

118.5. The extraction of value from the BHS business.

119. In the Panel's view, for the reasons set out above, it is clear that the material detriment test is satisfied whether the single act approach or the series of acts approach is adopted. Whilst it considers that both are justified, the Panel's preferred course between the two would be to rely on the series of acts approach. This is primarily because the Panel considers it somewhat strained to categorise all of the material detriment relied upon following the Sale (such as the extraction of monies) as being caused by the Sale on the basis that the Sale created the "risk" of those events occurring. Given the reliance placed upon the extraction of fees (when considering the quantum of the CNs, as addressed below), it would be preferable (in the Panel's view) for that extraction to fall more squarely within the detriment that has been caused.[10]

120. The Panel raised with Mr Moeran QC at the hearing whether the existence of the SPG Settlement and its impact on the Schemes' position was relevant to whether the material detriment test had been met (as well as the relevance of the SPG Settlement to the question of whether it would be reasonable to issue CNs, which latter issue is addressed under the Reasonableness test in the next section below). Following the helpful exchanges with Mr Moeran QC, in relation to the SPG Settlement's potential impact on the material detriment test, the Panel reaches the views set out below.

120.1. Whether an act or series of acts has caused material detriment is judged at the time that the Panel comes to make its determination and not at the "relevant time" (as defined in section 38A(3)[11]). Indeed, in any case in which the consequences of an act are not felt (or foreseeable) immediately, it would be difficult to judge

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[10] In taking this approach, the Panel recognises that under the statutory provisions, the quantum of a CN is capped by the "shortfall sum" (as defined under section 39) and not by the material detriment that is relied upon. In the present case, the Panel does not need to consider the views expressed by Warren J in *Bonas* [2011] Pens LR 109 (when considering the CN provisions which have since been materially amended) in relation to whether it would be reasonable to issue a CN that exceeded the material detriment that has been caused

[11] The Panel was informed by the Case Team that benefit accrual under the Schemes had ceased prior to the date of the Sale and therefore prior to the "relevant time" for the purposes of section 38A(3).

those consequences if the exercise was tested only at the time coincident with the act itself.

120.2. However, recoveries that are made, or anticipated to be made, as a result of related regulatory action under the Regulator's moral hazard regime (whether by way of compromise of such action or as a result of a CN or Financial Support Direction) are not something that the Panel considers can (ordinarily, or, at least, in the present case) be relied upon so as to eliminate material detriment that has otherwise been caused. Whilst consideration of those recoveries is not expressly excluded by the statutory provisions (unlike PPF compensation, see section 38A(9)(a)), the legislator cannot have intended that they could be relied upon so as to undo material detriment.

120.3. This view is consistent with what was said by the Panel in the *Carrington Wire* decision (TM8663) at paragraph 122.3 and avoids the bizarre consequences were this not to be the case:

"*The Panel does not consider, when determining whether the "material detriment test" has been satisfied, that it is appropriate to take into account amounts which might be (or even have been) recovered (including by way of settlement) from other targets under the same CN proceedings. It would be circular to rely upon the potential recovery under a CN in order to undo detriment to the Scheme, when considering whether the "material detriment test" has been satisfied*."

120.4. In the Panel's view, a recovery following regulatory action does not mean that material detriment has not been caused by the relevant act/failure or series of acts/failures. It may, instead, be viewed as a remedy provided for the material detriment rather than serving to undo the detriment that has been caused. Thus, in the present case, the act or series relied upon has caused material detriment. The intervening response of the Regulator (particularly in relation to action taken against other parties) should not be treated as falling within the effects or consequences caused by the act or series when considering the test in section 38(A). In other words, the recoveries made under the SPG Settlement have been *caused* by the regulatory action that was taken, not by the act or series relied upon in the present case.

120.5. Mr Moeran QC also pointed to the fact that the action against SPG was of a far wider ambit than the case brought against the

Respondent by relying upon events well before the Sale. Accordingly, there was no sound basis for apportioning the SPG Settlement so as to eliminate any material detriment caused by the Respondent's conduct. Whilst the Panel is cautious about placing reliance upon the content of the SPG Settlement when it has not seen its terms, it views this point as supportive of its conclusion in the present case.

121. Accordingly, the Panel is satisfied that the SPG Settlement does not change the answer to whether the material detriment test is met in the present case. It may, of course, still be a factor to be taken into account under the Reasonableness test which is considered below.

122. Finally, it is worth noting that section 38B provides for a statutory defence to the issue of a CN in cases which rely upon the material detriment test being met. On the facts of the present case, the Panel does not consider that the Respondent could remotely satisfy the requirements for the statutory defence.

The Reasonableness test

123. The final test to consider is the Reasonableness test. This requires consideration of not only whether it is reasonable to issue a CN to the Respondent at all but also in what amount. As stated above, the amount of the CNs sought by the Case Team in relation to the Respondent are: (i) £9,447,555 in relation to the Main Scheme; and (ii) £95,430 in relation to the Senior Scheme.

124. These figures are well within the statutory shortfall sum (under section 39(1)) which acts as a cap on the quantum of any CN and is fixed by reference to the relevant amount of the actual or estimated debt owed under section 75 of the Pensions Act 1995 at the time of the "act" (within the meaning of section 38(5)(a)) which is relied on in support of the CN. As stated in paragraph 21 above, the statutory shortfall sums are £478m in respect of the Main Scheme and £53m in respect of the Senior Scheme.[12]

125. Section 38(3) provides that a CN may only be issued if:

[12] Where reliance is placed upon a series of acts or failures to act, the relevant time for calculating the shortfall sum "*is determined by reference to whichever of the acts or failures in the series is, in the Regulator's opinion, most appropriate*" (section 39(4A)). In the Panel's view this would be the date of Sale (i.e. 11 March 2015) which is the date that the Case Team has relied upon in the Warning Notice.

"*(d) the Regulator is of the opinion that it is reasonable to impose liability on the person to pay the sum specified in the notice, having regard to-*
(i) the extent to which, in all the circumstances of the case, it was reasonable for the person to act, or fail to act, in the way that the person did, and
(ii) such other matters as the Regulator considers relevant, including (where relevant) the matters falling within subsection (7)."

126. The matters listed within section 38(7) are the following:

"*(a) the degree of involvement of the person in the act or failure to act which falls within subsection (5),*
(b) the relationship which the person has or has had with the employer (including, where the employer is a company within the meaning of subsection (11) of section 435 of the Insolvency Act 1986 (c. 45), whether the person has or has had control of the employer within the meaning of subsection (10) of that section),
(c) any connection or involvement which the person has or has had with the scheme,
(d) if the act or failure to act was a notifiable event for the purposes of section 69 (duty to notify the Regulator of certain events), any failure by the person to comply with any obligation imposed on the person by subsection (1) of that section to give the Regulator notice of the event,
(e) all the purposes of the act or failure to act (including whether a purpose of the act or failure was to prevent or limit loss of employment),
(ea) the value of any benefits which directly or indirectly the person receives, or is entitled to receive, from the employer or under the scheme;
(eb) the likelihood of relevant creditors being paid and the extent to which they are likely to be paid;
(f) the financial circumstances of the person…"

127. In determining whether a CN should be issued to the Respondent, the Panel has had regard to whether it was reasonable for Mr Chappell to act, or fail to act, in the way that he did (as required by section 38(3)(d)(i)) as well as to all of the matters listed in section 38(7). The Panel has also had regard to the objectives of the Regulator as set out in section 5 and to the matters listed in section 100.

128. Although the points considered below are addressed separately, the Panel considers that its task is to have regard to all relevant matters in the round and to decide in light of them all whether it is reasonable to issue a CN in the sum sought, a different sum or at all.

The extent to which it was reasonable for the Respondent to act or fail to act in the way that he did

129. The Panel reaches the clear view that it was not reasonable for the Respondent to conduct himself in the way that he did.

130. The Respondent failed to show any adequate regard towards the interests of the Schemes: on the contrary, he displayed a reckless disregard for their interests. This is clear because, despite being aware of the significant problems the Schemes presented to the viability of BHS, the Respondent conducted himself in the following manner:

130.1. The Respondent brought about the Sale without ensuring that adequate due diligence was conducted in respect of the Schemes. Indeed, he positively agreed to limited due diligence on this fundamental issue. That was an extremely reckless approach for the Respondent to take.

130.2. The Respondent's approach appears to have been driven by his desire to complete the Sale transaction no matter what.

130.3. Thus, the Respondent ignored his professional advisers' concerns about the limited due diligence and the risks of entering into the Sale without a concrete resolution for the Schemes having been put into place.

130.4. Even after the Sale, the Respondent did little to attempt to bring about a pensions resolution. He knew or should have known that the position could not continue without a resolution and he should have done his utmost to bring one about.

131. Besides the Respondent's disregard for the Schemes, he also brought about the Sale in circumstances in which he knew or should have known that he and his RAL colleagues were ill-suited for turning around the BHS business. Amongst other things, he had failed to arrange sustainable financing, he had no adequate turnaround plan and he had not recruited any senior figure with retail experience to head up BHS.

132. The Respondent's performance in running the BHS business after the Sale was, in the Panel's view, unreasonable for reasons relied upon by the Case Team as highlighted in paragraphs 75 to 79, 84 to 86 and 103 above. In particular, it was unreasonable for the Respondent to extract funds (or allow funds to be extracted) from the BHS business given BHS's own desperate need to retain cash, as reflected in the express

prohibition in the Sale and Purchase Agreement (referred to in paragraph 63.5 above). The extraction of funds gives rise to the inference that the Respondent was not acting in the best interests of the business but purely for his own personal gain.

133. The Panel is aware, based on comments made by the Respondent when interviewed by the Regulator, that he claims to have relied upon assurances from SPG that he would arrange for a pensions solution. The Panel also recognises that there are references in the documentary evidence which support assurances of that nature being given at various points in time. However, even assuming that the Respondent did place reliance upon such assurances at the time of the Sale (and perhaps, thereafter), Mr Moeran QC submitted that it provided no reasonable justification for the Respondent's conduct.

133.1. The Respondent, following the Sale, became responsible for the stewardship of BHS and its obligations towards the Schemes.

133.2. It was wholly unreasonable for him to rely upon non-legally binding assurances from a third party that somehow the position of the Schemes would be resolved.

133.3. As set out in paragraph 55.1 above, as early as 11 November 2014, Grant Thornton had explained that it was imperative that any restructuring of funding proposals for the Schemes was legally binding.

133.4. Accordingly, an abdication of responsibility by the Respondent provides him with no excuse.

133.5. As Mr Moeran QC suggested, the Respondent's conduct in this regard was indicative of a lack of regard on his part for the interests of the Schemes and a desire simply to complete the transaction.

133.6. Furthermore, reliance upon any such assurances could not, in the Panel's view, render reasonable the cavalier attitude that the Respondent adopted towards the Sale and subsequent running of BHS which positively damaged BHS and the interests of the Schemes, for example by the extraction of funds.

Specific factors listed in section 38(7)

134. Turning to the specific factors listed in section 38(7), the Panel takes into account the following (which are the factors considered relevant):

134.1. Degree of involvement. The Respondent was directly and closely involved in the Sale, its negotiation, the breadth of the due diligence and the Sale's final terms. He was also directly and closely involved in the running of the BHS business following the Sale and the extraction of funds. Given his central role, it is appropriate that he takes responsibility for the consequences of that conduct.

134.2. Relationship with the employer. The Respondent was a director of BHS following the Sale and also the 90% shareholder of its ultimate parent company, RAL.

134.3. Purposes of the act/failure to act. The obvious inference is that the purpose of the Respondent's conduct was to procure financial gain for himself and those associated with him. In the Panel's view, the evidence indicates that this purpose was pursued with a reckless disregard for the position of the Schemes. The Panel notes that the board minutes of RAL dated 11 March 2015 recorded that the directors considered it important that BHS continue to employ its approximately 12,500 staff given that the financial position of the business and the Schemes was not of the employees' making. Taking into account the evidence more generally, the Panel does not consider that this was a significant purpose on the part of the Respondent in entering into the Sale and being a party to the post-Sale conduct that the Case Team relies upon. Whilst the Sale may have temporarily deferred the loss of employment, which in isolation was a laudable objective, the other circumstances of this case clearly warrant the issue of CNs to the Respondent.

134.4. The value of benefits directly or indirectly received. As addressed below, the Respondent appears to have directly or indirectly benefited from a net total of payments of £4,310,900. Furthermore, some £2,400,000 in professional fees were funded by BHS which were for the benefit of RAL (of which the Respondent was the 90% shareholder).

134.5. Likelihood and extent of relevant creditors being paid. The extent to which the Scheme liabilities will be paid as creditors of BHS has been addressed above.

134.6. Financial circumstances of the Respondent. The Panel is not aware of the financial circumstances of the Respondent but notes that liquidators were appointed to Swiss Rock plc (now Swiss Rock Limited) on 2 September 2016. A petition has also been made for the winding up of RAL.

Impact of SPG Settlement

135. The Panel considers that the SPG Settlement is of potential relevance to the issue of reasonableness. For example, were the SPG Settlement to have led to a situation in which the Schemes were both fully funded (even on the most conservative basis), that could count against the reasonableness of the issue of a CN to the Respondent.

136. However, given that, even with the SPG Settlement, there remains a deficit in both Schemes (when calculated on the buy-out basis) and the quantum of the CNs sought against the Respondent is at a level that will still leave a deficit, the Panel does not consider that the SPG Settlement serves to take away from the reasonableness of the CNs given the quantum that the Case Team seeks. Furthermore, as indicated in paragraph 120.5 above, the Panel cannot conclude that the SPG Settlement has in fact ultimately eliminated any detriment that has been caused by the Respondent's conduct: the consideration of which would necessarily also require a speculative evaluation of the potential outcome of any regulatory action that might have been taken against SPG even in the absence of the Sale.

137. There is, however, one particular way in which the SPG Settlement has impacted on the CNs that are sought. Given the change in the funding position of the Schemes as a result of the SPG Settlement, the Case Team now seeks a different apportionment of the total sum sought under the CNs across the two Schemes. In the Warning Notice, the Case Team sought a ratio of 90:10 (Main Scheme: Senior Scheme) but it now seeks a ratio of 99:1 (Main Scheme: Senior Scheme). This change in the Case Team's case was notified to the directly affected parties in advance of the oral hearing.

138. The consequence of this change is that the CN sought in relation to the Main Scheme is of a higher amount than was originally identified in respect of that Scheme in the Warning Notice. Mr Moeran QC submitted to the Panel that this made no difference and the Panel could issue a CN in that higher amount. In the circumstances of the present case, the Panel agrees. It can see no restriction in the statutory provisions that

prevents the Panel from taking this course, and, given that the change in the Case Team's case was notified to the other parties who were afforded an adequate opportunity to consider that change, and the total sum sought across the two CNs is within the total sum sought in the Warning Notice, the Panel does not consider that any procedural (or substantive) unfairness arises. This outcome also appears to accord with the general approach taken by the Upper Tribunal of not treating the Warning Notice as a "*kind of strait-jacket*" (per Judge Colin Bishopp in *Granada UK Rental v The Pensions Regulator* [2016] UKUT 492 (TCC) at paragraph 33).

<u>Quantum of CNs</u>

139. Whilst, for ease of explanation, the Panel addresses the issue of quantum under a separate heading, it fully recognises that the relevant question under section 38(3)(d) is a composite one, namely "*whether it is reasonable to impose liability on the person to pay the sum specified in the notice*". Accordingly, in reaching its overall conclusion under the Reasonableness test, the Panel has taken into account collectively the issues addressed under the headings set out above in addition to those under the present heading.

140. The quantum of the CNs sought has been determined by the Case Team by reference to payments which the Case Team says have been extracted from BHS.

141. Mr Moeran QC explained that these sums in fact fall far short of the actual detriment that the Respondent has caused to the Schemes (which is in the region of between £36m to £56m) and are also well within the "shortfall sum" which serves as a statutory cap under section 39 (and amounts to £478m in respect of the Main Scheme and £53m in respect of the Senior Scheme). Accordingly, Mr Moeran QC says that the limited nature of the sums sought by way of CNs supports their reasonableness. In reaching its view under the Reasonableness test, the Panel takes into account the detriment that has been caused to the Schemes by the Respondent's conduct and that a more limited figure is sought by way of CNs.

142. The extractions relied upon by the Case Team can conveniently be grouped into 3 categories.

143. First, there are payments that have been made directly or indirectly to the Respondent or which appear to be for his, or his family's benefit. As stated in paragraph 84.1 above, the net amount of these payments is

£4,310,900. Given the Panel's views of the unreasonableness of the Respondent's conduct and the total detriment caused to the Schemes, it is plainly reasonable for these payments to be taken into account in setting the quantum of the CNs that are sought. The Respondent's conduct cannot reasonably be considered as justifying his receipt of benefits out of the BHS business.

144. Second, there are payments that were made either directly or indirectly to other BHS, BGL or RAL directors (or in Mr Bourne's case, his wife). As stated in paragraph 84.2 above, the net amount of these payments is £2,832,085. These were payments made for the benefit of individuals who the Respondent brought in to run the business and could fairly be described as part of his "team". Collectively, not only did they fail to deliver any value to BHS but, on the contrary, caused BHS significant detriment, yet they removed further value by way of these payments. The Respondent at the very least enabled and allowed these payments to be made at a time when BHS was in desperate need of cash. In the absence of any explanation by the Respondent justifying these payments and how they in fact served to benefit BHS, the Panel considers it reasonable that they be taken into account in setting the quantum of the CNs that are sought.

145. Third, there are professional fees totalling £2,400,000 that were paid to Olswang and Grant Thornton for advice in relation to the Sale. This was advice that was clearly for the benefit of the acquiring party, RAL (and thereby indirectly for the Respondent, as its 90% shareholder) yet it was funded by BHS out of the proceeds of the sale of Northwest House (via an interest free loan to RAL). This was not expenditure that was incurred either in the course of running the BHS business or for the benefit of BHS but was instead an acquisition cost that should have been borne by the acquiring party. The Panel recognises that, in an ordinary commercial acquisition of a viable business, acquisition costs may be loaded onto the acquired business as debt with the result that the acquirer indirectly bears those costs through reduced future profits (as net revenue is used to pay the acquisition costs rather than being paid to the business's owner). However, in the present case, there was never a realistic prospect that the post-Sale BHS business would be viable so that these costs would be paid out of what would otherwise be future profits. Therefore, the Panel considers it fair to view this amount as value extracted from BHS for the benefit (predominantly) of the Respondent and to the detriment of BHS. Further, that is clearly something that would not have happened, had the Respondent not brought about the Sale and these fees were incurred specifically so as to enable the Sale to

take place. Accordingly, in the Panel's view, it is also reasonable for this figure to be taken into account in the quantum of the CNs.

Conclusion on reasonableness

146. In his oral submissions, Mr Moeran QC summed matters up by submitting that:

"…*this is not just a commercial transaction that went wrong; this is a commercial transaction that was wrong. It was the sort of attitude to pension liabilities that must not be encouraged or allowed. This is exactly the sort of situation that moral hazard provisions were designed by and instigated by Parliament to meet*".

In the Panel's view, this is a fair summation based on the material that it has seen.

147. In all the circumstances, and for the reasons set out above, the Panel considers that it is reasonable to issue CNs to the Respondent in the amounts of £9,447,555 in relation to the Main Scheme and £95,430 in relation to the Senior Scheme.

Decision

148. The Panel has determined that CNs in the amounts of **£9,447,555** in relation to the Main Scheme and **£95,430** in relation to the Senior Scheme should be issued pursuant to section 38 to the Respondent listed in paragraph 3.1 above.

149. Such issue must not take place during the period within which this Determination may be referred to the Upper Tribunal (Tax and Chancery Chamber) (the "**Tribunal**") or, if this Determination is so referred, until the final disposal of the reference and of any appeal against the Tribunal's determination.

150. **Appendix 1** to this Determination Notice contains important information about the rights of appeal of directly affected parties against this decision.

Signed:

Chairman: Andrew Long

Dated: 15 January 2018

Appendix 1

Referral to the Tax and Chancery Chamber of the Upper Tribunal ("the Tribunal")

Any person who receives this Determination Notice as a directly affected person (pursuant to Section 96(2)(d) of the Act), or any person who appears to the Tribunal to be directly affected by this Determination, may refer this Determination to the Tribunal.

Under paragraph 2(2) to Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008 (S.I. 2008/2698) (the "Tribunal Rules") a reference notice must be received by the Tribunal no later than 28 days after the date this Determination Notice is given. The Tribunal may extend this period under Tribunal Rule 5(3)(b). A reference to the Tribunal is made by way of a written notice signed by you and filed with a copy of this Determination Notice. The Tribunal's address is:

The Tax and Chancery Chamber of the Upper Tribunal

45 Bedford Square
London
WC1B 3DN

Tel: 020 7612 9700

The detailed procedures for making a reference to the Tribunal are contained in section 103 of the Act and the Tribunal Rules.

You should note that the Tribunal Rules provide that at the same time as filing a reference notice with the Tribunal, you must send a copy of the reference notice to The Pensions Regulator. Any copy reference notice should be sent to:

Determinations Panel Support
The Pensions Regulator,
Napier House
Trafalgar Place
Brighton
BN1 4DW.

Tel: 01273 811852

A copy of the form for making a reference FTC3 'Reference Notice (Financial Services)' can be found at:

http://www.tribunals.gov.uk/financeandtax/Documents/forms/FTC31.doc