Claim No. 584 of 2011

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF EUROPEAN HOME RETAIL PLC

AND IN THE MATTER OF FAREPAK FOOD AND GIFTS LIMITED

AND IN THE MATTER OF THE COMPANY DIRECTORS DISQUALIFICATION ACT 1986

B E T W E E N :

THE SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS

Claimant

and

(1) STEVAN LLOYD FOWLER
(2) NEIL DUNCAN GILLIS
(3) NICHOLAS PIERS GILODI-JOHNSON
(4) STEPHEN MATTHEW HICKS
(5) MICHAEL STEPHEN MACKELCAN JOHNS
(6) PAUL MUNN
(7) JOANNE ELIZABETH PONTING
(8) WILLIAM PETER ROLLASON
(9) SIR CLIVE MALCOLM THOMPSON

Defendants

SKELETON ARGUMENT

OF THE FIRST AND EIGHTH DEFENDANTS

FOR THE TRIAL STARTING 21 MAY 2012

Reading List for week of 14 May 2006 – this has been provided separately on behalf of all the defendants

Definitions and Abbreviations as in the Affidavits (save as set out below)

References in the form – [**Vol./Tab/page(s)**]

INTRODUCTION

1. These are disqualification proceedings commenced by the Secretary of State for Business, Innovation and Skills ("**SoS**") originally against nine individuals pursuant to section 8 of the Company Directors Disqualification Act 1986 ("**CDDA**"). The proceedings followed an investigation carried out on behalf of SoS under s.447 of the Companies Act 1985, as amended ("**CA1985**"), commenced on 23 October 2006, into European Home Retail PLC ("**EHR**") and one of its subsidiaries, Farepak Food & Gifts Services Limited ("**FFG**"). The nine defendants were directors of one or other (or both) of EHR and FFG.

2. This skeleton argument is filed on behalf of the First Defendant ("**Mr Fowler**") and the Eighth Defendant ("**Mr Rollason**"), both of whom were directors of both EHR and FFG. Mr Rollason was the Chief Executive of EHR; Mr Fowler was appointed as Group Finance Director on 1 January 2006 and he actually started work on 9 January 2006 (which was after the start of the material period for the allegations).

3. The other Defendants represented at the trial are as follows:

   (1) The Third Defendant ("**Mr Gilodi-Johnson**") who was also a director of both EHR and FFG. He was managing director of FFG throughout the relevant period.

   (2) The Second, Fifth, Sixth and Ninth Defendants (respectively "**Mr Gillis**", "**Mr Johns**", "**Mr Munn**" and "**Sir Clive**" and collectively the "**non-executive directors**") who were all non-executive directors of EHR. Sir Clive was the non-executive Chairman.

4. The two Defendants who are not at this trial because they have given undertakings are the Fourth and Seventh Defendants ("**Mr Hicks**" and "**Mrs Ponting**"). They were both directors of just FFG: Mr Hicks was its finance director; and Mrs Ponting its services director. The terms of their undertakings and the reasons why they offered them are not relevant to these proceedings.

5. The case concerns the last 11 months of trading of the EHR Group and in particular, one subsidiary, FFG, which operated the well-known Farepak Christmas hampers and

vouchers business. While there was an understandable public reaction at the time over the collapse of FFG and the losses suffered by its customers, there has been absolutely no evidence adduced to support the sort of allegations that were being made in the press in the immediate aftermath. The SoS has conducted a large-scale investigation and has come up with a main allegation against the defendants, that they traded at unreasonable risk of creditors. It is important that this case be tried on the actual allegations the SoS has seen fit to make against the defendants and the facts fairly presented before the Court.

6. For obvious forensic reasons, the SoS has adopted language, both in the skeleton argument and in the evidence, that attempts to convey a particular impression about the nature of the case but is in fact quite misleading. Two will be referred to at this stage because they are made within the first 3 paragraphs of the SoS's skeleton argument:

    (1) The reference to FFG's customers and agents as "savers" or "Savers"[1];

    (2) The use of the term "cash sweep" and "swept" as though there was something wrong in the perfectly normal banking arrangements that existed in the Group with cross-guarantees and debentures by all subsidiaries.

7. It is difficult enough to discern the SoS's case from the diffuse criticisms and allegations scattered throughout the evidence and skeleton argument. It is unhelpful if the language used itself adds to the confusion as to what is really being said.

8. As will become apparent from what is said below, there is still uncertainty as to what the allegations are and what the SoS is really saying. It is however clear what the SoS's case is <u>not</u>:

    (a) It is <u>not</u> a wrongful trading case;

    (b) It is <u>not</u> based on there being no reasonable prospect of avoiding insolvent liquidation;

[1] See para. 15 of the skeleton argument

(c) It is <u>not</u> based on dishonesty or recklessness;

(d) It is <u>not</u> alleged that there was any personal benefit received by any of the directors.

9. The SoS's evidence and skeleton argument singularly fail to establish a case for disqualification. There are criticisms as to whether the defendants should have pursued one funding option in parallel to another or whether they should have dealt with a particular matter more urgently. It is said that there was inadequate information upon which to base decisions. But what it comes down to in the end is essentially the commercial judgment and decision taking of the defendants. In other words, there were a series of judgment calls that the defendants made. Were their judgments and decisions so seriously wrong and misguided as to be able to say that they should be disqualified? Or were their actions and decisions, as the defendants strongly say the evidence shows, based on full and accurate information well within the bounds of reasonableness for directors in the position they were?

10. The Court has always been reluctant to entertain challenges to the exercise by directors of their commercial judgment and yet this is what lies at the heart of the SoS's case. Even if there were matters that might have been done differently the criticisms that are made are insufficiently serious to justify disqualification.

11. The way that the SoS puts his case is essentially one of failing to consider issues properly at the time and failing to act urgently or with the necessary degree of vigour to deal with the anticipated funding gap. However, the SoS does not identify any other steps that could reasonably have been taken by the defendants in the circumstances even if they had thought about the matter in the way suggested. The SoS advocates a counsel of perfection, requiring, so it seems, directors to have to think about and consider matters even if there is no consequence at all to the alleged failure so to consider. If it cannot be shown that there was any consequence to the alleged failure to consider matters, then surely such failure cannot be sufficient to disqualify.

12. There is little sense of commercial reality in the way the SoS puts his case. Nor does he fairly put the defendants' conduct into context. It is heavily dependent on hindsight, reinterpreting events, emails and the defendants' knowledge in the light of

what happened subsequently and in particular the collapse of the Group and the losses suffered by the customers of FFG. While that is justifiably the cause of public sympathy, unfortunately it appears also to be the motivation for these proceedings. That has resulted in a case that is both misconceived legally and incoherent factually.

13. It is true to say that these defendants have complained on a number of occasions about the unfair and oppressive way that these proceedings have been conducted[2]. This has concerned a number of matters, including: the manner by which documents, particularly electronic documents have been exhibited and disclosed; the failure to adduce first hand evidence in the SoS's original evidence despite knowing what the defendants' defences were[3]; exhibiting vast amounts of documents to Mrs Burns' fourth affidavit without identifying which documents were relied upon; raising the new allegation in relation to the FFG 2005 accounts very late without a good explanation; and failing to comply with the latest order requiring identification of particular documents in the exhibits that are relied upon[4]. Except for the latter point which should be considered in the context of the SoS's general approach, these are probably not matters that need to be considered at the trial.

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14. The remainder of this skeleton argument will deal with the following matters:

[2] See para. 104 of the SoS's skeleton argument

[3] Extensive written and oral representations were made – see [**H1**]

[4] Para. 10 of the order of 2.4.12 – [**K1/8/p.55**]

SUMMARY BACKGROUND

15. The material period upon which the allegations are focused is from November 2005 to October 2006. Throughout that time the EHR Group comprised the following businesses (after a number of acquisitions in 2004):
    (a) Kleeneze[5] - the sale of home and personal products by catalogue through agents;
    (b) Farepak, operated by FFG[6] - Christmas savings club for retail vouchers and hampers[7];
    (c) Home Farm Hampers ("**HFH**"), which was a joint venture between FFG and Findel plc ("**Findel**"), 40/60 respectively - also a Christmas hamper business;
    (d) IWOOT[8] - a web-based business selling gadgets and toys;
    (e) Kitbag Ltd ("**Kitbag**")- on-line sportswear retailing;
    (f) eeZee tv - a joint venture tv shopping station; and
    (g) Cabouchon – jewellery (which by this time was part of Kleeneze).

16. It is the operation of the Farepak business, and FFG's dependence on EHR, that is at the heart of the SoS's case. The Farepak business model was started by Mr Gilodi-Johnson's father in the 1960s whereby agents formed local syndicates to collect money from customers throughout the year in order to purchase Christmas hampers. The agents placed the orders on behalf of their customers early in the year which were then paid for by instalments until October/November. In time the business began offering multi-retailer vouchers (as well as hampers) which could be given as gifts and redeemed in a large number of stores. The vouchers became much more popular than the hampers but they produced a lower margin for Farepak.

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[5] Operated by Kleeneze UK Ltd ("**KUK**"), Kleeneze Europe Ltd and Kleeneze Ireland Ltd

[6] Before the reorganisation in 2003, the Farepak business was operated by Farepak Mail Order Ltd ("**FMO**")

[7] It also packed hampers for Marks & Spencer and had a substantial third party voucher operation

[8] I want one of those.com Ltd

17. Originally, Farepak had purchased its vouchers from Park Group plc ("**Park**")[9], its main competitor in this market. In the late 1990s, it switched to Choice Gift Vouchers Ltd ("**Choice**"). As the retailers were only entitled to be paid by the voucher supplier when they had sold goods (ie when the vouchers were redeemed), the retailers themselves could only invoice the voucher suppliers after redemption. Thus the terms offered by Choice to all its re-sellers including Farepak were payment after redemption.

18. In 2000, the EHR Group[10] entered into new banking arrangements with Bank of Scotland (as it then was, later to be taken over by Halifax plc, and subsequently Lloyds TSB plc – referred to hereafter as "**HBOS**" or "**Bank**") in relation to the acquisition of Display Marketing Group plc ("DMG"). This was a £45m revolving credit facility. All Group trading companies were required to and did give cross guarantees and debentures over all their assets to secure the facility which was for the benefit of the Group as a whole.

19. The acquisition of DMG was not a success and following Mr Rollason's arrival in 2003[11] it was sold crystallising a substantial loss on the Group's consolidated balance sheet of over £35m. The Group was reorganised upon the specific advice of Macfarlanes and Ernst & Young ("**E&Y**") under Project Rupert, during the course of which FFG took over the Farepak business from FMO. The HBOS facility in the sum of £40m was renewed on the same basis at that time (and again on 21 December 2005), namely cross guarantees and debentures from all trading subsidiaries including FFG. All assets of the Group, including any cash from FFG's customers, were immediately upon receipt subject to HBOS's security. As cash was received by FFG into its account with NatWest, HBOS required that cash to be "swept" into EHR's

[9] Originally called Park Christmas Savings Club Ltd

[10] Then called Kleeneze

[11] Mr Rollason was appointed with the aim of selling DMG and diversifying the Group pursuant to a strategy developed by the board in early 2003.

HBOS account[12]. Because of HBOS's comprehensive security over all assets of the Group wherever located, the fact that cash was immediately swept from FFG to EHR is therefore irrelevant (as Macfarlanes confirmed).

20. In Mrs Burns' first affidavit there is a suggestion that the EHR Group was in terminal decline[13]. It is not clear whether the SoS relies on this as it does not feature in the skeleton argument. It is in any event not an accurate description of the financial state of the Group. In the year to April 2006 the Group's turnover increased by £20.8m to £196.7m, largely due to the contribution of the first full year of trading results of IWOOT and Kitbag. Further, even though the Group's result before amortisation and exceptional costs fell during the year compared with the previous year to a loss of £0.4m, budgets showed that the group's profit for the year to April 2007 recovering to £3.5m. At August 2006, whilst Group turnover was down against budget, the results were largely in line with budget[14].
21. In large part the case is about the way the defendants dealt with and reacted to two anticipated funding gaps. The first was in relation to FFG's payment of £12.1m[15] to Choice due at the end of January 2006 (which gives rise to separate allegations against Mr Rollason and Mr Fowler); and the second was the potential funding gap in October 2006 if the vouchers had to be paid for by FFG on purchase rather than after redemption.
22. The turning point between the two periods was the administration of Choice on 31 January 2006[16]. The relevant periods for consideration of the Defendants' conduct are therefore conveniently split between the pre- and post-Choice administration periods. The SoS seems to be suggesting that FFG's failure to pay Choice in full was the

[12] This was in any event of benefit to FFG and the Group as it reduced the Group's overall interest charge and FFG achieved a higher interest rate on its cash than it would have achieved in the market.

[13] See for instance paras. 17 and 149 of Burns 1 – [**Affs1/2/p.10 and 3/p.70**]

[14] See for instance the analyses done in paras. 40, 41 and 55-63 of Munn – [**Affs5/3/pp.12-14, 17-19**]

[15] At the beginning of January the payment was thought to be £11.5m

[16] See paras. 7 and 119 of skeleton argument

principal cause of it going into administration. This is disputed[17]. Whatever the cause of Choice's administration, the two periods are not linked and they have quite separate issues. It is odd therefore that both periods are part of the same general allegation of trading at the unreasonable risk of creditors.

23. The first period runs from November 2005 to 31 January 2006. There is no suggestion that the defendants should have considered ceasing trading in this period. The allegation is that the defendants did not adequately deal with the forecast insufficiency of funds to make the full £12.1m payment to Choice at the end of January 2006. The SoS has consistently failed to appreciate the chronology of events throughout January and what actually happened specifically between 20 January and 2 February. This is dealt with in detail in paragraphs 127 to 130 below.

24. The second period is concerned with the defendants' attempts to deal with the consequences of Choice's failure on the Group and FFG. After taking a short time in February both to deal with the immediate operational issues arising out of Choice's failure (in particular reassuring customers that their vouchers would be honoured) and to investigate alternative voucher suppliers, it was reported to the board of FFG on 21 February that one voucher supplier, Provident, was seeking payment up front. At EHR's board meeting on 1 March, it was said to be likely that FFG would have to pay up front for vouchers, unlike the payment on redemption terms enjoyed with Choice.

25. From March 2006 onwards, a number of proposals for a solvent solution to the potential funding problem were considered and progressed, with the active support of HBOS and its advisors PwC, and the Group's own advisors, Macfarlanes, Hoare Govett, ABN Debt and E&Y. These included a sale of FFG to Park, a rights issue, mezzanine funding, private equity, sales of certain parts of the Group and the purchase of HBOS's debt at a discount. These are described in detail in paragraphs 142 to 156 below.

[17] As explained below, Choice had already instructed PwC to prepare for some form of insolvency on 26 January, and had apparently decided on its course of action before it was informed on 31 January that FFG would not be paying in full.

26. On Friday 1 September 2006, HBOS's then preferred option of a pre-pack sale to Findel was rejected by HBOS because Findel had tried at the last minute to chip the price. The Park II proposal was immediately on the table which would have avoided the funding crisis in October 2006 by, amongst other funding initiatives, Park agreeing to provide £29m of vouchers on deferred payment terms and to purchase FFG for £6m on 1 January 2007. HBOS considered that this provided a "very neat solution to the current funding problem"[18] and instructed PwC to report on the proposal. A great deal of work was done in refining, modelling and discussing the proposed deal during September while waiting to hear from HBOS whether it would accept Park II or any reasonable modification of it. Macfarlanes had confirmed that FFG should continue trading while HBOS considered this.

27. On 3 October 2006, HBOS were still considering the matter and internally commented that they "may end up going with the management plan" which although "unappetising in many respects....is probably preferable to a lengthy insolvency and workout with all the added risk this brings with it."[19] However on 10 October 2006 HBOS surprisingly rejected Park II; whereupon FFG and the Group ceased trading, a trust account was set up with the consent of HBOS for FFG's customers' cash and, on 13 October 2006, EHR and ten subsidiaries were put into Administrative Receivership and FFG, FHL and FMO were put into Administration.[20] HBOS made a full recovery while the other creditors, including FFG's customers, are only likely to receive a small dividend[21].

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[18] Mr Kelly's email of 1.9.06 to Mr Rollason – [**CHRON 20/1/p.91**]

[19] Mr Kelly's email to DLA Piper – [**CHRON 23/1/pp.23-24**]

[20] All the companies are now in liquidation.

[21] The settlement of the liquidators' proceedings referred to in paragraph 26 of the skeleton argument was on the basis of no admission whatsoever of liability

THE ALLEGATIONS

28. Before looking at the legal position it is important to try to understand what the SoS's allegations of unfitness are. It is often asserted on behalf of the SoS[22] that the allegations as set out in the supporting affidavit[23] ought not to be treated like a criminal indictment[24] with all the technicalities and inflexibilities associated therewith. While that may be so[25], there is undoubtedly a duty on the SoS to make clear what allegations are being made so that the defendants can understand the case that they have to meet. That is particularly so in a case like this, where the SoS has spent years investigating and then formulating the allegations he wishes to make against the defendants and where such formulation critically affects the legal analysis of the case and the defendants' evidence in answer.

29. Unfortunately, the allegations are not clear. It is not even clear whether there is one principal allegation of trading at the unreasonable risk of creditors or a number of separate such allegations, for instance, in relation to the two periods either side of the Choice administration. The attempted clarifications of the allegations in correspondence have succeeded only in confusing the position and their latest elaboration in the skeleton argument provides a yet further shift in the case. The very late emergence of the new allegation in relation to FFG's 2005 accounts raised for the first time this February only fuels the suspicion that the SoS has not really worked out what his case is and is trying to leave as much open as possible, making disparate criticisms of the defendants' conduct, in the hope that something will emerge at the trial to bolster his case. Such an approach is unfair and oppressive.

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[22] See para. 61 of the skeleton argument

[23] As required by Rule 3(3) of the Insolvent Companies (Disqualification of Unfit Directors) Rules 1987, as amended ("the Disqualification Rules")

[24] See for instance *Re Looe Fish Ltd* [1993] BCLC 1160, per Jonathan Parker J; and *Re Continental Assurance Co of London plc* [1997] 1 BCLC 48, per Chadwick J

[25] And its utility as a proposition was doubted by Lewison J in *Re Crystal Palace Football Club (1986); Secretary of State v Goldberg* [2004] 1 BCLC 597

30. The allegations are set out in a summary form at the beginning of Mrs Burns' first affidavit[26] which is just an amalgamation (with small differences) of the individual allegations against each defendant appearing in the concluding section of the affidavit[27]. They are very formulaic.

31. The allegations have been further summarised in paragraph 5 of the SoS's skeleton argument. There is the main allegation of trading at unreasonable risk of creditors (explained further in paragraphs 108 to 118 of the SoS's skeleton argument) in respect of both EHR and FFG; and there are four further allegations which will be dealt with in paragraphs 47 to 67 below.

(a) Main allegation – trading at unreasonable risk of creditors

32. Paragraph 58 of Mrs Burns' first affidavit[28] tries to explain the main allegation as follows:

> There is a general allegation of, in effect, trading at the unreasonable risk of creditors, for the period November 2005 to October 2006. For convenience that allegation has been "broken down" over various periods. The Secretary of State's case is that these separate allegations should be considered not only separately but also in the context of the overall allegation referred to here and in respect of the entire period.

33. When asked what the defendants were to make of this "general allegation", the Treasury Solicitor replied in a letter dated 23 March 2011 to DAC[29]:

> The allegations against each director for each of the relevant periods of time are clearly and carefully particularised; the Secretary of State's position is that the effect of the matters set out in the evidence is that trading in each of the companies was

[26] Burns 1 paras. 63 to 77 – [**Affs1/2/pp.26-35**]

[27] Burns 1 paras. 1020 to 1087 – [**Affs1/10/pp.368-435**]

[28] Burns 1 para 58 – [**Affs1/2/pp.24**]

[29] [**J1/p.53**]

> carried on at the risk of creditors for the period from November 2005 to October 2006. That general case is, of course, not the basis for an additional allegation against any defendant because that would be to duplicate the detailed allegations which have been made in relation to each of them.

34. In other words, the "general allegation" is not an allegation at all and it is necessary to refer to the "broken down" allegations against each director. The trouble is that the periods are not broken down by reference to events but in two or three month periods. The SoS cannot be alleging that there is a new allegation starting at the beginning of each such random calendar month. But there is no other respect in which the allegation has been "broken down".

35. The trading at unreasonable risk to creditors' allegations are made in relation to both EHR and FFG. The FFG allegation for each 2 or 3 month period is in the following form:

> Mr [ ] as a director of FFG caused or permitted FFG to trade at the unreasonable risk of its creditors, including, without limitation, Savers in that at the start of or during that period he knew or should have known (without limitation):
>
> [then the particular alleged facts and matters are set out]
>
> .....
>
> And yet no, or no adequate steps were taken to address the forecast cashflow insolvency during this period; among other things:
>
> [then certain steps that were taken or developments that happened during the period are set out]

36. The EHR trading at unreasonable risk allegation relies on exactly the same particulars for each period as are set out in the corresponding FFG allegation. It is in the following form:

> Mr [ ] as a director of EHR caused or permitted EHR to trade at the unreasonable risk of its creditors, including, without limitation, FFG (which was one of its subsidiaries) and failed to take any or any adequate steps to procure that the board of FFG was functioning adequately in that at the start of or during that period he knew or should have known (without limitation):

> [then the particular alleged facts and matters are set out, identical to those in the corresponding FFG allegation]
>
> .....
>
> And yet no, or no adequate steps were taken to address the forecast cashflow insolvency during this period; among other things:
>
> [then certain steps that were taken or developments that happened during the period are set out, again identical to the corresponding FFG allegation]

37. It can be seen that within the EHR allegation there is a subsidiary allegation of failing to take any or any adequate steps to procure that FFG's board was functioning adequately. The Treasury Solicitor confirmed that this is a separate allegation[30], and its basis is seemingly explained in paragraphs 56 and 57 of the SoS's skeleton argument. Mr Rollason and Mr Fowler were directors of both companies, so it is difficult to see how this allegation adds anything to the case against them.

38. The connection with the allegation made in *Re Uno plc; Secretary of State for Trade and Industry v Gill* (2006) BCC 725 ("*Re Uno*") and the similar factual context are obvious. This will be dealt with in more detail below and in response to the SoS's points in the skeleton argument. For present purposes it is important to recognise that in *Re Uno* the defendants sought clarification as to the allegation being made and received a significant concession from the SoS (by letter dated 17 June 2002) that he was not alleging wrongful trading within the meaning of s.214 of the Insolvency Act 1986 and that it was "not part of the Secretary of State's case that there was no reasonable prospect of avoiding insolvent liquidation during the four month period." This was construed positively by Blackburne J as an acceptance on the part of the SoS "that there was a reasonable prospect of the group avoiding an insolvent liquidation during the four-month period."[31] This concession proved to be highly significant in the reasoning and conclusions of Blackburne J who dismissed the application largely on the basis that the concession deprived the SoS of the "additional ingredient" which

[30] Letter of 3.6.11 to K&L Gates – [**J1/p.79**]

[31] See para. 116 of the judgment in *Re Uno*

the learned Judge considered the SoS had to prove to succeed on a trading at the risk of creditors allegation and to merit disqualification.

39. In reliance on *Re Uno,* the defendants sought clarification of the precise meaning and scope of the allegation(s) against them. They also asked for, and received, the same (or arguably a somewhat wider) concession as was made in *Re Uno.* By letter dated 23 March 2011[32], the Treasury Solicitor made the concession in the following terms:

> On the basis of the current evidence, it is not part of the Secretary of State's case that at any relevant stage prior to 11 October 2006 the Defendants (or any of them) had no reasonable grounds for believing that the insolvent liquidation of EHR and/or FFG could be avoided.

In the same letter they also attempted (twice) to summarise their case as follows[33]:

> Without prejudice to the generality of the case as put in the evidence, fundamentally what the Secretary of State contends is that it was unreasonable to continue trading, with an ever increasing volume of creditors in quantum and value[34], in circumstances where serious risks to creditors were known about and inadequate steps were taken by the directors to find out more about such risks and then properly weigh up all relevant risks and options to decide which course it was appropriate to take.

40. Some two months after he had made the concession, the Treasury Solicitor on behalf of the SoS sought partially to resile from it by saying that they only intended to concede that it was not part of the SoS's case "that at any point prior to 11 October 2006 there was no reasonable prospect of either EHR or FFG avoiding an insolvent liquidation."[35] This was apparently on the basis that the SoS did not want to concede anything to do with the subjective beliefs of the defendants at the time. Furthermore, the SoS did not accept the positive corollary of the concession that was made in DAC's letters of 8 March and 1 April 2011 and accepted by Blackburne J in *Re Uno*.

[32] At – [**J1/p.53**]

[33] It was put the same way in a letter of the same date to K&L Gates, as was the concession.

[34] The suggestion of an "increasing volume of creditors" was also new without any obvious evidential support

[35] See letter of 3 June 2011 – [**J1/p.82**]

Further clarification of the SoS's confused position was sought, including in relation to an apparently new allegation that the defendants did not have adequate data and information in order to conclude that there may have been a reasonable prospect of avoiding insolvent liquidation, but the SoS refused to elaborate or "to debate the matter further in correspondence"[36].

41. The defendants were left in a wholly unsatisfactory position before putting in their evidence in answer, where with each letter of supposed clarification from the Treasury Solicitor, there was a further refinement to or even a completely new allegation made, unsupported by the evidence in Mrs Burns' first affidavit.

42. Now in the skeleton argument (para. 54), the SoS says this:

> The Secretary of State makes no positive case that liquidation was in fact inevitable at any given time prior to October 2006 (when both EHR and FFG entered insolvency procedures).[37]

43. The allegation of trading at the unreasonable risk of creditors is difficult enough as it is to define without the SoS constantly shifting his ground. The main allegation can only fairly proceed, in the light of the above, on the agreed factual basis that:

> **there were at all material times (ie from November 2005 to 10 October 2006) reasonable prospects of both EHR and FFG avoiding insolvent liquidation.**

44. That means that the various options being pursued throughout 2006 to resolve the funding gap arising out of the collapse of Choice had at all times reasonable prospects of succeeding and providing a solvent solution. Therefore the focus of the case in

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[36] The Treasury Solicitor's letter of 16 June 2011 – [**J1/p.87**].

[37] By contrast, Mrs Burns repeats in her 4th Affidavit the pejorative and totally inconsistent subheading for October 2006 – "Bowing to the inevitable" – before para. 225 – [**Affs2/3/p.79**] – repeating para 971 of Burns 1 – [**Affs1/9/p.352**]

relation to this allegation must be on the SoS's allegation of "too little too late" which itself seems to come down to two points:

(1) whether the defendants unreasonably delayed in appreciating the existence of a problem and then embarking on the search for a solution; and

(2) whether the various funding options should have been pursued in parallel rather than one after the other.

Both are bad points as will be seen when the full extent of what the defendants did is examined, as it will during the trial, and when the professional advice and support is taken into account.

45. The SoS has always resisted[38] (including in the skeleton argument[39]) providing any particulars as to the steps that were reasonably open to the defendants to take in the circumstances prevailing at the time. This is a fundamental and disturbing feature of the SoS's case.

46. Nabarro, on behalf of Mr Gilodi-Johnson, made a CPR Part 18 request for Further Information, principally seeking particulars of the steps that the SoS was alleging should have been taken by the defendants to address the alleged forecast cashflow insolvency. The SoS's response, provided on or around 17 May 2011, was that he was not obliged to provide any such particulars but, without prejudice to such contention, did attempt to set out a "non-exhaustive list" of some of the steps that should have been taken[40]. However the steps identified are so unspecific and generalised as to be fairly pointless[41] and paragraphs 12 to 18 are virtually identical. The only slight twist on the allegations set out in Mrs Burns' first affidavit is in relation to "the taking of proper professional advice" which the SoS was saying was insufficient if it was not both legal and financial and it had to be in relation to the specific facts of the case, not

[38] See K&L Gates' letter of 20 August 2009 in response to the draft affidavit requesting particulars of the steps that the SoS says should have been taken – [**J1/p.1**]

[39] See paras. 51 to 53 of the skeleton argument where the same spurious argument about causation and loss is repeated

[40] This is at – [**K1/4/pp.23-44**]

[41] It is also a rather poorly prepared document, in which there is a huge amount of repetition, even to the extent of mistakenly repeating paragraph 14 in paragraph 15.

general. This point will be dealt with in relation to professional advice in paragraphs 158 – 163 below.

(b) Seeking to mislead the boards of EHR and FFG in the period November 2005 to January 2006

47. This allegation is made against Mr Rollason, Mr Fowler and Mr Gilodi-Johnson in the following terms:

> Each of Mr Rollason and Mr Gilodi-Johnson (in each case from about 14 November 2005) and Mr Fowler (from 1 January 2006) as directors of each of EHR and FFG, sought to mislead, alternatively failed to take adequate steps to inform, the boards of those companies either promptly or at all regarding the developing situation in relation to the forecast inability of EHR to put FFG in funds to pay the Choice payment falling due in January (including, without limitation, any steps taken or proposed to be taken to address the position).[42] (emphasis added)

48. DAC sought clarification as to whether this (and/or the others set out below) involved an allegation of dishonesty. The unhelpful response from the Treasury Solicitor in their letter of 23 March 2011[43] was that the allegations are clear and whether or not they encompass an allegation of dishonesty "is not a debate which it is necessary to embark upon." This is contrary to the SoS's duties in respect of alleging dishonesty (indeed in any litigation) as articulated by Lewison J: "If dishonesty is to be alleged against a director, the allegation must be fairly and squarely made in the affidavit and must be fairly and squarely put in cross-examination."[44] When this was raised at the first CMC, the Court made the following order:

> Save with the prior permission of the Court, the Claimant is not allowed to allege in these proceedings (including without limitation at the trial of this matter), that any of

[42] Burns 1 para 67 – [**Affs1/2/p.28**]; See also as against Mr Fowler, Burns 1 para. 1022 – [**Affs1/10/p.370**] – and Mr Rollason, Burns 1 para 1072 – [**Affs1/10/p.423**]

[43] At – [**J1/p.53**]

[44] See *Re Crystal Palace Football Club (1986), Secretary of State for Trade and Industry v. Goldberg* [2004] BCLC 597, at para. 53

> the defendants has acted dishonestly in any respect relating to the allegations in issue in these proceedings...[45]

49. With an allegation of this sort, one would expect to find in the body of Mrs Burns' first affidavit the evidence upon which it is based. In particular insofar as it is said that these defendants deliberately sought to mislead the boards, the occasion(s) when it is said that was done and the matters upon which they sought to mislead. However, all Mrs Burns does is repeat the allegation in paragraph 412 and then set out some of the representations made on behalf of the defendants (when they were trying to work out what was being alleged)[46]. She does not even bother to answer the representations she set out.

50. This was pointed out by both Mr Rollason and Mr Fowler in their affidavits in answer[47], effectively demanding to know what the SoS's case is on this potentially serious allegation. Mrs Burns did not elaborate in her fourth affidavit. The defendants' reading of the allegation was also made clear in their affidavits in answer, namely that the references to "the developing situation", "the forecast inability" and the heading referring to the relevant period as to "January 2006" meant that it had nothing to do with Mr Rollason's board memo of 2 February 2006 which was after the event (and which is the subject of separate criticism by the SoS). Again there has been no response to this point.

51. The SoS's skeleton argument refers to this allegation in paragraphs 5.3, 108.1 and 162 and repeats the wording of "the developing situation" "up to the non-payment of FFG's main supplier, Choice, in January 2006".

52. Bizarrely the SoS repeats word for word in paragraph 163 of the skeleton argument what Mrs Burns said in paragraph 413 of her first affidavit, when she purported to set out a summary of the defendants' pre-action representations. Even though the

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[45] Para 9 of the Order of 5 July 2011 – [**K1/5/p.47**]. The SoS was still entitled to run the allegation of seeking to mislead in the respects alleged.

[46] Burns 1, para. 413 – [**Affs1/6/p.161**]

[47] See paras. 699 to 708 of Rollason 1 – [**Affs4/2/p.155-156];** and para. 723 of Fowler 1 – [**Affs4/3/pp.169-170**]

skeleton argument gives footnote references to Mr Rollason's and Mr Fowler's affidavits and then purports to summarise them, it actually totally ignores what they did say in those affidavits. So not only do the defendants (and the Court) not know what the SoS's case is on this but also he appears to have no answer to what the defendants say about it.

53. Most significant of all, the SoS has still not identified when and where the defendants sought to mislead the boards and the matters upon which they are said to have done so. It is unfair for the SoS to leave such a serious allegation completely unparticularised and to be "explored at trial". In the circumstances the SoS should not be allowed to make this allegation.

(c) Seeking to mislead the s.447 investigators

54. Much of what is said above about the "seeking to mislead the boards" allegation applies to this one also. The allegation is:

> Each of Mr Rollason and Mr Fowler as directors of each of EHR and FFG, sought to mislead the persons appointed under s.447 of the Companies Act in relation to EHR and FFG, as to the reasons for the failure and the financial ability of EHR/FFG to pay the Choice payment falling due in January 2006. [48]

55. In her first affidavit, Mrs Burns did not identify when and how Mr Rollason and Mr Fowler "sought to mislead" her and her co-investigators. Again she merely repeated the allegation and referred to the defendants' denials[49]. She did not even point to the particular passages in the interview transcripts that she relied upon.

56. Despite the lack of particularity, Mr Rollason and Mr Fowler attempted to deal with what appeared to be the allegation in their affidavits in answer[50], including making the fairly straightforward point that the investigators knew that as at 31 January 2006 the

[48] Burns 1 para 69 – [**Affs1/2/p.29**]; See also as against Mr Fowler, Burns 1 para. 1032 – [**Affs1/10/p.376**] – and Mr Rollason, Burns 1 para 1082 – [**Affs1/10/p.429**]

[49] See paras.414 and 415 of Burns 1 – [**Affs1/6/p.162**]

[50] Rollason 1 paras. 710-715 – [**Affs4/2/p.157**]; and Fowler 1 para. 725 – [**Affs4/3/p.171**]

bank had not yet approved the £5m extension to the facility. Even though it is clear when one reads the transcripts that there is some confusion on the investigators' and interviewee's parts as to the exact chronology of events, nevertheless this was not something that the defendants could possibly mislead or seek to mislead the investigators on. Furthermore there is no doubt that they did have a strategy, between 25 and 31 January 2006, of trying to force Choice to negotiate with its retailers[51] (this is explained further below).

57. Finally the skeleton argument gives four references to the interview transcripts that it is assumed the SoS relies upon. However, the references are confusing:

    (a) In paragraph 169 of the skeleton argument, there is a footnote reference to [**G2/5/91**] which is a Note of Interview with Mr Fowler on 9 March 2007 typed up by Mrs Burns (ie it is not a transcript) and follows the format of typed question and answer; the alleged inconsistency does not appear from the page referred to;
    (b) paragraph 170 of the skeleton argument refers to Mr Rollason "s.447 interviews" but the footnote reference [**G3/2/295**] is to an interview with Mr Fowler;
    (c) The other two references are in paragraph 171 of the skeleton argument and do not seem to support the proposition.
    (d) In paragraph 172, the SoS extraordinarily refers to the Oral Representations (at [**H1/4/196**]) which took place <u>after</u> the SoS had served the draft affidavit containing this allegation. Furthermore Mrs Burns says that she and the s.447 investigators were not involved in this process[52]. Quite apart from it being difficult to see how this can therefore be relied upon as part of the allegation, it cannot be described as misleading at all. Mr Rollason has consistently explained, backed up by contemporaneous documentation, that his strategy was to get Choice to negotiate with its retailers.

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[51] On 31 January, Mr Rollason arranged a meeting with Argos and Choice for 1 February but Choice's administration intervened.

[52] See Burns 1 paras. 85 and 86 – [**Affs1/2/pp.37-38**]

58. In short, this allegation has been inadequately particularised by the SoS and it remains totally unclear which passages from which interviews the SoS says Mr Rollason and Mr Fowler were seeking to mislead the investigators. In any event, this allegation adds nothing to the overall case, if the Court accepts the defendants' explanations for what happened in relation to Choice. The SoS does not accept the defendants' explanations but the fact that those explanations were also made to the investigators does not make it a further ground for unfitness. It would only be relevant if in some way the defendants had obstructed the investigation by giving false information, but no such allegation is made.

(d) New allegation in relation to FFG's April 2005 accounts

59. The last minute introduction of the new allegation against Mr Rollason and Mr Fowler concerning the FFG 2005 accounts has led to a flurry of activity in terms of both factual and expert evidence. It is unfortunate that because of the way matters developed, Mr Rollason and Mr Fowler were forced into putting their expert evidence in first, which the SoS has therefore had the advantage of seeing before putting in his. Because that expert evidence will not be considered until the end of the trial and because the SoS has not attempted to deal with it in his skeleton argument, it will not be analysed in detail here.

60. The new allegation is contained in Paragraphs 19 to 31 of Mrs Burns' fourth affidavit[53] and the SoS is maintaining his position that those paragraphs are all that he relies upon as founding unfitness. He repeats the extraordinary argument that he has continually deployed to avoid giving particulars that the consequences of alleged conduct are not relevant to considering disqualification (this is dealt with below). It is therefore still unclear the extent to which the particulars[54] that the SoS was ordered to

[53] At – [**Affs2/3/pp.7-11**]

[54] These are at – [**K1/9/pp.58-62**]

provide are relied upon[55]. Further to what extent is the SoS withdrawing from his position expressed in his skeleton argument for the CMC on 2 April (para. 31)?

> The Secretary of State does not make a case that the accounts should have been in a different format: ie that they should have contained additional disclosure and/or that they needed to be altered to show a true and fair view and/or that they should not have been signed off on a going concern basis.

61. The allegation is of a "failure to give any or any adequate consideration" to whether either or both of the partial payment of Choice or Choice's collapse were material post-balance sheet events requiring disclosure in the 2005 accounts or affected their going concern basis. In paragraph 216 of the skeleton argument it is said that both Mr Rollason and Mr Fowler told the AADB that they had not personally "considered these points at all". However even on Mrs Burns' own evidence (para.27 of the fourth affidavit[56]), she says that Mr Fowler "had thought about" those points and "had satisfied himself that no disclosure was required". Furthermore he clearly told the AADB that[57]. And Mr Rollason did not say that he personally did not consider those matters.

62. Another extraordinary thing about the new allegation is the apparent reliance by the SoS on "evidence" from E&Y[58] even though he is not calling them and did not refer to their AADB transcripts in the evidence in support of the new allegation contained in Mrs Burns' fourth affidavit. The SoS did not make any allegation in Mrs Burns' fourth affidavit that E&Y did not know about the administration of Choice (which was widely reported at the time in the press) or the part payment of Choice. If E&Y had a team onsite at the beginning of February[59] there is no way they would not have found out about Choice's administration. Furthermore the SoS does not refer to

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[55] See paragraph 214 of the skeleton argument

[56] At – [**Affs2/3/p.10**]

[57] See – [**H3/1/pp.128 and 132**] – "I think I was happy in my own mind that, well, the going concern shouldn't be an issue, given what I knew at that time....Q: So you are saying you did think about it and you reconciled it in your own mind that it wasn't required? A: Yeah, that – based on what I knew"

[58] See para. 217 of the skeleton argument

[59] See para. 217 of the skeleton argument

passages in the transcripts that refer to Mr Flitcroft's view for instance as to whether these were material post-balance sheet events and affected going concern[60]. That is the danger of relying on transcripts of interviews in a different forum without being able to test the "evidence" in cross examination[61].

63. Insofar as it is relevant to the way the SoS is putting his case, the expert evidence of Mr Mark Harwood, a senior audit partner of Baker Tilly UK Audit LLP, wholly supports the view taken at the time by Mr Rollason and Mr Fowler, namely that these two events were not, in the circumstances existing at the time, material post-balance sheet events and did not affect the going concern basis of the accounts[62]. Accordingly, FFG's accounts for the year to 28 April 2005 did not require any extra disclosure; nor should they have been qualified by the auditors.

64. If there was not a formal board meeting of FFG[63], in any event all the directors had actually seen and effectively approved the accounts and all knew of the two events relied upon, namely the partial payment of Choice and Choice's administration. In the circumstances, any alleged failure to hold a board meeting had no consequential effect and cannot be serious enough to justify disqualification.

(e) Failing to inform the boards of EHR and FFG February to October 2006

65. This allegation appears to be wholly unparticularised in either the SoS's evidence or the skeleton argument. The allegation is in the following terms:

> Each of Mr Fowler, Mr Gilodi-Johnson and Mr Rollason as directors of each of EHR and FFG failed to take adequate steps to inform, either promptly or at all, the boards

[60] See eg – [**H3/4/pp.248-249**] and [**H4/3/pp.275-276**]

[61] And the SoS is now quite clearly relying on E&Y and should therefore have called them.

[62] His report is at – [**Q1/3/p.131**]

[63] The directors' report was signed by the company secretary, Deborah Davey.

of those companies regarding the developing financial situation during the period February 2006 to October 2006[64]

66. There are no details in relation to the EHR board as to what the SoS says Mr Rollason and Mr Fowler failed to disclose. In relation to FFG, there is an allegation in the skeleton argument that there should have been earlier disclosure by Mr Rollason, Mr Fowler and Mr Gilodi-Johnson to the two other FFG directors of what was being discussed by the EHR board as to the options being pursued to deal with the potential funding gap[65]. It is not accepted that the other two directors, Mr Hicks and Mrs Ponting, did not know what the situation was and, for instance, that the rights issue was underway. In any event, FFG's interests, including those of its creditors, were necessarily (because of the banking arrangements, which are not now criticised) closely aligned to EHR's and it was in both their interests for EHR to find a solvent solution to the funding problem.

67. The SoS makes the fanciful proposition in paragraph 112 of the skeleton argument that if the FFG board (ie Mr Hicks and Mrs Ponting) had known of the potential funding problem in early 2006, they would have been in the position of deciding whether to continue with the 2006 Christmas cycle "and/or whether the terms on which cash would be lent to other group companies should be renegotiated." If, as appears, the SoS is not now criticising the banking arrangements and the structure of cross guarantees and debentures given by all trading companies in the Group together with the daily cash sweep, it is absurd to suggest that FFG could simply extract itself from those arrangements.

[64] Burns 1 para. 68 – [**Affs1/2/p.29]** See also as against Mr Fowler, Burns 1 para. 1023 – [**Affs1/10/p.370**] – and Mr Rollason, Burns 1 para 1073 – [**Affs1/10/p.423**]

[65] See paras. 222 to 228 of the skeleton argument.

LEGAL ISSUES

68. In the Law section of the SoS's skeleton argument, there is much that is uncontroversial. This will therefore concentrate on the law in relation to the main allegation of trading at unreasonable risk of creditors.

(a) Section 8 discretion

69. Before turning to the law in relation to the main allegation, some other points in relation to disqualification proceedings are dealt with.

70. These proceedings have been brought under s.8 of the CDDA ("disqualification after investigation of company") which, though it relies on the same concept of unfitness as in the more common s.6 CDDA, is somewhat broader in two respects: (i) the test in s.8 is "his conduct in relation to the company makes him unfit....." whereas s.6 is limited to "his conduct as a director of that company...."; and (ii) s.8 is discretionary without any minimum period whereas s.6 is mandatory with a minimum 2 year period.

71. Despite these differences, the courts have in practice applied the same principles in determining whether unfitness has been established particularly where, as in this case, the allegation of trading at the risk of creditors is commonly made in s.6 proceedings following an insolvency (eg *Re Uno*). Having said that there must be some significance given to the fact that Parliament has deliberately conferred a discretion on the Court under s.8 as to whether to order disqualification even where the Court finds unfitness, whereas it did not confer such a discretion under s.6[66].

(b) Standard of fitness

[66] Etherton J in *Secretary of State for Trade and Industry v Hollier* [2007] Bus. LR 352 was surprised that the parties had agreed that the same approach and principles should apply in both s.6 and s.8. Furthermore there is no time limit on bringing proceedings under s.8, so delay, and any consequential period of de facto disqualification may be one of the factors for the Court's discretion.

72. In determining unfitness, the court is only concerned with past conduct, namely that which is alleged by the SoS in relation to EHR and FFG. The court has to decide, per Hoffmann LJ in *Re Grayan Building Services Ltd; Secretary of State for Trade and Industry v Gray* [1995] Ch 241:

> whether that conduct, viewed cumulatively and taking into account any extenuating circumstances, has fallen below the standards of probity and competence appropriate for persons fit to be directors of companies.

73. The question is therefore as to where the line should be drawn. In earlier cases, the courts attempted to define a legal test of unfitness based on the statutory words, but these were deprecated by the Court of Appeal in *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164 which said that "the true question to be tried is a question of fact – what used to be pejoratively described in the Chancery Division as a "jury question"". The Court of Appeal was really trying to encourage parties not to try to compare the facts of what will inevitably be very different cases and situations. Nevertheless, the courts have, even since *Re Sevenoaks*, sought to formulate some principles, essentially of law, as to where the objective line is to be drawn between fit and unfit conduct. The question was actually described by Hoffmann LJ in *Re Grayan* as one of mixed fact and law.

74. By s.9 CDDA the court is required (for both s.6 and s.8 cases) "to have regard in particular" to the matters set out in Schedule 1 of the CDDA. But Schedule 1 is a non-exhaustive list and the court is concerned with the director's conduct as set out in the allegations relied upon by the SoS.

(c) <u>Incompetence as a ground of disqualification</u>

75. This case is really concerned with competence or the duty of skill and care. Leaving aside the allegations of misleading the boards and the investigators, the main allegation is all concerned with the reasonableness of the actions taken by the defendants and whether they should have acted differently. Accordingly the standard of competence expected of directors is critical.

76. Again in *Re Sevenoaks,* Dillon LJ said that incompetence or negligence did not need to be "total"[67] but it did need to be proved to "a very marked degree". In *Re Barings plc (No.5)* [1999] 1 BCLC 433, Jonathan Parker J said:

> A7. Where, as in the instant case, the Secretary of State's case is based solely on allegations of incompetence (no dishonesty of any kind being alleged against any of the respondents), the burden is on the Secretary of State to satisfy the court that the conduct complained of demonstrates incompetence of a high degree. Various expressions have been used by the courts in this connection, including 'total incompetence' (see *Re Lo-Line Electric Motors Ltd* [1988] BCLC 698 at 703, [1988] Ch 477 at 486 per Browne-Wilkinson V-C), incompetence 'in a very marked degree' (see *Re Sevenoaks Stationers (Retail) Ltd* [1991] BCLC 325 at 337, [1991] Ch 164 at 184 per Dillon LJ) and 'really gross incompetence' (see *Re Dawson Print Group Ltd* [1987] BCLC 601 per Hoffmann J). Whatever words one chooses to use, the substantive point is that the burden on the Secretary of State in establishing unfitness based on incompetence is a heavy one. The reason for that is the serious nature of a disqualification order, including the fact that (subject to the court giving leave under s 17 of the Act) the order will prevent the respondent being concerned in the management of any company. (emphasis added)

77. The burden of proving such serious negligence is firmly on the SoS and the court will be astute to the dangers of hindsight, knowing the companies have gone into insolvent liquidation and the fact that it is looking back over events with a fine toothcomb to pick over the defendant's conduct.

> It is very easy therefore to look at the signals available to the directors at the time and to assume that they, or any other competent directors, would have realised that the end was coming. The court must be careful not to fall into the trap of being too wise after the event.[68]

(d) Causation

78. In any allegation of negligence particularly by way of omission or failing to act, it is necessary first to put the allegation in context so that the factual circumstances under

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[67] As had earlier been suggested by Sir Nicolas Browne-Wilkinson V-C in *Re Lo-Line Electric Motors Ltd* [1988] Ch 477

[68] *Re Living Images Ltd* [1996] BCLC 348, per Laddie J

which the misconduct is said to have occurred can be understood. Second, it is equally important to know how a reasonable person would have acted in those circumstances.

79. As referred to above, throughout this case the SoS has refused to say what steps could realistically in the circumstances have been taken by the defendants that they did not take. It is extraordinary that in a case that is predicated on the allegation that "no or no adequate steps were taken to address the forecast cashflow insolvency", the SoS is unable to state, even simply, the steps that should have been taken. It is only when one gets to paragraph 284 of the skeleton argument that the SoS's case for the post-Choice period is explained as turning on just two points:

> "284.1 The failure to explore options earlier and with greater urgency, and
>
> 284.2 The failure to [sic] several options in parallel in this period against a background of ever increasing deposits[69] coming in from Savers."

80. If the SoS is relying purely on greater urgency and pursuing options in parallel (which is what happened), then it is assumed that he does not seek to argue that there were other options available to the defendants at the time to pursue. But the SoS continues to run the argument (see paras. 51 to 53 of the skeleton argument) that because there is no requirement for the SoS to show that the alleged misconduct caused loss, there is no requirement for the SoS to explain either what steps could or should have been taken by the defendants or what the consequences were. The SoS has made the point repeatedly[70], such as in the Answer to Mr Gilodi-Johnson's CPR Part 18 Request[71] and in the Particulars of the FFG 2005 Accounts allegation[72].

81. The SoS is totally missing the point. The request for particulars is nothing to do with causation and loss. It is about understanding the case that the SoS is seeking to make

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[69] It is misleading and wrong to refer to these as "deposits" as though FFG was a bank. These were pre-payments for goods ordered.

[70] Even going back to Treasury Solicitor's letter of 3.9.09 – [**J1/p.7**]; and repeated on 23.3.11 – [**J1/p.54**]

[71] See paras. 1 and 7 at – [**K1/4/pp. 24 and 26**]

[72] See para. 2 – [**K1/9/p.58**]

as to the steps that he says should and could have been taken at the time by the defendants. It is not possible to judge the defendants' conduct in relation to this sort of allegation unless it is shown in what way they could have acted differently. It is necessary information and the SoS's bemusing resistance to providing it undermines his case and leads to the inevitable conclusion that he cannot identify any other steps that ought to have been taken.

(e) Particular responsibility to FFG's customers

82. A new matter to emerge from the SoS's skeleton argument is the suggestion, hinted at in paragraphs 73 to 76 of the skeleton argument, that because the so-called Savers were "especially vulnerable" by reference to their "socio-economic profile" and their pre-payments over many months, there is a special responsibility, or even duty, towards them. But having apparently accepted the Group's banking structure and the necessity for a cash sweep, it is difficult to see how the SoS can properly allege that FFG's customers are a special category of creditor. The suggestion that cash from FFG's customers was in some way held on trust by FFG for them was completely rejected by Mann J in *Re Farepak Food and Gifts Ltd (in administration)* [2007] 2 BCLC 1[73].

83. The formulaic allegation in relation to FFG is of causing or permitting it "to trade at the unreasonable risk of its creditors, including, without limitation, Savers..." (emphasis added). The allegation concerns all FFG's creditors, as further indicated by the use of the words "without limitation". The SoS cannot now allege, as paragraph 76 of the skeleton argument suggests, that the defendants were "taking advantage of those who make pre-payments" in the same form as a Crown debts allegation[74]. It has

[73] Mann J said it was "completely implausible" and would "turn Farepak into a very odd savings organisation. Even banks do not have to do that" (para. 34). The relationship between FFG and its customers was purely contractual.

[74] The analogy of a Crown debts allegation is inappropriate. A Crown debts allegation is based on not paying the Crown on the due date and instead using monies collected on behalf of the Crown to pay other debts, taking advantage of the Crown's forbearance. In this case, pre-payments were received by FFG from its

never been alleged, and the SoS should not now be allowed to do so, that the defendants in some way discriminated against one class of creditor. In *Re Uno* the allegation was of trading at the risk of a specific class of creditor, the cash paying customers. In this case, the allegation is not based on a specific class of creditor but on unsecured creditors in general.

(f) <u>Trading at unreasonable risk of creditors</u>

84. The latter point leads into the analysis below as to the content of the SoS's main allegation of trading at the unreasonable risk of creditors. The SoS has made it absolutely clear that he is not running a case of wrongful trading within the meaning of s.214 Insolvency Act 1986[75]. However trading can only be at the risk of creditors if the company is insolvent, on either a cashflow or balance sheet basis. Necessarily, when considering this sort of allegation, the court has to decide whether the directors were wrong to have decided to continue trading while insolvent. That is not to say that the SoS has to prove wrongful trading within the meaning of s.214; but merely to be aware that the context must be that the companies were trading while insolvent. If they were not, the SoS does not even get to first base.

85. The SoS's leading counsel in this case devotes some 18 pages in his book to attempting to define the relationship between an allegation of wrongful trading and one of trading at the risk of creditors (he calls the latter "marginal cases")[76]. As to whether there is a different test for unfitness meriting disqualification than that laid down in s.214 Insolvency Act 1986, the courts do appear to have accepted a trading at the risk of creditors' allegation. But all those cases are explicable on the basis that either they were, on analysis, actually wrongful trading allegations or there was some

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customers for future delivery of goods. The sums so received were not overdue for payment at any material time.

[75] See paras. 55 and 94 of the skeleton argument

[76] Directors' Disqualification and Insolvency Restrictions (3rd ed), by Adrian Walters and Malcolm Davis-White QC – paras. 5-05 to 5-26. He was obviously too modest to refer to his book in the skeleton argument

other element or ingredient that took it across the line. The analysis of such an allegation in *Re Uno* is both useful and enlightening.

86. Trading while insolvent is not in itself necessarily wrongful. It is not even a requirement for establishing wrongful trading under s.214 Insolvency Act 1986. What makes trading wrongful under s.214 is if trading is continued after the point (described as the “critical point” in Macfarlanes’ notes[77]) when the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. On the basis of the SoS’s concession, that critical point was never passed and a wrongful trading claim could not have succeeded.

87. The argument that something less than a wrongful trading allegation is sufficient for disqualification is generally based on Peter Gibson J’s comments in *Re Bath Glass Ltd* [1988] BCLC 329:

> Even if such conduct does not amount to wrongful trading within s.214, in my judgment it would still be conduct amounting to misconduct and so relevant to s.6.

88. However this has been taken out of context with what went before. Peter Gibson J was discussing an allegation of unfair discrimination in relation to Crown debts which, as discussed above, can itself be the basis of an allegation.[78] All that Peter Gibson J was saying, and this is undoubtedly correct, is that the test for unfitness under s.6 CDDA is different to the test for wrongful trading under s.214 – under s.6 “any misconduct of the respondent qua director may be relevant, even if it does not fall within a specific section of the Companies Acts or the Insolvency Act”. In any event, the comments were obiter as Peter Gibson J dismissed the application as the misconduct was not serious enough to make the directors unfit.

89. The first case where a lower threshold than wrongful trading was accepted by the courts was *Re Synthetic Technology Ltd; Secretary of State for Trade and Industry v*

[77] For instance the advice of 17 July - [**CHRON 14/5/pp.122-127**]

[78] And the Court of Appeal’s approval of this statement in *Re Sevenoaks* was made in the same context – see p.183.

Joiner (1993) BCC 549 – "taking unwarranted risks with creditors' money". However this allegation is difficult to disentangle from the other findings of serious wrongdoing and in particular of unfair discrimination against the Crown. In other words there was not a simple allegation of trading at the unreasonable risk of creditors.

90. It is clear from the authorities that simply alleging trading while insolvent is not enough. There has to be something more to take the matter above the threshold for disqualification. Parliament has seen fit to set the standard for directors' duties in relation to continued trading when their company is insolvent through the test set out in s.214 Insolvency Act 1986. Professional advice (such as Macfarlanes in this case) is understandably and justifiably based on the standard set out in s.214. It cannot be right that, where there is no further element of misconduct, the SoS should be able to prove unfitness without establishing a breach of s.214.

91. As Chadwick J said in *Secretary of State for Trade and Industry v Gash* [1997] 1 BCLC 341:

> The companies legislation does not impose on directors a statutory duty to ensure that their company does not trade while insolvent; nor does that legislation impose an obligation to ensure that the company does not trade at a loss. Those propositions need only to be stated to be recognised as self-evident. Directors may properly take the view that it is in the interests of the company and of its creditors that, although insolvent, the company should continue to trade out of its difficulties. They may properly take the view that it is in the interests of the company and its creditors that some loss-making trade should be accepted in anticipation of future profitability. <u>They are not to be criticised if they give effect to such view.</u> (emphasis added)

92. According to Walters and Davis White QC (para.5-11) the lesser "unwarranted risk" test requires the SoS to "establish <u>at least</u> the following":

> (1) That the company was unable to pay its debts as they fell due.
> (2) That the defendant knew or ought to have known that the company was insolvent (in a cash flow sense).
> (3) That the company continued to trade.
> (4) That the continued trading produced an increase in the company's deficit thus prejudicing creditors and/or that payment of some creditors (e.g. those not pressing for payment) was delayed or not made so that continued trading was at their risk and expense.

(5) That the continued trading exposed the company's creditors (and possibly others, such as employees) to an unreasonable risk that the company would fail.
(6) That the continued trading was unreasonable in all the circumstances.

Apart from (3) above, it is not clear at all that the SoS can establish the other elements of the test (and they will each be dealt with in turn under the factual section below).

93. The single allegation in *Re Uno* was that during the 4 month period between November and March 2000:

> the defendants caused or allowed the Companies to trade at the risk of cash paying customers, without taking adequate or sufficient steps to ensure that, in the event that the companies were unable to find a buyer or obtain re-finance, cash paying customers would receive the goods ordered or a full refund[79]

The Judge did not allow the SoS to add the word "unreasonable" before "risk" in the first line. In that respect it differs from the allegation in this case. It is also different because it singles out one class of creditor, the cash paying customers, who had paid deposits for their furniture, and specifies that they were left unprotected if the companies could not be sold or re-financed. In truth this was really an allegation of taking unfair advantage of or unfairly discriminating against unsuspecting members of the public who had paid cash deposits. Perhaps surprisingly, there does not seem to have been an allegation under paragraph 7 of Schedule 1 of the CDDA[80] despite it being alleged that they sought to increase the cash deposits being collected in during the period by a discount scheme that was designed to enable the companies to continue trading during this period.

94. There are striking similarities with this case:
(1) The cash deposits were used as working capital for the companies;
(2) It was industry practice to use these monies as such and not to segregate;

[79] Para. 118

[80] Cf *Re City Pram & Toy Co. Ltd* [1998] BCC 537

(3) No professional advisor had said that the deposits needed to be segregated or that they were held on trust;

(4) Their cash flow projections showed that, in the absence of re-financing, they would exceed their overdraft facilities;

(5) A number of possible solutions were actively pursued during the relevant period that would have provided a solvent solution;

(6) However as soon as the last viable solution failed, the companies were put into administration;

(7) Throughout they had legal and accountancy advice as to the adequacy of their forecasts and whether it was appropriate to continue trading in that way.

95. Blackburne J decided that it was not enough to prove that the defendants had caused the companies to continue to trade while knowing that they were insolvent. Normally with that sort of allegation it is necessary to prove that they knew or should have known that there was no reasonable prospect of avoiding an insolvent liquidation, ie wrongful trading. As that had been conceded by the SoS, some other form of misconduct, such as unfair discrimination of a particular class of creditors, had to be proved. The Judge could not find any other misconduct and was "wholly unpersuaded that the charge of unfitness is made out." He concluded thus:

> 155........The defendants' evidence, which was not disputed, was that if the group had ceased trading on November 6 cash-paying customers awaiting delivery of the goods they had ordered (i.e. those who had paid deposits either by cash or by cheque or by debit card) would have received nothing in the event of a liquidation (and would not have received the goods that they had ordered) and the group would have had to lay off several hundred employees. The judgment which the defendants had therefore to make, and keep under constant review throughout the four-month period, was whether to cease trading there and then, with the inevitable consequence of an insolvency in which the group's unsecured creditors, including in particular those who had paid cash deposits but not yet received their goods, would receive nothing and in which, in addition, there would be the loss of several hundred jobs on the part of the group's employees, or whether to continue to trade in the reasonable expectation of effecting a corporate solution which would ensure that all creditors would be paid and all customers would receive the goods for which they had provided a deposit (and many, if not all, of the employees' jobs would be safeguarded). In short, the directors were faced with an unenviable dilemma: whether, by ceasing to trade, to condemn existing cash-paying customers and other unsecured creditors to the certainty of receiving nothing or whether, by continuing to trade and continuing therefore to receive deposits and otherwise incur credit, to subject future cash-paying customers

and others extending credit to the group to the risk of loss, but to do so in the knowledge that there was a reasonable prospect of achieving a solution to the group's difficulties which would enable everyone to be paid in full.

.....

157 In the instant case the defendants could have taken what counsel for the defendants described as "the easier course" of going into some form of insolvent administration. But, after taking advice, they made the conscious decision, essentially a commercial judgment, not to pursue that course because, as I accept and the Secretary of State has not sought to controvert, they reasonably believed that there was a reasonable prospect of finding a corporate solution, thereby achieving a satisfactory outcome for all of the group's creditors, including not least its cash-paying customers.

158 It is clear that the defendants were acutely conscious of this dilemma and, in particular, of the risk to cash-paying customers if no corporate solution was found.

....

162 There was likewise no suggestion that any part of the defendants' motivation was to line their own pockets or that they had some other dishonest or consciously improper purpose in mind in continuing to trade the group. It could not be said that in acting as they did they were acting incompetently, let alone markedly so. Nor could it be said (even if it were open to the Secretary of State to do so) that, in acting as they did, they were displaying a cynical disregard for the interests of the cash-paying members of the public on whose continuing custom–along with the support of others–the group was reliant if the corporate solution was to be achieved.

.....

164 But I am concerned with the conduct of the defendants rather than, although I am fully mindful of, the plight of the cash-paying customers. Not only am I not persuaded that the defendants' conduct during the four-month period is to be characterised as unfit but ignoring the benefit of hindsight, I see no real grounds for criticising them at all. From all that I have read and heard, the defendants, faced by early November with the declining financial fortunes of the group, went out of their way to pursue a solution which throughout the period had a reasonable prospect of succeeding and which, if achieved, would have satisfied all of the group's creditors, including not least the cash-paying customers.

96. These are the critical passages on the law:

144 Chadwick J.'s observations[81], which I gratefully adopt as an accurate statement of the law, mean that, ordinarily, a director will not be at risk of a finding of unfitness, such as to lead automatically to disqualification, *merely* because he knowingly allows the company to trade while insolvent, *i.e.* he allows the company to incur credit (including, I would add, accepting a payment from a customer in advance of the supply of the relevant goods or service) even though, at the time and as he knows, the company is insolvent and later goes into liquidation. It does not add anything to the proposition to say that, in causing the company to incur credit (or accept payment in

[81] Referred to above

> advance of the supply of the goods or service), the director was "taking advantage" of the third party in question. In a sense, every company which incurs credit when, as its director knows or ought to know, it is insolvent, is "taking advantage" of the third party supplier of credit. If the director is to be found unfit there must ordinarily be an additional ingredient. Normally that ingredient is that, at the time that the credit is taken (or the advance payment received, which is in essence the same), the director knows or should know that there is no reasonable prospect of his company avoiding insolvency.
> ....
>
> 148 It follows that the statement in *Mithani* (at para.716) (that a director should be regarded as guilty of conduct showing a serious want of probity if he is party to permitting the company to accept deposits or advance payments in circumstances where there is no certainty that the company will be able to meet the customer's order and the customer's payment is put at risk) states the matter too broadly.
> ....
>
> 149 The question here is quite simply whether, notwithstanding that at all material times there was a reasonable prospect of avoiding insolvency, nevertheless in causing the two companies in the group to accept (and, in the case of Uno, through the promotion scheme to encourage) the payment of deposits in order to enable trading to continue while a search continued for a corporate solution in circumstances where they knew that, if in the limited time available they should fail in that search, the companies would have to go into insolvent liquidation (or something similar) the defendants' conduct crossed the threshold of unfitness so as to merit automatic disqualification.

97. As noted above, the case was really about unfair discrimination of the cash paying customers, not of creditors generally. In this case the allegation concerns creditors generally and there is no direct allegation of unfair discrimination against them (nor should the SoS be allowed to adjust his case to make such an allegation). If a company is trading while insolvent, it is inevitably trading at the risk of its creditors generally (and the directors' duties are, in that situation, to act in the best interests of creditors generally) but it is not necessarily unreasonable to do so. If, at the same time, because of potentially viable solutions to the problem, there is a reasonable prospect of avoiding insolvent liquidation for the benefit of creditors generally, there must be something else about the directors' conduct that was so unreasonable as to justify disqualification. The additional element in this case is difficult to discern.

98. In commenting on *Re Uno*, Walters and Davis-White QC say that "This does not mean that, for example, directors in a similar position who <u>trade recklessly without professional advice</u> and <u>without carefully monitoring the company's financial position</u> will escape disqualification even where it is not alleged, in addition, that the directors

should have known that there was no reasonable prospect of the company avoiding insolvent liquidation." They went on to try to summarise the test as follows: "whether the defendant acted unreasonably in the knowledge of the company's insolvency to the detriment of creditors."

99. So the issue is the reasonableness of the defendants' conduct in the face of the companies' insolvency, if they were actually insolvent.

100. The SoS often repeats Sir Clive Thompson's remark that the case is about "not enough was done to avoid insolvency, and what was done was done with insufficient energy or urgency"[82]. This is expanded upon in the skeleton argument (largely in paragraphs 108 to 118). In paragraph 108, the SoS says "the "unreasonableness" allegation is based in substance on an allegation of doing too little too late in the face of the position the Group was in (and each of the Companies was in) at the relevant times." Unhelpfully, in relation to the pre-Choice period, the SoS says that the issue is what the defendants should have done, had they had the relevant information, but does not set out what the SoS says they should have done.

101. In relation to the post-Choice failure period, the SoS appears to be criticising an "all-or-nothing" approach to the decision as to continued trading at any point in time. He does not, however, identify an alternative either to ceasing to trade or pursuing viable options for a solvent solution to the funding problem. In paragraph 110, the SoS quite wrongly refers to the defendants' calculation that the companies should continue trading while any proposal for a solvent solution was "still "alive" with any (however slight) prospects of success." The SoS has accepted through the concession that there were reasonable prospects of avoiding liquidation throughout the period and there is no evidence that the defendants were basing their decisions on proposals that did not have a reasonable prospect of success.

[82] See para. 62 of Ms Burns' affidavit – [**Affs1/2/p.25**]

102. Once again, the SoS refuses to state whether it is his case that the companies should have ceased trading before 10 October 2006. He introduces the wholly new point as to the particular vulnerability of FFG's customers but, as noted above, this cannot create a special duty to them. He also makes the wholly unrealistic point in paragraph 112 that FFG should have considered either not continuing with the 2006 Christmas cycle or "whether the terms on which cash would be lent to other group companies should be renegotiated." This completely ignores the existing banking arrangements.

FACTUAL MATTERS

103. The facts will be explored in detail at the trial. In the SoS's skeleton argument there is scant reference to the underlying documents. Furthermore, the SoS has completely failed to provide the identification ordered by the Court of the documents among the huge exhibits to Mrs Burns' fourth affidavit that the SoS will rely on and therefore potentially put to the defendants[83]. These defendants intend raising this point at the start of the trial.

104. These defendants wish to correct the false picture painted by the SoS in the skeleton argument particularly in relation to the crucial period around the administration of Choice.

105. The facts will be considered in relation principally to the main allegation of trading at the unreasonable risk of creditors. The most convenient way of doing so is to deal separately with the pre- and post-Choice failure periods. Even though both periods are said to be part of the same general allegation (which in itself undermines the credibility of the allegation) they give rise to completely different issues. The SoS recognises this[84].

[83] Para. 10 of the Order made on 2.4.12 – [**K1/8/p.55**]

[84] See para. 119 of the Skeleton argument

106. In order to test the factual basis for the main allegation, it is useful to look at the evidence by reference to the essential elements of an allegation of trading at unreasonable risk of creditors as set out in Walters and Davis-White QC (see paragraph 92 above). They will be taken in the same order.

(1) Cashflow insolvency

107. It is suggested that it is first necessary to show that the company was unable to pay its debts as they fell due; in other words, cashflow rather than balance sheet insolvency. In this case, there was no cashflow insolvency. The normal badges of cashflow insolvency are creditors issuing statutory demands or claim forms and getting judgments, but there was nothing to that extent going on. All there was, was an anticipated or forecast cashflow problem at some point in the future when, if refinancing or some other corporate solution was not found, the Group would exceed its overdraft facilities and presumably not be able to pay its debts as they fell due.

108. The one allegation of actual cashflow insolvency is in paragraph 22 of Mrs Burns' first affidavit[85] where she was referring to January 2006 and said: "The Secretary of State's case is that FFG (and the Group) simply did not have the money to pay the debt and was cash flow insolvent." This allegation is not repeated in the main body of the affidavit; nor in the allegations themselves, in which there is only reference to the "forecast cashflow insolvency".

109. The SoS appeared to be relying on some form of balance sheet insolvency although again it was unclear what was really being alleged. In Mrs Burns' first affidavit, she said that the "Group remained balance sheet insolvent (on a consolidated basis) at all times thereafter", meaning from April 2003[86]. The SoS is careful to refer only to the consolidated position because both EHR's and FFG's

[85] At – [**Affs1/2/p.12**]

[86] See para. 153 of Burns 1 – [**Affs1/3/p.71**]

individual accounts show that throughout the material period, they were balance sheet solvent. As the SoS is keen to emphasise the separateness of the companies within the Group, it must be right to test a company's solvency by reference to its own balance sheet and trading position. The consolidated balance sheet includes the historic losses suffered in 2003 from the sale of DMG and does not reflect the ongoing trading position of the individual companies within the Group.[87] The auditors, E&Y, certainly did not consider that EHR, FFG or the Group were insolvent and the market did not either based on the published financial information.

110. There is no reference to this in the skeleton argument and it is therefore unclear the extent to which the SoS is seeking to prove insolvency. It is unsatisfactory, to say the least, to be left in this position shortly before the trial, on this important point. It is unsustainable to rely on the consolidated Group position for proving the insolvency of either EHR or FFG. If the SoS cannot prove that they were insolvent, he cannot prove that they were trading at the risk of creditors.

(2) Knowledge of cashflow insolvency

111. Obviously this is dependent on either or both of EHR and FFG actually being cashflow insolvent. Simply because steps were taken to manage the Group's cash, what the SoS calls "creditor stretching", does not mean that they were cashflow insolvent. Clearly, in July 2006, the defendants did not consider either EHR or FFG to be balance sheet or cashflow insolvent, as they told Macfarlanes who recorded that FFG was not "presently cashflow insolvent...Its concern is that at some future point in time it may find itself cashflow insolvent"[88].

112. If the SoS cannot establish these first two elements, he cannot succeed on the above analysis of the allegation.

[87] See paras. 75 to 77 of Fowler 1 – [**Affs4/3/pp.18-19**]

[88] See Macfarlanes' written advice dated 7.7.06 at – [**CHRON13/4/180-186**]; and see paras 388 to 389 of Rollason 1 – [**Affs4/2/p.85**]

(3) Continued trading

113. As stated above, there is no dispute that the companies continued to trade during the material period. They only did so on the basis that the defendants concluded that there were reasonable prospects of successfully finding a solvent solution by which all creditors would be paid and insolvent liquidation would be avoided. They also had at all times the support of HBOS.

(4) Deficit increase or delayed payment of creditors

114. The thinking behind this element seems to be that some sort of detriment to creditors from continued trading has to be shown. The SoS must show that the deficit in both EHR and FFG increased during the time that they were trading at the unreasonable risk of creditors (assuming that is established). No such evidence has been adduced.

115. The only evidence of a significant delayed payment by FFG was in relation to the Choice payment due in January 2006. However this was quickly resolved by agreement with the administrators of Choice and was paid pursuant to that agreement. This cannot be relied upon as establishing that continued trading was at Choice's expense.

116. As for EHR, the position is not clear at all. Although there is some evidence of "creditor stretching" (as the SoS terms it) by subsidiaries of EHR between January and April 2006, this was not out of the ordinary nor unreasonable in any sense. Indeed it was perfectly normal commercial practice. It does not establish anything approaching a detriment to creditors specifically arising from the decision to continue trading.

(5) Continued trading exposing creditors to an unreasonable risk;

(6) Continued trading unreasonable in all the circumstances

117. These two really go together and lie at the heart of the case which the SoS has confirmed is based on "unreasonableness"[89]. Consideration of these issues will be divided up between the pre- and post-Choice failure periods. The issue of professional advice is then dealt with.

(a) Period up to Choice's administration

118. There are certain aspects of the Choice episode that the SoS confuses and he consistently paints a misleading picture as to what happened and, more importantly, Mr Rollason's and Mr Fowler's state of mind between 20 January and 2 February 2006. Inevitably this will be explored in detail in cross examination but certain matters need to be ironed out now.

(i) between 20 and 30 January, Mr Rollason and Mr Fowler both reasonably believed that HBOS would be granting a £5m extension to the facility that would enable FFG to pay the full £12.1m;

(ii) when they were negotiating with Choice on 31 January, they reasonably believed that the £5m extension to the facility would be approved the following day on 1 February;

(iii) those attempted negotiations with Choice involved both payments by instalment and tripartite discussions between Choice, EHR/FFG and Argos to try to ensure Choice's survival;

(iv) however before that could happen, Choice unilaterally decided to go into administration without engaging in those negotiations;

(v) therefore the meeting with HBOS on 1 February was no longer about the extra £5m because it was clear that agreement would be reached with the administrators of Choice as to payment by instalments; Mr

[89] Para. 108 of the skeleton argument

Rollason and Mr Fowler only asked for and received a small extension (£1.2m effectively) and the Group remained within the facility; HBOS offered to take the balance of the £5m to its credit committee should EHR have needed it.

119. The SoS relies on the renegotiation of the facility and its approval on 21 December 2005 and the cashflow forecasts that were being produced between November 2005 and January 2006. Mr Fowler was of course not at the Group until 9 January 2006.

120. Mr Hulland, the Group's Finance Director at the time, was tasked with renegotiating the facility with HBOS in mid-2005, even though it was not actually up for renewal until the end of 2006. As Mr Rollason says, EHR took the prudent course of opening negotiations with HBOS in good time to get the right facility in place and employed Quayle Munro, independent specialists in the field, to ensure that the terms agreed were in line with what was available and normal in the market place[90]. It is important to recognise that HBOS was provided from August 2005 onwards with extensive information during the course of the renegotiation, including the 3 year medium range plan and annual budgets. These included monthly cashflows, balance sheets and profit and loss accounts, none of which showed that there would be any excess of the £40m HBOS facility[91].

121. Mr Rollason and the rest of the board (and presumably HBOS[92]) clearly believed when the renewed facility of £40m was approved on 21 December 2005[93]

[90] See para. 90 of Rollason 1 – [**Affs4/2/p.21**]

[91] Mr Griffiths of HBOS confirms that he received the medium range plan and monthly management reports – eg para 25 – [**Affs3/7/p.8**]

[92] See para. 27 of Mr Griffiths' affidavit – [**Affs3/7/p.9**] – showing that HBOS was content with the forecast peak utilisation of £37m which he considered "reasonable" (marked on the medium range plan at – [**CHRON 2/8/p.76**]

[93] See the minutes at – [**C1/3/p.81**]

that it would be sufficient for the Group's long term cash requirements. Mr Hulland said in his report to the board dated 16 December 2005:

> **Cash:** as usual we are carefully reviewing cashflow over the key January/February period when cashflows peak and inflows from Farepak customers are relatively low. We anticipate that our facilities will be substantially utilised during this period.[94]

Mr Rollason makes the point that he would not have signed a new facility that he knew would be breached soon after[95].

122. Mrs Burns refers to some cashflow forecasts from 14 November 2005 in paragraph 257 of her first affidavit[96] which, she says (with the exception of one for 28 November 2005) showed that if EHR paid its forecast creditors in full on their due dates (including FFG in order to pay Choice) it would exceed its HBOS facility from the week ending 6 February 2006 until April 2006. Just looking at that table, one can see an extraordinary divergence in the figures, coming down by over £9m from the first forecast to the third[97]. Mr Rollason has explained that he instigated the production of 12 weekly cashflow forecasts in October 2005 and these subsequently increased to 20 week forecasts[98]. As can be seen from the sharp drop in the first 3 forecasts relied upon, the Group, and in particular the subsidiary companies that had to provide the information for consolidation, were not yet producing accurate and reliable forecasts. They were considered at the time by Mr Hulland to be a work in progress[99]. On 3 December 2005, Mr Rollason was telling Mr Hulland that "we desperately need a proper weekly cashflow forecast".[100]

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[94] See – [**D12/3/p.176**]

[95] See para. 126 of Rollason 1 – [**Affs4/2/p.30**]

[96] At – [**Affs1/5/p.111**]; Unhelpfully there is no reference to the 28.11.05 forecast showing no potential breach and the remaining references to – [**E1(2)/12/pp.194X-198**] – are completely illegible.

[97] In one they had miscalculated the sales ledger receipts – [**CHRON 2/11/p.176**]

[98] See para. 104 of Rollason 1 – [**Affs4/2/p.24**]

[99] Mr Hulland considered that there was "an inbuilt element of pessimism" in the forecasts because the subsidiaries would naturally be conservative in presenting their forecasts to the Group – [**G2/2/p.42**]

[100] At – [**CHRON 2/12/p.198**]

123. Mr Rollason first found out that there may be a potential cashflow problem which could have led to a breach of the facility on Friday 23 December 2005, which was after the time when anything could realistically have been done about it until after the Christmas break[101]. None of the previous cashflow forecasts showing a breach of the facility had been shown to him by Mr Hulland and given that Mr Hulland proposed and negotiated the renewal of the £40m facility, he clearly gave the impression to Mr Rollason and the rest of the EHR board that he was comfortable with a facility of £40m.

124. Mrs Burns refers to some further emails between Mr Hulland and Mr Rollason in her fourth affidavit[102] in which she says that they "discussed the cashflow forecasts at some length"[103]. However the emails referred to do not at any time state that there was anticipated to be a breach of the facility. Rather they all suggest that, while EHR may be close to the limit of the facility, there was still some headroom[104].

125. As soon as the matter was brought to his attention, Mr Rollason began taking steps to address it, including making Ms Spinage come in immediately after the holidays to go through the forecasts. The SoS hardly refers to this[105]. The first possibility that was explored by Mr Rollason with the help of other members of the finance department was to see if surplus cash could be borrowed from the joint venture vehicle, HFH[106]. It is difficult to see what could be wrong with exploring this option, as it was specifically provided for in the JV agreement.

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[101] Mr Hulland's handover email was sent at 16:14 – [**CHRON 2/12/p.337**] – and the office was due to be closed until 3 January 2006

[102] No explanation has been offered by her as to why these emails were not referred to and exhibited to her first affidavit.

[103] Para. 73 of Burns 4 – [**Affs2/3/p.28**]

[104] Emails of 20.11.05 (headroom of £3m) – [**CHRON 2/11/P.182**]; 30.11.05 (headroom of £670k) - [**CHRON 2/11/P.194**]; 3.12.05 (headroom of £600k) - [**CHRON 2/11/P.196**].

[105] See para. 144 of the skeleton argument

[106] This was a joint venture with Findel plc, 60/40. See the emails at – [**CHRON 3/1/pp.2-4**]. Mr Rollason had previously tried to address the issue of cash within HFH and Deborah Davey suggested it this time.

126. The SoS asserts, presumably by way of criticism, that "creditor stretching" was introduced in January 2006. In fact, steps were taken at that time to manage cashflow but it is again difficult to see that there was anything unreasonable about the steps that were taken in this regard. Mr Fowler discovered on his arrival that the subsidiaries had their own cheque books and were able to pay suppliers and creditors without much control being exercised by the Group. His introduction of a requirement for authorisation and approval of amounts over £10,000 was a sensible and appropriate control mechanism for the management of the Group's cash and normal for a Group of this size and diversity[107].

127. But the main step taken to deal with the forecast excess of the new facility was to approach HBOS for a £5m extension. This too is hardly referred to in the skeleton argument[108], yet it is crucial for a proper understanding of the two matters that the SoS says his case turns on: the defendants' knowledge and their reaction to it[109].

128. The chronology was as follows:

20 January (Fri)	Meeting between Mr Rollason, Mr Fowler and Mr Griffiths, EHR's relationship manager at HBOS[110]. This was the earliest meeting that could be arranged[111]. Both Mr Rollason and Mr Fowler came away from the meeting with the impression that the £5m extension would be forthcoming in time for the payment to

[107] See para.114 of Fowler 1 – [**Affs4/3/p.27**]

[108] Only paras. 144 and 182

[109] Para. 155 of the skeleton argument

[110] Mr Griffiths' manuscript notes of the meeting are at – [**CHRON 3/3/pp.30-32**]

[111] Para. 144 of Rollason 1 – [**Affs4/2/p.34**]; and para. 104 of Fowler 1 – [**Affs4/3/p.25**]. They already had a lunch in the diary to introduce Mr Fowler on 31 January.

	Choice on 30 January. They discussed the arrangement fee that would be payable.[112]
	Mr Fowler's finance report for his first EHR board meeting on 25 January was sent out the same day referring to the approach to HBOS for a £5m temporary facility[113].
23 January (Mon)	Mr Rollason met Mr John Jesky of Family Hampers who said that Family Hampers had been in financial difficulties for some time and had not been able to pay Choice in full and would not be able to pay Choice at the end of January[114].
24 January (Tue)	Mr Rollason arranged to meet Mr M Johnson of Choice the following day[115].
25 January (Wed)	EHR board meeting[116] at which the positive outcome to the meeting with HBOS was discussed[117].
	Mr Rollason and Mr Fowler met Mr M Johnson of Choice at which the difficulties they were experiencing because of Family Hampers' non-payment were discussed. Mr Rollason encouraged Mr Johnson to meet with Argos (Mr Davis) to try and do a deal[118].
26 January (Thur)	Mr Fowler sent up to date cashflow forecasts to Mr Griffiths of HBOS showing that with the £12.1m going

[112] See paras. 144 to 145 of Rollason 1 – [**Affs4/2/p.34**] and paras. 107 to 110 of Fowler 1 – [**Affs4/3/p.26**]

[113] At – [**D13/3/pp.184-267**]

[114] Para. 147 of Rollason 1 – [**Affs4/2/p.35**]

[115] Para. 149 of Rollason 1 – [**Affs4/2/p.35**]

[116] Minutes at – [**C1/4/pp.82-85**]

[117] Para. 155 of Rollason 1 - [**Affs4/2/p.36**]; para. 127 of Fowler 1 – [**Affs4/3/p.31**]; see also para. 59 of Gillis – [**Affs5/2/p.19**]; para. 80 of Munn – [**Affs5/3/p.24**]

[118] And Mr Rollason chased this up over the next two days and it appeared that Mr Johnson had been trying to fix up a meeting with Argos – [**CHRON 3/4/p.84**]; paras 158 to 159 of Rollason 1 – [**Affs4/2/p.37**]; paras. 128 to 133 of Fowler 1 – [**Affs4/3/pp.31-32**]

	out to Choice, the Group would need to utilise the £5m extension in the following week[119]; Mr Fowler asked Mr Griffiths in the email to "Please call to discuss" but he never did, encouraging the belief that HBOS did not have a problem with the temporary extension[120].
27 January (Fri)	Mr Griffiths made some notes of the meeting on 20 January[121] having received the cashflow forecasts and Mr Winton's comments are in manuscript on the side.
30 January (Mon)	Mr Griffiths told Mr Fowler (who told Mr Rollason[122]) that the £5m temporary extension could not be made available until they had met with Mr Winton and the earliest they could meet would be 1 February[123]. The CHAPS payment to Choice was immediately cancelled. As Mr Rollason could not speak to anyone at HBOS, they took immediate steps to see if the HFH cash could be accessed and drew up cashflows to see the impact of doing so[124].
31 January (Tue)	Mr Rollason spoke to Mr M Johnson of Choice before 9am to attempt to negotiate payment of the £12.1m in 3 tranches, with an initial payment of £6.5m[125]. As part of the attempted negotiation, Mr Rollason sought to involve Argos and he arranged for a meeting to take place the next day with Argos. When he later spoke to

[119] At – [**CHRON 3/4/pp.91-92**]

[120] See para. 116 of Fowler 1 – [**Affs4/3/p.28**]

[121] This have been misleadingly placed in the chronological bundle at 20.1.06 – [**CHRON 3/3/pp.33-34]**

[122] Who was at a meeting with Park and Family Hampers in Liverpool trying to broker a deal to save Family Hampers and Choice – Para. 162 of Rollason 1 – [**Affs4/2/p.38**]

[123] See paras. 134 to 138 of Fowler 1 – [**Affs4/3/pp.32-33**]; and paras. 163-167 of Rollason 1 – [**Affs4/2/pp.38-39**]

[124] See email from Mr Rollason to Mr Fowler of 30.1.06 – [**CHRON 3/5/p.114**]

[125] This was immediately followed up by Mr Fowler's email to Choice – [**CHRON 3/5/p.123**]

	Mr Johnson to persuade him to come to the meeting, he was unenthusiastic but said he would call back later[126]. FFG paid £6.5m to Choice as per the negotiated schedule, Mr Rollason basing the figure on a calculation of the amount owed by Choice to non-Argos retailers and the available headroom. There remained some £1.9m of headroom even after this payment.[127]
	As arranged the day before, Mr Rollason and Mr Fowler met Mr Griffiths by way of a pre-meeting for the meeting the following day on 1 February with Mr Winton[128].
	Later in the day, Choice went into administration[129].
1 February (Wed)	The meeting with Mr Winton and Mr Griffiths arranged two days before to seek approval for the £5m temporary extension still took place[130]. However, because of the administration of Choice, EHR did not need the £5m temporary extension as they were confident that they could agree a payment schedule with the administrators that would enable EHR to remain within the existing facility. Mr Winton did however extend the facility there and then by £1.2m, indicating that he had authority to do so[131]. He also indicated that if EHR required the full £5m extension (ie £3.8m on top of

[126] See Mr Rollason's contemporaneous file note of 31.1.06 – [**CHRON 3/5/p.138**]

[127] See paras. 168-172 of Rollason 1 – [**Affs4/2/pp.39-40**]; and paras. 140-146 of Fowler 1 – [**Affs4/3/pp.33-34**]

[128] See paras. 173 of Rollason 1 – [**Affs4/2/p.40**]; and para. 148 of Fowler 1 – [**Affs4/3/p.35**]

[129] Unbeknown to Mr Rollason and Mr Fowler when they were seeking to negotiate, Choice had instructed PwC on 26 January and had been preparing to put Choice into some form of insolvency process for a few days – see para. 349 of Burns 1 – [**Affs1/5/p.141**]. Accordingly it is not accepted that the part payment by FFG caused Choice's collapse.

[130] Mr Griffiths' manuscript notes are at – [**CHRON 3/5/pp.178-179**]; the typed up version inaccurately refer to the meeting taking place on 2.2.06.

[131] See paras. 178-181 of Rollason 1 – [**Affs4/2/pp.41-42**]; and paras. 149-152 of Fowler 1 – [**Affs4/3/pp.35-36**]

	what he approved at the meeting) he would support a request to HBOS's credit committee.
2 February (Thur)	Mr Rollason finalised his board memo (that he had been requested to do by Sir Clive) and circulated it to all members of the EHR board[132]. Attached to the memo was a cashflow forecast until June 2006 showing that EHR would remain within its facility throughout that time, including paying the balance to Choice's administrators.

129. So between 20 and 30 January, Mr Rollason and Mr Fowler believed they had resolved the potential cash problem by an extension to the facility. If they did not believe that, it is inconceivable that they would not have been seeking other means of financing the payment. On 30 and 31 January, they believed that the extension would be approved on 1 February. Therefore for one day only, 31 January, FFG was unable to pay Choice in full but they fully expected to be in a position to do so the next day. In the meantime, they sought to negotiate a deal with Choice (and Argos) that would ensure its survival for the benefit of the industry as a whole. However, Choice decided to go into administration and that changed everything. EHR did not need the extra £5m and reached an agreement with the administrators and paid on the agreed dates. It did not exceed its facility at any time.

130. Despite having made some play in her first affidavit about not paying Choice's administrators on time, it appears that Mrs Burns now accepts that FFG did come to an agreement with the administrators and abided by it[133]. Accordingly, FFG paid its debts as they fell due and was not cashflow insolvent.

[132] The finalised memo is at – [**CHRON 3/5/pp.166-170**]

[133] See para. 153 of Burns 4 – [**Affs2/3/p.57**]

131. Paragraphs 180 and 181 of the SoS's skeleton argument show the lack of commercial reality in the SoS's case and the use of hindsight. It is suggested that "once it became clear Choice was not minded or not in a position to negotiate with its other creditors and/or bankers to satisfactory effect" FFG should have paid in full. Choice unexpectedly went into administration without any forewarning to FFG, so there was no time when "it became clear"[134]. Once it went into administration, any debtor would naturally seek to negotiate time to pay with the administrators. There was no longer any urgency to pay the balance.

132. The point made in paragraph 181 is taken totally out of context by the SoS. The reality was that, if, as transpired, FFG was able to reach a satisfactory agreement with the administrators that avoided the need to extend the facility by £5m (and thereby incurring a large arrangement fee), any commercial organisation would do so and no one was prejudiced as a result. It is a fact that FFG was only unable to pay Choice in full for one day (and Mr Rollason and Mr Fowler believed they would have been able to pay in full the next day had it been necessary to do so). The cashflow annexed to the 2 February memo showed that EHR was able thereafter to pay its debts as they fell due and would not exceed the facility.

133. Furthermore, the SoS's case in relation to this period seems to be predicated on the notion that there was a "£5.6m hole" in the Group's finances[135]. As demonstrated above, there was no such hole, merely the inability to pay one creditor in full on one day and there was no knock-on effect to whether EHR or FFG was a going concern or not. It is absurd to suggest, if the SoS does[136], that as a result of what happened on 31 January and the events surrounding Choice's administration, the defendants should have sought insolvency advice or even considered ceasing to trade. It was a viable, profitable business and the defendants had to deal with the

[134] It did not even threaten to do so when Mr Rollason was seeking to negotiate on 31 January.

[135] See para. 192 of the skeleton argument

[136] Paragraph 112 of the skeleton argument seems to indicate that FFG should have considered whether to continue with the 2006 cycle. Also see paras 8.10 and 9.8 of the SoS's Part 18 Further Information – [**K1/4/p.29 and 32**]

consequences of the administration of Choice, the most immediate of which was the reassurance to customers that their vouchers would be honoured by FFG (which they were) and to find a replacement voucher provider that would satisfy FFG's customers for Christmas 2006.

134. Furthermore, as the SoS has conceded that there were reasonable prospects of avoiding an insolvent liquidation, it is difficult to see how the SoS has an even arguable case that the defendants should have at that stage considered ceasing to trade.

(b) Post-Choice administration period

135. The SoS's case in relation to the post-Choice administration period has changed again and now appears to divide into two periods: (i) February – March 2006; (ii) April to October 2006. The latter period apparently turns on "the failure to explore funding options earlier and with greater speed" and the failure to pursue funding options in parallel[137]. At least there now seems to be a further concession that there were no other options available to the defendants to pursue at that time. Having pressed and pressed for details of what other steps the defendants should have taken, it is now clear that the only attack that is made on their conduct for the 6½ months that appeared to be at the heart of the SoS's case is the vague general one of a lack of urgency and not pursuing options in parallel. These two related issues are dealt with in paragraphs 149 – 156 below.

(i) February to March 2006

136. It is a little more difficult to discern what the SoS's case is for the period February to March 2006. This is dealt with in the section of the SoS's skeleton argument between paragraphs 194 and 210. It appears to boil down to one point,

[137] See paragraph 284 of the skeleton argument.

namely that the defendants should have realised immediately upon the failure of Choice that it was inevitable that FFG would have to pay up front for the vouchers and that therefore there would be a funding gap that had to be addressed immediately.

137. The case as so put again lacks any sense of commercial reality and is laden with hindsight. It is vitally important to assess the defendants' conduct by reference to what they did know at the time and what they could reasonably have discovered.

138. On Choice's administration, Mr Rollason and Mr Fowler immediately considered whether Choice itself ought to be acquired from the administrators and this was discussed with HBOS on 1 February[138]. In Mr Rollason's 2 February memo there was reference to this and also to the alternative voucher suppliers, identified at that stage as being Park's High Street voucher and Provident[139]. Park which was the main competitor to FFG used its own vouchers and had negotiated its own credit terms from the retailers. And Mr Rollason understood that the arrangements that FFG had with Choice as to payment on redemption had been in existence since the late 1990s (ie well before he had joined the Group). Before there had been time to do any investigation of the market, it was reasonable for Mr Rollason to believe that FFG would be able to find a voucher supplier who would offer deferred payment terms like Choice[140].

139. After meeting with Choice's administrators on 6 February 2006, (at which they agreed that the full balance did not need to be paid immediately), Mr Rollason and Mr Fowler then met with KPMG in Leeds to discuss a possible acquisition of Family Hampers through HFH. Mr Rollason and Mr Fowler were concerned that a further administration in the industry would be highly damaging and wanted to see if that could be avoided if at all possible. This was further explored over the next week or so, but Findel (the JV partner in HFH) decided that the TUPE cost was too great.

[138] HBOS said they would consider making a working capital facility available for such purpose – para. 181 of Rollason 1 – [**Affs4/2/p.42**]

[139] At – [**CHRON 3/5/p.169**]

[140] Choice had offered payment on redemption to all its re-sellers.

Family Hampers went into administration on 15 February and it was acquired by Park for £1, leaving Park with some 66% of the market[141].

140. Mr Gilodi-Johnson, as managing director of FFG, had been tasked with dealing with both the fallout from the administration of Choice and the search for a new voucher provider. It was clearly necessary for FFG to reassure its customers both that existing Choice vouchers would be honoured and that there was a credible new multi-retailer voucher on offer for Christmas 2006. By 20 February, Mr Gilodi-Johnson had made some preliminary investigations and was able to report to the FFG board that the options open to FFG were: "the creation of our own multi-redemption voucher; the High Street voucher; the Provident voucher. All are being investigated."[142] As to FFG creating its own voucher, it was reported that the retailers may consider it but only "on less attractive terms, including <u>some form</u> of payment up front or into escrow to mitigate their risks" (emphasis added).

141. Mr Gilodi-Johnson further updated the FFG board on the position at the meeting on 21 February 2006, having made contact in the meantime with Grass Roots and Provident[143]. Provident had "suggested up front payment, NGJ had proposed an escrow account", indicating that there was negotiation going on about payment terms. The proposed terms from Grass Roots were unknown. All the FFG directors (including Mr Hicks and Mrs Ponting) knew of the collapse of Choice and, by this date, the possibility of payment up front and they took the responsible course of budgeting on the following alternative bases, including three different payment terms (up front, escrow and on redemption):

> The following budget assumptions were agreed.
> - Hampers packed at same rate as Family
> - Multi redemption voucher discount:
>   (a) 7.5%
>   (b) 8%
>   (c) 8.5%
> - Interest

[141] See paras. 199 to 202 of Rollason 1 – [**Affs4/2/p.46**]; paras. 162-163 of Fowler 1 – [**Affs4/3/pp.38-39**]

[142] His Business Report is at – [**D20/1/pp.16-19**]

[143] FFG minutes at – [**C2/4/p.89**]

(a) Up front;
(b) Escrow and on redemption
- Look at worse case, best case and anticipated.
- Review costs
- Review marketing costs

142. At the EHR board meeting on 1 March 2006[144], it was made clear that

> due to the administration of Choice it was likely that vouchers will be paid for on purchase rather than redemption. This would extend the Group's period of maximum borrowings by three months which would start in October.

The implications for FFG were recognised:

> The implications for Farepak are:
> - Likely loss of margin on vouchers of approximately 1.5% and lower interest receivable as voucher payment is anticipated to be on issue rather than on redemption – cost: c. £1.0 million;
> - Loss of Farepak hamper packing partner.

As Mr Rollason points out, until the identity of the new voucher supplier was known and the terms of payment were agreed, it was not possible to update the cashflow forecasts with sufficient accuracy to allow the Board to take responsible decisions[145].

143. The EHR board resolved to pursue a possible sale of FFG and HFH to Park and Mr Rollason was to approach Park with a sale price and attempt to agree with Findel a means of splitting the proceeds of a sale of HFH. Obviously if a sale of FFG could be agreed, the cashflow issue and funding gap would not arise.

[144] EHR board minutes at – [**C1/5/p.86**]

[145] See paras. 211 and 212 of Rollason 1 – [**Affs4/2/pp.48-49**]. Paragraph 202 of the Skeleton argument seems to recognise this although it unrealistically suggests that "projections on various bases could have been prepared". The FFG budget was asked to be prepared on a payment up front basis.

144. Mr Rollason did immediately resume negotiations with Mr P Johnson of Park as to a sale of FFG[146]. These continued with offers and counter offers ending with Park's offer of £12m for the assets of both FFG and HFH[147]. Mr Rollason reported on his discussions with Park at the EHR board meeting on 22 March 2006[148] and said that Park had been unwilling to consider issuing shares or to increase its offer of £12m with a deferral of some of the consideration. Park had confirmed that it would be prepared to offer its own High Street vouchers and to pack hampers for Christmas 2006. The board mandated Mr Rollason to make a further attempt to persuade Park to increase its offer by including a deferred element.

145. Meanwhile, Mr Gilodi-Johnson had been investigating further the alternative voucher suppliers and negotiating with them. His report to the FFG board for the meeting on 21 March contained extensive analysis on the various options, including their attractiveness to the customers, the payment terms and margins available and there was a report from Quaestor a firm of research and marketing strategists attached[149]. Mr Gilodi-Johnson favoured the Bonusbond voucher offered by Grass Roots, based on customer preference research and the net margin. At the board meeting[150], it was reported that Findel was preparing a report on the creation of its own voucher and that Grass Roots may have issues surrounding its payment terms to retailers (ie whether the normal payment on redemption would remain).

146. Following the issue of the Trading Statement on 23 March 2006, it was decided to bring forward the next EHR board meeting to 10 April[151] in order

[146] This had already been discussed between them on 17 February – see para. 102 of Rollason 1 – [**Affs4/2/p.46**]

[147] See paras. 215 to 217 of Rollason 1 – [**Affs4/2/p.49**]. See also para. 19 of Johnson – [**Affs3/3/p.6**]. As the offer from Park was for assets rather than the shares, there was a tax charge that would reduce the net proceeds to EHR.

[148] Minutes at – [**C1/6/p.90**]

[149] The board pack is at – [**D20/2/pp.97-215**]

[150] Minutes at – [**C2/5/p.91**]

[151] It was previously scheduled for 27 April 2006

specifically to discuss the implications to the Group of the change in payment terms for a new multi retailer voucher provider to FFG[152]. Mr Rollason and Mr Fowler then set about preparing the Funding Paper which entailed considerable work (on top of the detailed and time consuming process of the subsidiaries' and consolidated budget setting process which had started in February) involving a number of different financial models and required input from Mr Hicks who had to project on behalf of FFG for the earlier payment of the vouchers[153].

147. It can therefore be seen from the above that the defendants acted perfectly reasonably and with all due speed in dealing with the situation facing EHR and FFG following the collapse of Choice. The SoS makes the same generalised criticism in relation to this period of February-March that "the steps taken were simply too few and too slow"[154] but without indicating what steps should have been taken and when. The defendants were surely entitled to take a reasonably short period of time to investigate the position as to alternative voucher providers and the payment terms. Furthermore, it was vitally important to establish accurate and supportable figures necessary to pursue any funding option, and this took some time.

148. The SoS's case is dependent on showing that it should have been immediately obvious to all on 1 February that voucher payment terms would inevitably have to be up front. This is based on pure hindsight and ignores the reality and knowledge that the defendants reasonably had at that time.

[152] See para. 232 of Rollason 1 – [**Affs4/2/p.52**]

[153] See paras. 235 and 243-248 of Rollason 1 – [**Affs4/2/pp.52 and 54-56**]; and paras 207-208 and 219-222 of Fowler 1 – [**Affs4/3/pp.48 and 51-52**]. The funding paper is at – **[C1/7/pp. 96-99**] – attached to the board minutes

[154] Para. 204 of the skeleton argument

(ii) April to October 2006

149. There is a distinct change in emphasis of the SoS's case for the period April-October 2006. It no longer appears to be part of the SoS's case that other options for funding should have been considered. Rather it now comes down to whether the options should have been considered in parallel rather than one by one[155]. It is not understood where the allegation that "increasingly [Mr Rollason's] reports that various options were realistic were simply accepted at face value" comes from or is supported in the evidence. Nor is the relevance of "the likely profile of Savers' funds coming in"[156] apparent.

150. There is nothing in the pursuing options in parallel point. It is certainly the case that the rights issue while it was being actively pursued upon the advice of Hoare Govett would be undermined by the pursuit of other options in the market. But as soon as negative advice was received in relation to the prospects of the rights issue succeeding, various other options were pursued in parallel. It is unclear what the SoS says could also have been done in July to October that was not done.

151. It is necessary to repeat that the SoS has conceded that throughout this period right until 10 October 2006 there was a reasonable prospect of avoiding insolvent liquidation, which necessarily carries with it that it must be accepted that one or more of the financing options that were being explored had, at any point in time, a reasonable prospect of succeeding in delivering a solvent solution whereby all creditors would be paid. The SoS therefore has to find something other than the reasonable pursuit of these viable financing options that would constitute serious enough incompetence or misconduct by the directors so as to merit disqualification. All he has come up with is that some of the options should have been pursued more in parallel.

[155] See paras. 229 and 284 of the skeleton argument

[156] Also in para. 229 of the skeleton argument

152. The mantra, expressed for instance in paragraph 645 of Mrs Burns' first affidavit[157], is that "too little was done too late and too little weight was given to the fact that there was a very serious risk, <u>which was or should have been obvious to all involved at the time,</u> that none of the various funding options would be carried into effect, either at all or on time" (emphasis added). Is the SoS seriously suggesting that not only the defendants, but also all the lawyers, accountants and financial institutions had deluded themselves into thinking that there were viable funding options?

153. There is no point going through a detailed chronology here of what happened in this period. Instead, a few of the more significant events, which the SoS has largely skated over, are picked out below:

(a) The EHR "special" board meeting on 10 April 2006 to discuss the various options for bridging the funding gap for which the Funding Paper was prepared[158]; the board actively considered all available options and decided to approach HBOS for a seasonal facility, failing which the favoured option was a sale of FFG and a rights issue;

(b) Following a meeting with Hoare Govett on 19 April and with HBOS on 24 April, the EHR board meeting on 4 May 2006 carefully considered all the options and decided to go with the £20m rights issue plus sale of Farepak[159]; the board went for the option that at the time seemed achievable, on the back of Hoare Govett's advice, and was best for the long term[160]; Hoare Govett advised that the pursuit of other financing options could damage the chances of the rights issue succeeding[161];

[157] At – [**Affs1/7/p.241**]

[158] Minutes and Funding Paper at – [**C1/7/pp.94-99**]

[159] This was actually soon after dropped following a meeting with HBOS, its advisor PwC and ABN Debt when PwC confirmed that it would complicate the rights issue – [**CHRON 8/1/p.150**]

[160] Minutes at – [**C1/8/pp.100-105**]

[161] See para. 65 of Garton – [**Affs3/6/p.18**]; para. 17 of Macgregor-Smith – [**Affs3/10/p.5**]

(c) Hoare Govett had told HBOS in May 2006 that the rights issue had a "realistic prospect" of success[162];

(d) PwC did not recommend to HBOS any insolvency options in Project Doorbell Phase I[163];

(e) On 25 May (while the rights issue was progressing), EHR signed an engagement letter with ABN Debt Advisory Division ("ABN Debt") to give independent advice on debt restructuring[164];

(f) In mid-June, HBOS were of the view that "an insolvent break up would be the last and final option"[165] and Hoare Govett were "bullish" about the rights issue[166];

(g) On 15 June, Mr Fowler and Mr Hicks met with Grass Roots to discuss, inter alia, changing the payment terms; Grass Roots said they would think about the proposal and respond in writing within 2 weeks[167];

(h) Following Hoare Govett going lukewarm on the rights issue towards the end of June, Mr Rollason and Mr Fowler, together with advice from ABN Debt and PwC, were exploring other financing options, including Goldman Sachs, Morgan Stanley, Bank of America and Credit Suisse, having prepared a power point presentation for use with potential funders[168];

(i) There was an emergency board meeting on 3 July 2006 following the market announcement, at which the board were kept "up to date with the

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[162] See para. 551 of Burns 1 – [**Affs1/7/p.208**]. They had also said the same to EHR as reported at the 31.5.06 board meeting – [**C1/9/p.106**]

[163] The 16.5.06 report is at – [**E2(1)/4/pp.120-133**]

[164] Letter is at – [**CHRON 8/1/pp.124-131**]

[165] See Angus to McMillan email of 15.6.06 – [**CHRON 10/7/p.240**]

[166] See Kelly to Angus memo of 13.6.06 – [**CHRON 10/5/p.131**]

[167] Paras. 336-337 of Fowler 1 – [**Affs4/3/pp.77-78**]

[168] This is at – [**E1(1)/9A/pp.136.1-136.22**] and see minutes of 27.6.06 board meeting at – [**C1/10/p.110**]. There had also been a meeting with Numis as a replacement broker for Hoare Govett at which Sir Clive, Mr Rollason and Mr Fowler had shaken hands with Mr Hemsley on a fully underwritten rights issue of £20m – although Mr Hemsley now disputes this – see para. 19 of Hemsley – [**Affs3/1/p.6]**

current situation and able to contribute to the process"; it is clear that the rights issue, other funders and potential buyers of various businesses were all progressing[169];

(j) The E&Y draft working capital report dated 6 July 2006 for the purposes of the rights issue[170] confirmed the credibility of the projections that the defendants were using as it concluded that there would be headroom of over £4m if the rights issue produced proceeds of £19.8m;

(k) Bank of America made an offer on 7 July 2006[171] and Morgan Stanley provided a discussion document on Project Mercury[172];

(l) Very significantly, on 13 July 2006, Goldman Sachs made an indicative offer of £20m "fully subordinated to HBOS"[173]; this was exactly what HBOS were looking for and Goldman Sachs were given exclusivity during which to carry out due diligence;

(m) There was another unscheduled board meeting of EHR on 17 July 2006 (attended in part by Hoare Govett) at which the various options were discussed[174];

(n) There were discussions between Mr Rollason and Mr Burrage of Grass Roots on 20 July including about revised payment and credit terms which remained open until 9 or 11 August 2006[175];

[169] Minutes at – [**C1/11/p.144**] – This significant meeting is downplayed in para. 648 of Burns 1 – [**Affs1/8/p.243**]

[170] At – [**N1(2)/6/pp.605-718**]. E&Y had worked on this for some two months which gave comfort that the figures being used were correct

[171] See para.656 of Burns 1 – [**Affs1/8/p.245**]

[172] See – [**CHRON 13/7/pp.236-243**]

[173] The offer is at – [**CHRON 14/1/pp.1-4**] This was totally downplayed in one short sentence in para. 675 of Burns 1 – [**Affs1/8/p.251**] (and with a misreference to the document in the trial bundle); the SoS seeks even more desperately to marginalise this in paragraph 277 of the skeleton argument, saying that "for a short period, Goldman Sachs expressed interest".

[174] See minutes at – [**C1/12/p.116**].

[175] See Burrage email of 28.7.06 – [**CHRON 15/7/p.214**]. Rejection at – [**CHRON 16/11/p.280**]. See also paras. 408 to 410 of Rollason 1 – [**Affs4/2/pp.89-90**]

(o) The fact that HBOS were willing to extend the covenant testing dates throughout the period showed their support for a solvent solution[176];

(p) There was another EHR board meeting on 25 July 2006, at which they went through all the options and the E&Y Report and decided to give Goldman Sachs exclusivity for two weeks to do due diligence[177];

(q) Mr Rollason's detailed email of 13 August 2006 explained where they were in terms of a number of possible solutions (he also knew the basis of Goldman Sachs' revised offer which he realised would be unacceptable to HBOS)[178];

(r) Findel's first offer on 17 August 2006 which HBOS considered showed an "apparent seriousness of approach" and "reasonably positive", such that it again extended the covenant date[179] and resisted allowing FFG to have a trust account for future receipts[180];

(s) At the EHR board meeting on 21 August 2006 all options were discussed (including Findel and Park) and Mr Lewis of Macfarlanes advised that "based on the possibility of the Findel offer being realistic, no action is required either at Farepak or EHR plc"[181];

(t) There were a succession of FFG board meetings, with minutes reviewed by Macfarlanes, on 22, 25, 30 and 31 (x2) August and 1, 2, 4, 6, 8 and 11 September 2006[182];

(u) The fast moving events between 24 and 30 August 2006, during which time Findel made a pre-pack offer to HBOS, Deutsche Bank was still an option, there were rival bidders for Kleeneze and others interested in

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[176] See Fraser's email of 25.7.06 – [**CHRON 15/4/p.56**] – from which it appears that HBOS and PwC were actively looking for purchasers of the business and were turning their attention towards Findel

[177] Minutes at – [**C1/13/p.119**]

[178] At – [**CHRON 16/13/p.284**]

[179] See Kelly's email to Angus – [**CHRON 17/4/p.194**]

[180] See Kelly's email to Mr Rollason and Mr Fowler – [**CHRON 17/4/p.208**]

[181] Minutes – [**C1/15/p.127**]

[182] At – [**C2/10-C2/19**]

Kitbag and IWOOT (including Goldman Sachs) and Mr Rollason was progressing a possible deal with Park (which included a £3m injection by the trustees)[183]; PwC was advising on the possible purchasers; Mr Kelly thought Park "brought a solvent solution a little closer"[184], but still favoured Findel[185];

(v) Park II avoided the cashflow problem in October 2006 and on the face of it seemed to fit HBOS's requirements; HBOS's initial reaction was very positive – "they could well offer us all a very neat solution to the current funding problem"[186];

(w) Mr Kelly's email of 3 October 2006 said, "if Findel messes us around then we may end up going with the management plan. This is fairly unappetising in many respects given it doesn't de-risk the Bank but it is probably preferable to a lengthy insolvency and workout with all the added risk this brings with it."[187]

154. The above merely identifies a few events which occurred during the period when everyone was exploring all possible solvent solutions. It shows the support throughout from HBOS for a solvent solution and demonstrates the entitlement of the defendants to believe that such a solution was achievable.

155. While the rights issue was being progressed between May and late June with the support of Macfarlanes (drafting the prospectus) and E&Y (drafting the working capital report), and the advice of the specialists, Hoare Govett, the attention was all

[183] See Kelly's email to Angus of 25.8.06 referring to "management had been very clever in pulling together the outline proposal with Park..." – [**CHRON 18/3/p.266**] – and HBOS again agreed to extend the covenant testing date. Park to conduct due diligence on 29.8.06

[184] At – [**CHRON 19/5/p.109**]. And Angus said it was a "step along the road to a solvent solution" – [**CHRON 19/6/p.164**]

[185] HBOS and PwC considered that Park would need to fund the Group in the sum of £8-10m for it to be viable – [**CHRON 19/6/p.173**]

[186] Kelly's email of 1.9.06 to Mr Rollason – [**CHRON 20/1/p.91**]

[187] See – [**CHRON 23/1/pp.23-24**]

focused on the rights issue. This was based on Hoare Govett's advice that it would be damaging to the rights issue if the market perceived the Group as also pursuing mezzanine finance at the same time[188]. The defendants decided that in the circumstances they should concentrate their efforts on the rights issue but they had in place the means quickly to switch to other options either through ABN Debt or PwC or a sale of one or more of the companies. The SoS recognises that there may be validity in that approach[189] and it was well within the bounds of reasonableness for the defendants to have taken that decision.

156. Once it was clear that there were problems with the rights issue, a number of options were pursued in parallel as described above and Mr Rollason and Mr Fowler (and the other defendants) could not have done more. It is impossible to understand what the SoS's criticism really is as to their conduct in this later period.

157. There is a section in the skeleton argument headed "May-June: market announcement required?" (between paragraphs 259 and 275). Quite apart from there being unfounded allegations that inaccurate factual instructions were given to Macfarlanes and that Macfarlanes gave negligent advice, the SoS then says that "these are not matters which are alleged as distinct matters of unfitness" (paragraph 271). In other words, the whole section has been included purely for its prejudicial, rather than probative value, which is unbecoming of the SoS and regrettable.

(c) <u>Professional Advice</u>

158. The SoS has a section at the end of his skeleton argument (paras. 312 to 321) in which he challenges the notion that the defendants were entitled to rely on the professional advice that they received. The SoS refers only to Macfarlanes' advice on insolvency. It should not be forgotten that EHR had the benefit not only of advice

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[188] See para. 65 of Garton – [**Affs3/6/p.18**]; para. 17 of Macgregor-Smith – [**Affs3/10/p.5**]

[189] See para. 245 of the skeleton argument

from Macfarlanes, but also from Hoare Govett, ABN Debt and E&Y and they had the support of HBOS and its advisors, PwC.

159. It is telling that PwC, through the various phases of Project Doorbell and having looked into the Group's financial situation and proposals in great detail, at no time suggested either that the search for a solvent solution was futile or that EHR and/or FFG ought to consider ceasing to trade and stop using cash received from FFG's customers. On the contrary, their involvement is a strong indicator that there remained throughout, even during September 2006 when they were looking at Park II, reasonable prospects of avoiding an insolvent liquidation. The Group also had strong support for its strategy from the other advisors.

160. The criticism from the SoS is as to the taking of specialist insolvency advice; more particularly the allegation is that Macfarlanes' "general, generic insolvency legal advice" was inadequate and they should have taken "both legal and professional financial insolvency advice in a timely manner and by reference to the facts of [sic] the circumstances"[190]. In paragraph 318 of the skeleton argument[191], the SoS criticises the advice for simply having "set out the law, without going on to advise whether on the facts it was appropriate to continue trading". He goes on to say that Macfarlanes "were relying on the directors to make their own judgments on the facts."

161. These criticisms are both unfair and unsustainable. If the defendants had surrendered their discretion completely to Macfarlanes, effectively putting Macfarlanes into their shoes to make the decisions, the SoS would have criticised the defendants for abrogating their responsibility[192]. The SoS had to attack in some way the professional advice sought and received by the defendants because it is an inescapable fact that there were so many professionals looking at what the defendants were doing.

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[190] Paras. 14.5, 15.5, 16.4, 17.5 and 18.4 of the SoS Part 18 Further Information – [**K1/4/pp.38-42**].

[191] The point is repeated in para.116 of the skeleton argument

[192] Indeed the SoS makes the point in para. 92.2 of the skeleton argument that "Reliance on professionals does not absolve a director from bringing his own judgment to bear" – which is precisely what the defendants did.

162. Despite what the SoS says, the documentary evidence containing the advice shows not merely that it was related to the specific facts of the case (and not just general) but also that the defendants were acting properly and reasonably in relying on such advice in deciding to continue trading and to operate the sweep. Some examples are set out below:

(a) The SoS particularly refers to the 17 July 2006 advice from Macfarlanes. The written advice which was first provided in draft on 7 July 2006, and then discussed at a meeting on 17 July 2006, had attached to it a Memorandum which was a "comprehensive note of practical issues for directors"[193]; this was obviously in general terms but the advice itself, however, was clearly not, setting out the relevant facts and the particular application to both FFG and EHR; it contains advice on the "critical date" and records that neither company was then actually balance sheet or cashflow insolvent;

(b) Tim Lewis and Simon Beale of Macfarlanes advised at a meeting on 17 August 2006 (also attended by Mr Farrow of ABN Debt)[194], provided email advice on 18 August 2006[195], and then attended the EHR board meeting on 21 August 2006[196], at which the advice was: "based on the possibility of the Findel offer being realistic, no action is required either at Farepak or EHR plc";

(c) As reported at FFG's board meeting on 22 August 2006, Macfarlanes had confirmed that their July written advice remained unchanged[197];

[193] See – [**CHRON 14/5/pp.122-127**] – however the Memorandum is not in the trial bundle attached to the 17.7.06 version. It can be found at – [**CHRON 13/4/pp.187-217**]

[194] The note of the meeting is at – [**CHRON 17/5/pp.242-244**]

[195] At – [**CHRON 17/5/p.251**]

[196] Minutes at – [**C1/15/p.127]**

[197] Minutes at – [**C2/10/p.116**]

(d) There was a meeting on 23 August 2006 with E&Y, attended by Messrs Gilodi-Johnson, Fowler and Hicks and Ms Spinage, to discuss insolvency matters[198];

(e) Between 23 and 25 August 2006, there was a series of oral and written advice given by Macfarlanes to FFG concerning their specific responsibilities and emphasising the need to maintain a dialogue with EHR in order to judge whether it will be able to meet the payment in October/November; Mr Beale referred to HBOS playing a large part since it "in effect control EHR's purse strings"[199]; this was clearly very fact specific, not generic advice;

(f) E&Y were specifically instructed to advise on insolvency matters and this also was clearly not just generic advice[200];

(g) Macfarlanes attended the EHR board meeting on 30 August 2006[201] and carefully reviewed a number of FFG's board minutes;

(h) E&Y gave further insolvency advice on 1 September 2006[202];

(i) Mr Lewis advised on 1 September 2006 as to whether FFG should be put into an insolvency process while there was a real possibility of a £13m subordinated loan being made and HBOS's continued support, his advice was that "they should not."[203]

(j) Mr Beale's letter of advice dated 4 September 2006 is critical explaining that the most important criteria were whether Park II was achievable and whether HBOS supported the Group as a whole in the interim; he also advised that "there seems little benefit in withholding monies from EHR...as this will not protect the customers on Farepak's insolvency and

[198] The note is at – [**CHRON 18/1/p.13**].

[199] The most critical document is at – [**CHRON 18/3/pp.323-326**]. Also see – [**CHRON 18/2/pp. 146, 158, 187]** – and Mr Rollason's response to Macfarlane's email on 25.8.06 in which he confirmed that the Park option was "real and deliverable as of today" – [**CHRON 18/3/pp.347-348**]

[200] See their engagement letter at – [**CHRON 18/3/pp.356-366**]. See also E&Y's note at - [**CHRON 18/3/p.355**]

[201] Minutes at – [**C1/17/p.132**]

[202] See – [**CHRON 20/1/pp.48-49**]

[203] See his email to Mr Fowler, copied to Mr Rollason at – [**CHRON 20/1/p.54**]

may indeed also adversely affect EHR's ability to provide further support"[204]; this advice was considered at FFG's board meeting on 4 September 2006[205];

(k) Macfarlanes must have reconfirmed their advice on 27 September 2006 as this was referred to in FFG's board minutes[206];

(l) Macfarlanes at no time, despite their extensive involvement in the refinancing process including drafting the prospectus and advising on market announcements, advised EHR or FFG to cease trading or to pursue some other strategy.

163. This insolvency advice actually exposes the major difficulty with the SoS's case. Insolvency specialists, both legal and financial, advise their clients by reference to the statutory test for wrongful trading in s.214 IA 1986. If directors receive advice that so long as they have reasonable grounds for believing that there are reasonable prospects of avoiding an insolvent liquidation they can continue to trade while that remains the case, surely it must be reasonable for directors to act in accordance with such advice. If they went against such advice, and precipitately put their company into liquidation while there was a reasonable prospect of finding a solvent solution, thereby causing loss to creditors, they should be at more risk of disqualification than someone who actually followed the professional advice. If the SoS is right that there is some lesser threshold for disqualification, then this raises very serious questions for professionals as to where that line is to be drawn and how to advise directors.

CONCLUSION

164. The proceedings should be dismissed with costs. There is no substance to them factually or legally. The conduct of Mr Rollason and Mr Fowler (and the other

[204] Letter is at – [**CHRON 20/4/pp.168-170**]

[205] Minutes at – [**C2/17/p.184**].

[206] Minutes at – [**C2/23/p.221**] – and Macfarlanes were clearly happy with that reference – [**CHRON 22/9/p.224**]

defendants) cannot possibly justify disqualification. Indeed no real criticism can validly be made of the defendants' conduct. The SoS's case is dependent on hindsight and fails to place the defendants' conduct in its proper commercial context.

165. As demonstrated above they made strenuous efforts to find a solvent solution by which all creditors, including in particular the customers of FFG, would be paid in full. They acted throughout with the benefit of and in accordance with the professional and other specialist advice that they received and with the support of HBOS. In the circumstances they found themselves, there was nothing more that the defendants could realistically have done.

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14 May 2012

Claim No. 584 of 2011

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF EUROPEAN HOME RETAIL PLC

AND IN THE MATTER OF FAREPAK FOOD AND GIFTS LIMITED

AND IN THE MATTER OF THE COMPANY DIRECTORS DISQUALIFICATION ACT 1986

B E T W E E N :

THE SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS

Claimant

and

(1) STEVAN LLOYD FOWLER
(2) NEIL DUNCAN GILLIS
(3) NICHOLAS PIERS GILODI-JOHNSON
(4) STEPHEN MATTHEW HICKS
(5) MICHAEL STEPHEN MACKELCAN JOHNS
(6) PAUL MUNN
(7) JOANNE ELIZABETH PONTING
(8) WILLIAM PETER ROLLASON
(9) SIR CLIVE MALCOLM THOMPSON

Defendants

SKELETON ARGUMENT OF THE FIRST AND EIGHTH DEFENDANTS

For the trial beginning on 21 May 2012 with pre-reading in week of 14 May

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