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

UPDATED SKELETON ARGUMENT ON BEHALF OF THE 2nd, 5th, 6th and 9th DEFENDANTS ("the EHR Non-Executives")

Pre-reading: A suggested pre-reading list, agreed on behalf of all the Defendants, has already been filed with the Court; a further copy of that separate document is filed herewith.

A chronology and a short dramatis personae accompanied the original of this skeleton (a fuller Dramatis Personae was filed and served on behalf of the Secretary of State on 11 May 2012).

*Copies of authorities referred to in this Skeleton form part of the combined authorities bundle lodged on 14 May 2012. References to authorities mentioned below have been inserted in the form "**A+volume number/tab**."*

*Use of cross references: All references in this Skeleton Argument are, where possible, references to the documents as they appear in the Chronological Bundles and take the form "**CHRON+volume/tab /page**". All other references are to the additional volumes of the trial bundles and take the form "**letter+volume/tab/page**". Any references to a paragraph/s of an affidavit take the form "**deponent+numbered affidavit/paragraph"** followed by the trial bundle page reference.*

Preliminary & pre-reading:

1. This opening skeleton argument is filed on behalf of the 2nd, 5th, 6th and 9th Defendants (referred to collectively below as "the EHR Non-Executives"), being Mr Neil Gillis ("Mr Gillis"), Mr Michael Johns ("Mr Johns"), Mr Paul Munn ("Mr Munn") and Sir Clive Thompson ("Sir Clive"). The Secretary of State ("SoS") seeks Disqualification Orders against each of them under section 8 of the Company Directors' Disqualification Act 1986 ("CDDA 1986") on the grounds that the conduct of each of them as a director of European Home Retail PLC ("EHR") was such as to make them unfit to be concerned in the management of a company.

2. The other 3 Defendants before the Court, the 1st Defendant ("Mr Fowler"), 3rd Defendant ("Mr Gilodi-Johnson") and 8th Defendant ("Mr Rollason"), sat on the boards of both EHR and its relevant subsidiary Farepak Food & Gifts Limited ("FFG"). They were executive directors of and were employed by one or both of EHR and FFG, and (subject to the supervision of their respective boards as a whole) they were responsible for managing the businesses[1]: in particular in the case of Mr Fowler as Finance Director of EHR and a director of FFG; in the case of Mr Gilodi-Johnson as Managing Director of FFG and a director of EHR; and in the case of Mr Rollason as Chief Executive Officer of EHR and a director of FFG. The SoS seeks Disqualification Orders against each of those 3 Defendants on the basis of their conduct in their capacities as directors of both EHR and FFG.

[1] As executive directors they were also entitled to participate together with senior management in the EHR share option scheme (which the non-executives were not): see eg A2(1)/4/118.

3. By contrast, each of the EHR Non-Executives was, and was only, a non-executive director of EHR. None of them was employed by or responsible for managing the businesses of EHR or any group company; and they were not directors of FFG or any of EHR's other subsidiaries. So, the focus of any case against the EHR Non-Executives must (necessarily) be narrower and be upon their conduct as non-executives of EHR alone.

4. The core of the case against the EHR Non-Executives is, or appears to be, the allegation that in the performance of their roles as non-executive directors they "did too little, too late". So the central issues are whether it is right to say that they did too little too late; if so, whether that was so serious as to make them unfit; and if so, whether as a matter of discretion they should be disqualified under the CDDA 1986.

5. The allegation of doing too little too late is a rolled-up plea that during the period between November 2005 to early October 2006 (a) they failed to do things which they should have done; and/or (b) should have done what they did more quickly. So the first tasks are (i) to identify what it is said they failed to do; why it is said they should have done it; and when; and (ii) to identify what it is said they did too slowly; and how and by when it is said they should in fact have done it, and why. In a case of unfitness, the answers should be tolerably plain. But it is a feature of the SoS's evidence and argument that the SoS does not fully engage with and offer answers to those questions, still less does he do so in any way which adequately addresses the position of the EHR Non-Executives as distinct from the other 3 Defendants. And the attempt to offer some answers in the opening skeleton leads to allegations being made which are different from those which have previously been advanced, and which have not been addressed in anyone's evidence.

6. If any alleged failures by the EHR Non-Executives were to be found (which they should not be) the next task, in order to make a case for a Disqualification Order, would be to establish the gravity of such failures, in order to assess both whether they amount to unfitness and if so whether to make a Disqualification Order. Here again the SoS declines to identify, either at all or with any precision, what he says were the consequences of the failures alleged against the EHR Non-Executives. The SoS's position appears to be that in principle consequences are irrelevant. But the seriousness of alleged conduct can only be assessed by considering its proper context, including the

actual or potential consequences of the conduct in question[2]. One claimed consequence of the EHR Non-Executives' alleged failures which is discernible from the SoS's skeleton is the proposition that EHR may otherwise have come to the end of its refinancing attempts before it did, so that there was "at least a chance that losses to creditors would have been considerably less"[3]. But no particularity is offered.

7. It is hoped that the position will be clearer after the SoS's oral opening. In the meantime the EHR Non-Executives answer robustly "No" to each of the issues (a) whether it is right to say that they did too little too late; (b) if so, whether that was so serious as to make them unfit; and (c) if so, whether as a matter of discretion they should be disqualified under the CDDA 1986.

8. To the contrary, when the EHR Non-Executives' conduct is examined in its relevant and correct factual context - and without confusing their position with that of executive directors - each of them did as much as should reasonably have been, and be, expected of them.

9. The principal relevant problem which EHR faced was to address the challenge of raising additional finance for a listed public company, with valuable investments in a number of retail businesses, in order to resolve a foreseen shortfall of some £16 million in the businesses' cash-flow[4] (but not profitability). Strenuous endeavours were made to raise that finance, and it is not (or not seriously)[5] disputed by the SoS that those efforts had reasonable prospects of success and would have avoided insolvency. It is not disputed by the SoS that, as the EHR Non-Executives say in their evidence, they believed that the prospects were good. That the efforts were ultimately unsuccessful is of course very unfortunate, and something which everyone regrets. But it is not said that no attempts at refinancing should have been made; and the fact that in the end they proved unsuccessful is not advanced as a ground of criticism of the EHR Non-Executives.

[2] This of course is a different question from the question whether the conduct in question was causative of any actual loss, which is the point addressed in the SoS's skeleton @ paragraphs 51-53.

[3] Paragraph 8 of the SoS's skeleton.

[4] Munn/5@ AFFS5/3/3.

[5] Paragraph 54 of the SoS's skeleton and J1/52-3 and 82-87.

10. The main criticism of the EHR Non-Executives appears to be that they should have caused the financing efforts by the executives and management to have been started sooner; and then, once started, to have been pursued more strenuously by attempting all possible funding solutions in parallel from the outset. But putting on one side the enormous advantage of hindsight - which must be carefully guarded against in examining directors' conduct[6] - the SoS cannot make out that criticism:-

    (1) The cash-flow problem resulted from the failure at the very end of January 2006 of FFG's supplier, Choice, and the fact (acknowledged by the SoS at paragraph 7 of his skeleton) that the payment terms available from suppliers thereafter significantly changed (in part due to the demise of Choice but also in part due to the demise during February 2006 of Family Hampers).

    (2) During the 3 weeks or so immediately after the collapse of Choice, the viability of EHR's buying Choice's business or of FFG obtaining equivalent payment terms elsewhere were investigated.

    (3) Having established that the purchase of Choice was not an option to pursue, and that it was unlikely to be possible to obtain payment terms equivalent to those offered by Choice, management reported these matters to the board of EHR in time for its meeting on 1 March 2006. Potentially serious cash-flow consequences for the Group, if FFG was required to pay for vouchers before rather than after Christmas, were immediately identified at that board meeting[7].

    (4) But if finance was required, raising it could not start immediately: what was required were detailed and robust[8] cash-flow forecasts across all the businesses in the group in the changed circumstances, so the precise quantum and timing of the shortfall could be rigorously identified, and so that formal approaches to raising the necessary finance could be made on the basis of reliable figures. That task was undertaken in March and was not and could not be the work of a moment[9]. The

[6] The importance of avoiding a hindsight approach is addressed in Section B(vi) below.

[7] Gillis/78 @ AFFS5/2/23-4.

[8] I.e. by means of the "bottom-up" iterative process described by Mr Gillis at Gillis/90 @ AFFS5/2/26-7.

[9] See Gillis/90 @ AFFS5/2/26-7; Munn/93 @ AFFS5/3/26-7.

figures which were produced were robust and reliable; and they stood up to scrutiny (including by PwC and the Bank) throughout the financing process. The need for and value of that detailed work is illustrated by the fact that the resultant figures showed that about an additional £40 million needed to be available before Christmas 2006, of which approximately £24 million could be met from existing resources.

(5) Figures were considered at the EHR board meetings on 22 March 2006 and then further final figures were considered at the board meeting on 10 April 2006. Decisions were made at that point as to how the necessary finance was to be raised. What was then required was not a panicked approach which pursued multiple and potentially inconsistent methods of raising the necessary finance, which would have jeopardized the success of any of them. What was required was a professional, measured but determined approach to pursuing all the realistically available options in a way which maximised the chances of success[10].

(6) In the absence of the Bank being willing to provide a seasonal facility, a rights issue was, based on advice, considered to be achievable[11] and the best long-term solution to the problem. Pursuing parallel alternative options in competition with the rights issue was likely to jeopardize the success of the issue; and that view was and is supported by ABN Amro[12], who acted throughout as brokers and corporate finance advisers to EHR. Accordingly in April the rights issue was pursued. From early May, as ABN's views developed, the step was taken of investigating whether funding might be available through ABN's internal debt finance department, a course which provided an alternative whilst avoiding the problem that external approaches risked damaging the rights issue. In June, once it emerged that there was a real risk that a rights issue would not raise enough and funding was not available from ABN itself, approaches were made to external funding providers.

[10] Thompson/8-9 @ AFFS5/4/5-6.

[11] McGregor-Smith/9 & 16 @ AFFS3/10/3 & 5 - The view from ABN in April was that a rights issue was "eminently do-able".

[12] "any suggestion to the market that mezzanine or other hybrid funding might be required in parallel could damage the prospects of the funding ... any perception of additional risk to investors had to be avoided if possible": McGregor-Smith/17 @ AFFS3/10/5. See also Farrow/46 @ AFFS3/5/13.

Then from early July all available options to achieve a solvent solution were pursued concurrently, including orderly disposals of the businesses. And a solvent solution was very nearly achieved, in particular (see further below) with, separately, Goldman Sachs, Findel and Park.

(7) The SoS does not identify any realistic option which he says was available but which was not pursued[13]. Once any ground for criticising the decision to pursue the right issue first is cleared out of the way, there is no sensible case that things were not done as quickly as was reasonably possible.

Pre-reading

11. The SoS's skeleton itself identifies very few documents as being relied on. And it is unfortunate that, despite the order made on 2 April 2012, the SoS has still not satisfactorily identified the documents from the exhibits to Burns 4 upon which he relies, against whom and for what purposes. Again it is hoped that the position will become clearer from the SoS's oral opening.

12. In the meantime, the EHR Non-Executives have agreed with the other Defendants a suggested pre-reading list, and a further copy of that separate document, which was filed with the Court on 11 May 2012, is filed herewith.

Structure of the remainder of this skeleton

13. The rest of this Skeleton Argument is divided into the following sections:-

(A) Introduction – the factual background and the broad nature of the allegations made against the EHR Non-Executives.

(B) The relevant law (a) in general and (b) its specific application to this case:

(i) the statutory framework;

(ii) identifying what constitutes 'unfit conduct';

[13] The suggestion pops out of the SoS's skeleton, apparently for the first time, that some sort of bridging finance should have been obtained pending a more leisurely rights issue; alternatively to cover the cash flow "spike" in October in the absence of any rights issue. But (as far as the EHR Non-Executives are aware) the Bank rejected just such a seasonal facility. See further at paragraphs 46 & 47 below.

(iii) the particular position of non-executives;

(iv) the significance of advice;

(v) allowing for the difficulties of balancing whether to cease trading or continue – 'the real and unenviable dilemma';

(vi) the importance of avoiding hindsight in assessing directors' conduct.

(C) An encapsulation of the "charges" as they appear from the SoS's skeleton, together with the EHR Non-Executives' brief responses to them, divided into sections as follows:

(i) The period November 2005 to January 2006.

(ii) The period February and March 2006.

(iii) The period April to August 2006.

(iv) The period September to October 2006.

(v) Other allegations.

(D) Conclusion.

A. Introduction

EHR and its business divisions

14. EHR was a publicly quoted holding company which at the relevant time had over 40 wholly-owned subsidiary companies, many of which, including Farepak Mail Order Ltd., were non-trading.[14] The group's activities were divided into 6 separate businesses. Although publicly quoted on the LSE's main market, the family of the late founder of EHR (formerly known as Kleeneze plc) Mr Bob Johnson, held the majority of the shares through various family trusts[15]. The 6 group businesses consisted of (i) the Kleeneze business, which sold cleaning and home products through agents, and operated from

[14] See the structure charts at A1/1/A&B.

[15] See for example the account at Johns/26-8 @ AFFS5/1/9.

premises in Warmley, Bristol; (ii) the Farepak business, selling Christmas hampers, gifts and retail redemption vouchers; (iii) the Kitbag business, which was one of Europe's largest online sports retailers; (iv) the IWOOT business, an internet retailer selling gifts and gadgets; (v) the eeZee TV business, a joint venture operating a shopping channel on Sky Digital; and (vi) Cabouchon, a jewellery business. Those businesses were not run by EHR. Each of the businesses was carried on by separate operating subsidiaries of EHR, each of which subsidiaries had their own assets and liabilities, their own autonomous boards and management and their own staff[16]. Each subsidiary had its own managing director and finance director. The boards of Kleeneze and Kitbag for example can be seen from A2(2)/16/3 and A2(2)/17/28. At EHR level, apart from Mr Rollason, Mr Fowler and Mr Gilodi-Johnson, the management included a finance team headed by Mr Fowler, as Finance Director, to whom from 1 May 2006 all the Finance Directors of subsidiaries reported[17]. This all appears to be common ground. Overall, the group of companies employed over 600 staff and had thousands of distributors and agents by whom the majority of their sales activities was carried out.[18]

15. Since 2000, the group had had a banking facility with HBOS secured by cross-guarantees and a debenture over all group assets. As part of the facility all group companies' HBOS accounts were treated as combined. Under the terms of the facility, amounts held by any company in accounts other than with HBOS had to be swept daily to HBOS; and this meant in particular that each evening FFG, which banked with NatWest[19], was required by HBOS to sweep the credit balances on its accounts into a central HBOS account at EHR[20]. EHR therefore had a central treasury function, and maintained inter-company balances reflecting the movements in and out from and to FFG and other subsidiaries. This central banking and treasury arrangement is, of course, an extremely common arrangement and is not (at least now) a ground of criticism.

[16] For a description of the position, which does not appear to be challenged, see Munn/39 @ AFFS5/3/12.

[17] See the structure chart at A1/1/D.

[18] A2(1)/6/218; A2(1)/4/97.

[19] Because of HBOS's lack of branches: see Gilodi-Johnson/43 @ AFFS4/1/7-8; accepted at paragraph 15 of the SoS's skeleton.

[20] See for example Fowler/63 @ AFFS4/3/17.

16. Given the banking arrangements, the group's cash-flow model took advantage of the different cash-flow "profiles" of the different businesses within the group. FFG received cash for the purchase of vouchers predominantly between the Spring and the Autumn in each year, most of which it did not need to use until after Christmas. That cash was made available by EHR to Kleeneze and other businesses in the group - and FFG earned significant amounts of interest in return - for those businesses to use particularly in the run-up to Christmas in order to acquire stock. They then repaid the amounts advanced to them from sales made before and after Christmas. The in-flows and outflows were substantial, but it is important to note (a) that with the immaterial exception of eeZee TV, the businesses, including that of FFG, were all essentially profitable (see next paragraph below) and (b) contrary to the suggestion made in the SoS's evidence (but not repeated in his skeleton) FFG's business model did not depend on Savers' cash received in the following year's cycle in order to pay for vouchers acquired in the previous year's cycle.[21]

17. As we have said, the group as a whole, and each business subsidiary except the new joint venture eeZee TV (whose losses were small), traded profitably. Profits were mainly made in the second half of the financial year. The largest profits were generated by the Kleeneze business[22]. FFG's turnover was, and was recognised to be, in decline; but that should not be misunderstood: it did not mean that FFG was not profitable. An allegation that FFG in particular was loss-making seems to be made in Burns 1[23], but it is wrong and is dealt with in the Defendants' evidence.[24] Although repeated in Burns 4[25] the point is not repeated in the SoS's skeleton. It may be that it is now accepted as inaccurate, not least because in the Schedule to the Undertakings which the SoS has agreed with Mr Hicks and Ms Pointing in these proceedings, the SoS agreed that FFG accounts showed its assets exceeded its liabilities and was profitable (subject to exceptional items), albeit that turnover and profitability were in gradual decline.

[21] Burns1/117-9 @ AFFS1/3/57-8.

[22] 2004 and 2005 audited figures can be found at A2(2)/16/710.

[23] Burns1/7 @ AFFS1/1/4 and e.g. Burns1/1033.2 @ AFFS1/10/377.

[24] Gilodi-Johnson/112 @ AFFS4/1/19; Gillis/31 @ AFFS5/2/12; Thompson/109 @ AFFS5/4/30.

[25] Burns4/51 @ AFFS2/3/20.

18. The group was forecast to trade profitably from May 2006 through to April 2008 (which is the limit of any forecasts prepared). PwC examined these budget forecasts on behalf of the Bank and endorsed them. [26]

19. Another inaccuracy in Burns 1, which it is convenient to clear out of the way, is the assertions that new businesses which EHR had acquired in late 2004 and early 2005 never performed to target; and that EHR (by which the SoS means its trading subsidiaries) consistently failed to meet turnover, operating profit or profit before tax targets between 2004 and 2006[27]. This is comprehensively dealt with (with references to the monthly figures for the trading subsidiaries) by Mr Munn at paragraphs 40 and 41 of his Affidavit[28]. Burns 4 does not challenge Munn and the assertions in Burns1 are not repeated in the SoS's skeleton. It seems that, correctly, they are not being pursued.

20. The balance sheet of EHR and each main subsidiary, including FFG, showed a *surplus* not a deficit. In relation to EHR the surplus was just under £6m in April 2004, just over £8.7m in April 2005 and just over £6.5m in April 2006. For FFG the corresponding surpluses were just under £2.4m, just under £3.7m and just under £2.4million[29]. Kleeneze and Kitbag were also in surplus[30].

21. There is however an assertion made in Burns 1, which is liable to create a very misleading impression of the true position, that the "group" had been balance sheet insolvent since 2003.[31] That is an assertion made by reference to the audited *consolidated* balance sheets for the group shown in EHR's audited accounts for the years to 30 April 2003 to 2005 and draft accounts for 2006. This has been dealt with in detail in the Defendants' evidence (see e.g. Thompson/107-112 and Munn/53-57[32]) and the point is not pursued in Burns 4 or the SoS's skeleton. It may be therefore that it is

[26] See for example Munn/ 111, 112 and 117 @ AFFS5/3/31-33.

[27] Burns1/17 and 149 @ AFFS1/2/10 and AFFS1/3/70.

[28] AFFS5/3/12-13.

[29] See e.g. Fowler/75 @ AFFS4/3/18-19; and Munn/55 @ AFFS5/3/17.

[30] Audited figures at A2(2)/16/710 & A2(2)/17/735.

[31] See paragraphs 143-153, which is then carried through to the allegations of unfitness contained in Burns 1.

[32] @ AFFS5/4/29-30 and AFFS5/3/16-17 respectively.

also accepted that this point is wrong. But in case there remains any life in it, it is convenient to make four short observations at this stage. First, assuming the point not to be merely the uninformative truism that the consolidated balance sheet shows negative shareholders' funds (in the case of the April 2005 figures of £7.5 million), the point appears intended to be a claim that EHR and its relevant trading subsidiaries had since 2003 been insolvent in the "balance sheet" sense of section 123(2) of the Insolvency Act 1986. Secondly, "balance sheet insolvency" is a lawyers' (not an accountants') shorthand phrase for the test in section 123(2); but the test does not refer to and is not to be assessed by reference to any statutory balance sheet, still less a group consolidated one. The test in the subsection is simply whether the value of the assets of the company is less than the amount of its liabilities. Thirdly, if it is relevant to look at any balance sheet for the purpose of that test, it must be the balance sheet of the company (and only the company) in question. And as we have said, each of the balance sheets of EHR and its trading subsidiaries showed a surplus of assets over liabilities not a deficit. Fourthly, in producing statutory consolidated accounts, the position of *all* the subsidiaries in the group requires to be brought into the consolidated balance sheet, including the position of non-trading subsidiaries. For present purposes that included bringing into the consolidated balance sheet an accumulated deficit[33] on profit and loss account (amounting in total in 2005 to just under £12 million) which was attributable in large measure to the loss made by a no-longer-trading subsidiary (Farepak Mail Order[34]) following its disposal of the DMG business. But that deficit was not an actual liability which fell to be paid by EHR or any of the relevant trading subsidiaries. Once that deficit is stripped out, the consolidated balance sheet too shows a surplus.

The EHR board of directors

22. The EHR board had executive directors who were very experienced and capable and who also formed a majority of the board of FFG. Mr Rollason is a qualified accountant, a former finance director and before he joined EHR he had had significant experience of managing substantial companies at board level. Mr Fowler was also a qualified

[33] Albeit reducing, as a result of profitable trading.

[34] Referred to in the evidence as "FMO". The Farepak business had been transferred to FFG from FMO as part of a reorganisation carried out with advice from Macfarlanes and E&Y (dubbed "Project Rupert"), leaving FMO dormant but with a large accumulated deficit on P&L account. See eg CHRON1/4/110-115.

accountant and also had experience of running substantial companies at board level. Mr Gilodi-Johnson had taken an MBA (with distinction) from Oxford before joining the Kleeneze group (as it then was) in 2002.

23. The Non-Executives were an extremely experienced and distinguished group, who together brought complementary skills to the board (Mr Johns only having joined the board from 9 September 2005). Each of them, when not attending to EHR board matters, had full-time commitments elsewhere including, in the case of Mr Munn and Mr Gillis managing other businesses in an executive capacity. Indeed it was precisely because of their outside roles, and the experience which that gave them, that they were valuable non-executive members of the board. The EHR Non-Executives had no offices or staff at EHR. They did not have any involvement in the day to day management of EHR or of its subsidiary companies. But that is not, of course, a defect in their appointment or in their performance of their roles. Properly understood - as to which see further below - that was not their function.

Corporate governance within EHR

24. The unchallenged evidence is that appropriate corporate governance and the maintenance of appropriate systems were taken very seriously and approached responsibly by the EHR Non-Executives and the board as a whole.

25. The principles of the *Financial Reporting Council's Combined Code on Corporate Governance* ("the Combined Code") was adhered to and, as required by the Listing Rules, fully reported on in EHR's Annual Report[35].

26. As recognised by the Combined Code, it was the role and responsibilities of the executive directors to run the business[36]. Half the board (excluding the chairman), in accordance with the Combined Code, were non-executives, whose roles and responsibilities were distinctly *not* to be involved in running the business.[37]

[35] See e.g. the draft report for 2006 @ A2(1)/6/192-4.

[36] A copy of the Combined Code is in the Authorities Bundle at A4/16. See principles A2 and A3.

[37] Combined Code, A.3.2.

27. There was a non-executive Chairman (Sir Clive) who as recommended by the Combined Code had not previously had an executive role in the business[38]. There was a senior independent director[39] (Mr Munn); and a non-executive charged with liaison with the majority shareholders (Mr Johns).

28. There was an audit committee chaired by the Senior Independent Director, with other non-executives present. The audit committee met quarterly, and sometimes more frequently. It discussed with the auditors in the absence of the executive directors to enable any issues to be identified and addressed. No relevant issues were identified about EHR's financial control or its accounting procedures or practices[40].

29. There was a Remuneration Committee formed of EHR Non-Executives to consider the remuneration of management.

30. The EHR board met at least monthly (and much more frequently in the second half of 2006). Detailed board papers were prepared by the executives and circulated before the meetings (the majority of the 20 D bundles before the Court are filled with the EHR board papers from January 2004 to September 2006). The board papers contained amongst other things a Chief Executive's report and a Finance Director's report each with relevant supporting papers. The systems in place included that the individual businesses maintained (under supervision of their respective boards and finance directors) their own monthly management accounts, including cashflows; and any issues requiring consideration at EHR board level were identified in the board papers. There was amongst other things analysis of actual results against budget; and any issues arising were highlighted[41].

31. Strategic Plans and three yearly Medium Range Plans were prepared by management and examined at board level[42].

[38] Combined Code, A.2.2 at Authorities A4/16.

[39] Combined Code, A.3.3 at Authorities A4/16.

[40] Munn/49 & 50 @ AFFS5/3/15-16.

[41] Thompson/80 & 81 @ AFFS5/4/22-23.

[42] Thompson/80 @ AFFS5/4/22-23.

32. Risk assessments were prepared by management and examined at board level, and in which the EHR Non-Executives participated, in order to anticipate and assess future threats to the group's activities.[43]

33. Annual budgets and cashflows (supported by "fact packs") were prepared and examined at board level. Thereafter forecasts against budget were examined at specific board meetings ear-marked for the purpose[44].

34. In short, detailed systems were in place by which the Non-Executives fulfilled their role and by which all the information which the Non-Executives needed for that purpose was or should have been brought up to them on the EHR board.

The problems which EHR faced during 2006 and the specific issue which ultimately led to its ceasing business.

35. EHR and its subsidiaries ceased trading and then went into a combination of administration or administrative receivership on 13 October 2006 immediately after the group's bank, HBOS, rejected (as it was perfectly entitled to do) a proposal ("Park II") which would have resulted in all the group's unsecured creditors being paid in full and the Bank being secured pending an orderly sale of the group's remaining businesses. That is not challenged.

36. The result of the rejection was that instead of a managed break-up of the group businesses on a solvent basis, "fire sales" of the businesses out of administration/ administrative receivership occurred. The Bank was paid in full, but other creditors including creditors of FFG, were not.

37. The Park II proposal was considered at the highest level within HBOS. Contrary to paragraph 301 of the SoS's skeleton, it was not rejected by HBOS on 25 September 2006. The SoS's own evidence is that the decision to reject Park II was made on 10 October 2006.[45] Right until the date of its rejection by the Bank Park II had a substantial prospect of being accepted.

[43] Gillis/14 @ AFFS5/2/7.

[44] Thompson/45 & 80 @ AFFS5/4/15 & 22-23.

[45] Kelly/156-7 @ AFFS3/8/47.

38. As we have described at the beginning of this skeleton, the problem which the Park II proposal was addressing was a "spike" in the Group's cash requirement in excess of its existing facilities. It is important to emphasise, given the misunderstandings which seem to have crept into Burns 1, that that spike was created not by unprofitable trading but by a fundamental change in the terms on which vouchers could be obtained by FFG following the collapse into administration of Choice, its voucher supplier, on 31 January 2006 and the subsequent collapse shortly afterwards of Family Hampers, a customer of Choice and competitor of FFG's.

39. In the days following Choice's collapse, buying Choice or seeking to obtain equivalent terms in the market to those which had been offered by Choice was explored.

40. By the end of February, it was established by management that acquisition of Choice was not a course to pursue; and that the only terms now likely to be available in the market from alternative suppliers required payment for vouchers on issue in the Autumn, not redemption during the months after Christmas.

41. This was reported to the board of EHR for its meeting on 1 March 2006. The cash-flow problem which that involved was immediately identified at that board meeting[46]. What was required was a detailed modelling[47] for the year ahead across all business divisions, so that the amount and timing of the problem could be crystallised, before funding solutions were identified, approaches made and plans implemented.

42. In the meantime it was clear no immediate cash-flow issues arose: the detailed cash flow circulated to the EHR Board on 2 February for the 20 weeks to June[48] indicated no cash flow issues; and that did not change subsequently.

43. A further EHR Board meeting took place 3 weeks later on 22 March 2006[49]. A likely cash shortfall of in the region of £20-25m, in the absence of action being taken, had

[46] See for example Munn/89ff @ AFFS5/3/26.

[47] See eg Munn/93 @ AFFS5/3/26-27.

[48] CHRON3/5/170.

[49] C1/6/90-93.

been identified [50]; but that was not yet the result of a full analysis. So whilst the possible scale of the issue had been identified, full and more precise figures were not yet available; and of course what was needed were figures which were sufficiently detailed and robust to be presentable for the purpose of raising the additional finance[51].

44. The detailed figures were available by early April 2006 and a funding paper was circulated to the EHR board on (or about) 7 April 2006[52]. These forecasts were the basis for all the subsequent funding approaches which were made. During all those funding approaches, there was no suggestion they were not robust and reasonable.

45. A further board meeting took place on 10 April[53]. At that meeting, the options were considered in detail. It is not suggested by the SoS that there were any other practical options which should have been considered. Nor is it suggested that any of the options considered were inappropriate.

46. A decision was made to request a seasonal bank facility to bridge the gap, or failing that to pursue a rights issue.[54]

47. The executives reported on the position as it then stood at the EHR Board meeting on 4 May. From a meeting with the Bank which had taken place on 24 April, it appeared that the Bank was not prepared to provide additional funds, but wanted to work with EHR to arrive at an acceptable funding structure. The project to achieve this funding came to be known by the Bank as "Project Doorbell". In the meantime, the executives had been exploring a rights issue with ABN, EHR's brokers; and a paper from ABN was before the board at the meeting. That report from ABN was positive and indicated that the rights issue was achievable; and it is not suggested by the SoS that it was not. This then was what was pursued.

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[50] See CHRON4/5/418 (2nd para).

[51] See eg Munn/100 @ AFFS5/3/28.

[52] D14/6/163A.

[53] C1/7/94-99.

[54] C1/7/91: preferably, with a sale of the Farepak business (which management had been exploring since March).

48. A further EHR board meeting occurred on 31 May 2006. The papers before the board indicated ABN considered a £20m rights issue realistic[55]; and a paper was considered summarising the views of PwC, appointed by the Bank, on the forecasts and other figures. That paper indicated PwC thought the maximum funding requirement was £16.3m. Pre-marketing to institutions was set for the end of June with "impact day" for the rights issue set for the week commencing 17 July. In the meantime, during May, ABN's debt finance arm had become involved to look at the possibility of ABN itself providing all or some of the required funds.

49. During the following month, June, ABN in Amsterdam indicated it did not have the appetite to provide debt finance, and it also became apparent that ABN in London was now taking a much less positive view and considered that the rights issue was unlikely to raise all the required funds. As a result contingency plans were put in hand by management, and ABN approached third party providers of funding. An approach to Numis, an alternative broker to ABN, was made and was positive. And before 27 June an initial meeting had been had with Goldman Sachs. All of this was reported to and considered at the EHR board meeting on 27 June 2006[56]. The board was told a further meeting with Goldman Sachs was scheduled for the same day. And a further meeting with Numis was set up following the board meeting, which Sir Clive also attended.

50. 6 days later, on 3 July 2006, a further board meeting of EHR took place. From this point (despite the apparent claim to the contrary in the SoS's skeleton) there were 3 EHR board meetings a month until the Park II proposal was put to the Bank on 1 September 2006.

51. By the 3rd July meeting, a market announcement had been made; Numis had fallen away; and it was clear that if a rights issue was going to proceed at all it would be on a different basis than had been proposed before. The Bank remained supportive of a solvent solution, and the focus became upon achieving a solvent solution using all available options, including an orderly sale of the businesses. Management were authorised to release confidential information to prospective purchasers.

[55] Munn/116 @ AFFS5/3/32-33. Also C1/9/106.

[56] See eg Munn/123-5 @ AFFS5/3/34-35.

52. At the next meeting on 17 July, the rights issue was formally abandoned, but active discussions remained in progress with Goldman Sachs and had also started with Deutsche Bank, in both cases for the provision of Mezzanine finance which would have provided the necessary funding. Goldman Sachs had made an indicative offer on suitable terms for the full sum required, and was plainly seriously interested.

53. By the 25th July meeting, action had been and continued to be taken on a number of fronts. Goldman Sachs had been granted (at its request) a 2-week exclusivity period for the provision of finance. In the meantime orderly sales of the businesses were being explored with a number of possible purchasers. The question of taking insolvency advice was also considered.[57]

54. By the 7th August meeting, the position with Goldman Sachs had reached the stage that KPMG were conducting due diligence for them; and lawyers were drafting the documents. Expressions of interest had also been received from 3i and NM Rothschild; and orderly sales of the businesses were also being pursued. Since FFG had been taking formal insolvency advice for some time, it was decided that Macfarlanes should give advice to the EHR directors at their next meeting. Advice from Ernst & Young about insolvency measures was also sought and an insolvency contingency planning meeting occurred with E&Y towards the end of August[58].

55. In an email to the board by Mr Fowler on 17 August, it was reported that HBOS had rejected offers from Deutsche Bank and from Goldman Sachs (who had changed their offer to one which the Bank would not accept), and that a board meeting would occur on 21 August to consider the position.

56. At the meeting on 21st August, Macfarlanes were there. At this stage, advanced discussions were in progress for the sale of part of the business to Park (a proposal called "Park I" in the papers) and the whole of the business to Findel, both of which were significant players in the voucher market, and both of whom had made offers. The sale to Findel appeared in particular to be a serious proposition. The intention was that if the sale to Findel did not occur, it was proposed to sell FFG to Park, with HBOS'

[57] See eg Johns/139 @ AFFS5/1/34-35.

[58] CHRON18/1/13.

approval, on deferred payment terms. Both routes offered a solvent solution. On that basis and on the basis of Macfarlanes' advice, the decision was made to continue.

57. On 25 August an agreement in principle was reached with Park in relation to Park I; and it was put to the Bank. The Bank rejected Park I on 30 August 2006[59], and chose to go instead with a solution with Findel[60].

58. However the agreement with Findel was rejected by HBOS on 1 September, because at the last moment Findel opportunistically "chipped" the price[61].

59. EHR and the group were about to go into insolvency, when Mr Rollason and the management, together with Park, came up with a revised proposal, Park II. This was put to the Bank on 1 September 2006 and was received favourably: it was described by the Bank as "a very neat solution"[62].

60. Park II remained with the Bank for decision from the beginning of September until 10 October. During that time, the terms were revised and refined; PwC conducted a review and testing of the figures for the Bank; lawyers were instructed and produced detailed transactional documents (some of the several drafts of which are contained in trial bundle P1); and management took steps at the operational level to carry into effect the integration with Park's business which Park II involved.

61. On 10 October 2006 the Bank rejected Park II.

The broad nature of the allegations made against the Non-Executives in that context

62. The principal allegation made against the EHR Non-Executives is summarised by the SoS by means of the somewhat formulaic phrase that the EHR Non-Executives caused or permitted EHR to trade at the unreasonable risk of its creditors.

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[59] CHRON19/6/201.

[60] As at the 21 August EHR board meeting, the Findel proposal was a solvent solution to acquire the whole business. But thereafter its position changed. By 29 August its proposal was to acquire some but not all of the subsidiaries, with creditors of FFG and Kleeneze not being paid in full (CHRON19/4/356); and on 1 September it then further reduced its offer by £3million (see next footnote).

[61] CHRON20/1/74; CHRON20/4/379-80.

[62] CHRON20/1/91.

63. As far as the EHR Non-Executives are concerned, the question is, of course, correctly focussed on *EHR's* trading at risk to *its* creditors. But it is worth making three observations on the importance of the different perspectives which EHR and FFG should properly have had. First, EHR's principal creditors were (depending upon the particular time of year), only the Bank, FFG and one or more other group companies. Secondly, at EHR level, any consideration directed towards whether creditors of subsidiaries might or might not get paid, is of broader scope than simply looking to the position of FFG and its creditors. If the group as a whole failed, then it was not just creditors of FFG that might not get paid. Thirdly, at the level of EHR (or the group as a whole) there was (and was forecast to be) only a relatively modest percentage deterioration of the creditor position during the period during which attempts were made to avoid insolvency.

64. The allegation of EHR's trading at unreasonable risk to its creditors resolves itself, on analysis, into the allegation, already mentioned, of the EHR Non-Executives doing "*too little too late in the face of the position the Group was in*"[63] rather than, as it sometimes is, being akin to a wrongful trading allegation[64] (on which see further paragraphs 103ff. below). It is accepted by the SoS that he does not (and cannot) say that there was no reasonable prospect of avoiding insolvent liquidation[65]. In his skeleton, the SoS's case is described as follows: "*the Secretary of State's case is that whether or not (objectively) there may have been a reasonable prospect of avoiding liquidation, the Defendants did not have sufficient and adequate information themselves reasonably to reach the conclusion that there was such a reasonable prospect .... The question is whether the risks taken, on the basis of the information available to and the knowledge of the directors, were unreasonable*"[66]. The Skeleton then goes on that "*the key issue is what each of the Defendants knew or should have known and, had they had the relevant*

[63] Paragraph 108 of the SoS's Skeleton.

[64] Indeed the SoS agrees in para 55 of his skeleton that for present purposes 'trading at the unreasonable risk of creditors is not to be equated with the test for wrongful trading'.

[65] Paragraph 54 of the SoS's Skeleton.

[66] Paragraph 55 of the SoS's Skeleton.

information, what they then should have done"[67].

65. The focus of the allegation therefore appears to be on the state of mind and knowledge of each Defendant for two purposes:-

    (1) in order to illuminate and explain why the Defendant in question did too little too late, rather than having done more, more quickly[68]; but also it seems

    (2) in order to establish that his state of mind was unreasonable, even if someone with the appropriate information and proper thought processes would not have done anything differently or more "vigorously"[69].

66. The EHR Non-Executives have given their account (in AFFS5) as to what they were doing and (so far as they can reasonably remember) what they were thinking at the relevant times. That evidence shows that they did not do too little too late; that they took care to keep themselves informed; and that they approached matters responsibly and entirely reasonably. So the allegation is not made out on the facts.

67. But in any case (without of course in any way making a concession), thinking or for that matter acting unreasonably is not in itself enough to amount to unfitness, as to which see below.

B. The relevant law: (a) in general and (b) its specific application to this case

68. The SoS's skeleton contains a very general treatment of the law in this area, which is mostly unexceptional. But it only addresses to a very limited extent the areas of greatest relevance to the case against the EHR Non-Executives. Accordingly, whilst detailed argument on the law will be left for closings, it is convenient nevertheless to treat the law in a little detail in opening.

[67] Paragraph 109 of the SoS's Skeleton.

[68] Always assuming of course that that were the case on the facts, which it was not.

[69] The argument seems to proceed, as we understand it, as though this were a judicial review. The proposition seems to be that even if a reasonable person would have taken a particular step (or risk), that step (or risk) is in its context unreasonable if you were not armed with relevant information or did not take relevant things into account when you took the step (or risk). "Vigour" is the SoS's word.

(i) the statutory framework & the purpose of the jurisdiction

69. The present proceedings have been brought under section 8 of the CDDA 1986.[70] So far as is material, section 8 of the CDDA 1986 provides as follows:

> "*(1) If it appears to the Secretary of State from investigative material that it is expedient in the public interest that a disqualification order should be made against a person who is, or has been, a director or shadow director of a company, he may apply to the court for such an order.*
>
> *(1A) "Investigative material" means –*
>
> *...*
>
> *(b) information or documents obtained under –*
>
> *(i) section ... 447 ... of the Companies Act 1985;*
>
> *...*
>
> *(2) The court **may** make a disqualification order against a person where, on an application under this section, it is satisfied that his conduct in relation to the company makes him unfit to be concerned in the management of a company."* [**emphasis added**]

70. A "*disqualification order*" is, of course, "*an order that for a period specified in the order – (a) he shall not be a director of a company, act as receiver of a company's property or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company unless (in each case) he has the leave of the court ...*".

71. Accordingly, it is right, as the SoS says in his Skeleton Argument[71] that the issue in these proceedings as a matter of jurisdiction is whether the conduct of the EHR Non-Executives *as directors of EHR* was such as to make them unfit to be concerned in the management of a company. For ease of reference and the sake of brevity, the SoS's abbreviation of 'unfit conduct' is adopted. But it is important to keep in mind that that means 'conduct such as to make the defendant in question unfit *to be concerned in the management of a company'.*

72. Section 9 of the CDDA 1986 then provides:

> "*Where it falls to a court to determine whether a person's conduct as a director of any particular company or companies makes him unfit to be concerned in the*

[70] Authorities Bundle A1/1.

[71] At paragraph 35.

management of a company, the court shall, as respects his conduct as a director of that company or, as the case may be, each of those companies, have regard in particular -

(a) to the matters mentioned in Part I of Schedule 1 to this Act, and

(b) where the company has become insolvent, to the matters mentioned in Part II of that Schedule;

and references in that Schedule to the director and the company are to be read accordingly."

73. For ease of reference, the terms of Parts I and II of Schedule 1 to the CDDA 1986 are set out in a Schedule at the end of Skeleton. None of the matters specified in Parts I or II are alleged in this case against the EHR Non-Executives. In particular, it forms no part of the SoS's case against the EHR Non-Executives - nor could it be alleged - that they committed any misfeasance or breach of a statutory, fiduciary or other duty owed by directors to a company. Moreover, although reference is made in the SoS's skeleton argument to paragraphs 6 and 7 of Schedule 1 to the CDDA[72], unsurprisingly it is not alleged by the SoS (in evidence or in the Skeleton Argument) that any of the EHR Non-Executives were responsible either for the causes of EHR becoming insolvent or for any failure by EHR to supply any goods or services which had been paid for.

74. Schedule 1 both directs the Court to the matters to which it is to have particular regard when deciding unfitness, and it provides a guide as to the type of conduct which amounts to unfitness. And it is far from irrelevant that none of the Schedule 1 matters are or can be alleged against the EHR Non-Executives. Nevertheless (of course) the matters listed in Schedule 1 are not to be treated as exhaustive; Re Sevenoaks Stationers (Retail) Ltd [1991] Ch 164 @183[73]. Submissions as to what may constitute 'unfit conduct' in the absence of Schedule 1 matters, are made in Section B(ii) below.

75. As regards the *discretion* conferred upon the Court to make a Disqualification Order, the EHR Non-Executives agree of course that it is a discretion which is to be exercised judicially having regard to the purpose of the legislation. That purpose has been usefully

[72] At paragraphs 72-73.

[73] Authorities Bundle A1/9.

summarised by Lord Woolf MR in Re Blackspur Group plc [1998] 1 WLR 422 @ 426[74] in the following terms:

> "*The purpose of the 1986 Act is the protection of the public by means of prohibitory remedial action by anticipated deterrent effect on further misconduct, and by encouragement of higher standards of honesty and diligence in corporate management, from those who are unfit to be concerned in the management of a company.*"

76. But where the EHR Non-Executives differ from the SoS is in his assertion that that discretion pursuant to section 8 should be exercised in a manner which equates to the operation of section 6 CDDA 1986, or that the mandatory minimum term under section 6 must also be applied under section 8. Section 6 *requires* the Court to make a disqualification order for at least 2 years whenever unfit conduct has been found. To make an Order under section 8 whenever unfitness is found, would be a mis-exercise of the discretion. It would be to disregard the fact that, unlike cases brought pursuant to section 6, the legislature deliberately conferred a discretion under section 8 even where unfitness was found on the facts. That the distinction between the mandatory jurisdiction conferred by section 6 and the discretionary jurisdiction conferred by section 8 was deliberate is clear from the terms of the *Cork Report*[75].

77. In particular, therefore, although under section 6 a Court cannot consider whether or not it remains in the public interest for a disqualification order to be made against a defendant by the time the relevant trial concludes, nor whether the purpose of the legislation requires the making of an Order; under section 8 the Court can and should consider such questions. Under section 8, these are not questions just for the SoS (as Ms Burns seems to suggest). There is no time limit for proceedings under section 8 such as there is under section 6. And under section 8, considerations relevant to the discretion include the age of the events concerned, the length of time it has taken to bring the proceedings, the nature of the allegations made out, whether they were one-off or repeated events, and whether there is any risk now of their being repeated. The Court

[74] Authorities Bundle A1/23.

[75] *Insolvency Law and Practice, Report of the Review Committee 1982* @ paragraphs 1816-1819: Authorities Bundle A4/15.

should also take into account the effect of the proceedings, the effect of any Order and the fact that, throughout their currency, proceedings such as these will already have had a substantial quasi-prohibitory effect.

78. Moreover the nature of the allegations made against the EHR Non-Executives, even if they could be made out (which they cannot), are not such as would warrant the exercise of the Court's discretion to disqualify otherwise well qualified and able individuals from acting as directors or otherwise being concerned in the management of a company in the future. Indeed, based on the allegations made, it cannot be said to be in the public interest to make disqualification orders against (and thereby "*keep off the road"*) otherwise eminently qualified individuals who have made, and who will otherwise continue to make, significant and valuable contributions to well-functioning businesses.

79. It was and remains (we repeat) obviously very regrettable that the best endeavours to save the EHR group were ultimately unsuccessful. But if any disqualification order were to be made in respect of the EHR Non-Executives in the circumstances of the present case, contrary to achieving the 'deterrent effect' which is sought to be relied upon by the SoS, it is likely only to have an adverse effect upon standards of corporate governance. For it will operate to deter reputable non-executive directors from becoming or continuing to be involved in attempts to rescue an otherwise ailing company. If the safer course for a reputable director (in order to avoid the possibility of facing proceedings pursuant to the CDDA 1986) is simply to end the business (or resign – which may amount to the same thing) rather than run the risk of being criticised for spending time legitimately trying to rescue it, the creditors of insolvent (yet salvageable) companies will suffer, not to mention the economic consequences for employees and those whose business involves dealing with the companies concerned. This is not the policy of insolvency law generally, nor of the CDDA 1986 in particular.

80. All of the foregoing, are of course, submissions directed to the exercise of the discretion if the Court reached that stage, raised at this point (without implying any concession) because the SoS effectively submits in his skeleton that there is no meaningful discretion to be exercised.

81. But overwhelmingly the main point which the EHR Non-Executives (and we) make is that no question of their unfitness arises. So it is to the issue of what constitutes unfitness to which we turn.

(ii) identifying what constitutes 'unfit conduct'

82. That a director may fairly be *criticised* in respect of his conduct is not enough to make him unfit to be concerned in the management of a company; something much more is required. See for example Secretary of State for Trade and Industry v Ferrier and Brown (2003) 26 September, Court of Session, Outer House (@ paragraph [163])[76]:

> "*With the benefit of hindsight, it is possible to criticise Mr Brown for certain of the actions that he took and for certain actions that he failed to take. As I have indicated, however, I am not persuaded that his conduct over the relevant period was such as to make him unfit to be concerned in the management of a company. In particular, I am not persuaded that Mr Brown displayed such gross incompetence or breached the standards of commercial morality to such an extent that it rendered him unfit to be involved in the management of a company.*"

83. The question is classically phrased as whether the defendant's 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*"; Re Grayan Building Services [1995] Ch 241 @253 (per Hoffmann LJ)[77]. Similarly, in Re Lo-Line Electric Motors Ltd [1988] Ch 477 @ 486[78] Sir Nicholas Browne-Wilkinson V-C said:

> *'Ordinary commercial misjudgment is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt that in an extreme case of gross negligence or total incompetence disqualification could be appropriate.'*

[76] Authorities Bundle A3/6.

[77] Authorities Bundle A1/15.

[78] Authorities Bundle A1/8.

84. Since it forms no part of the SoS's case against the EHR Non-Executives - nor could it - that they committed any breach of a statutory, fiduciary or other duty owed by directors to a company, that basis for unfitness can be put on one side[79]. In addition, there is an important distinction to be drawn between allegations of 'lack of probity' and those of 'incompetence'[80]. The EHR Non-Executives do not understand the SoS to be alleging that there was any lack of probity on their part. So that basis for unfitness can also be put on one side.

85. Accordingly, the issue for the Court is whether any of the EHR Non-Executives fell so far below the standards of competence to be expected of persons fit to be directors such that it is in the public interest for them to be disqualified i.e. that they were "*so completely lacking in judgment as to justify a finding of unfitness*"[81].

86. In this context it is conventional to cite the guidance given by the Court of Appeal in Re Sevenoaks Stationers (Retail) Ltd [1991] Ch 164 @176[82] in the following terms:

> *'It is beyond dispute that the purpose of s 6 is to protect the public, and in particular potential creditors of companies, from losing money through companies becoming insolvent when the directors of those companies are people unfit to be concerned in the management of a company. The test laid down in s 6, apart from the requirement that the person concerned is or has been a director of a company which has become insolvent, is whether the person's conduct as a director of the company or companies in question "makes him unfit to be concerned in the management of a company." These are ordinary words of the English language and they should be simple to apply in most cases. It is important to hold to those words in each case. The judges of the Chancery Division have, understandably, attempted in certain cases to give guidance as to what does or does not make a person unfit to be concerned in the management of a company. Thus in Re Lo-Line Electric Motors Ltd ... Browne-Wilkinson V-C said: "Ordinary commercial misjudgment is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt in an extreme case of gross negligence or total incompetence disqualification could be appropriate". Then he said that the director in question—"has been shown to have behaved in a commercially culpable manner in trading through limited companies*

[79] We deal below at 147ff. below with the supposed "duty" of the EHR Non-Executives said to be owed in relation to FFG, which is in truth not a duty owed at all.

[80] See e.g. Re Cubelock Ltd [2001] BCC 523 @535 (paragraphs 51-52): Authorities Bundle A2/9.

[81] Re Barings plc [1999] 1 BCLC 433 @ paragraph A12: Authorities Bundle A2/6.

[82] Authorities Bundle A1/9.

when he knew them to be insolvent and in using the unpaid Crown debts to finance such trading". ... Such statements may be helpful in identifying particular circumstances in which a person would clearly be unfit. But there seems to have been a tendency, which I deplore, on the part of the Bar and possibly also on the part of the Official Receiver's Department, to treat the statements as judicial paraphrases of the words of the statute which fall to be construed as a matter of law in lieu of the words of the statute. The result is to obscure 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".'

87. However, whilst the assessment of the conduct of directors in its context is peculiar to the facts of each case, the standard applied by the Court is and must be uniform. So, it is both legitimate and desirable to have regard to the substance of previous determinations by the court as to what is and/or is not sufficient to constitute unfit conduct; per Park J in Re Cubelock Ltd [2001] BCC 523 @535 (paragraphs 49-50 and 55-56)[83].

88. For the purposes of assessing whether any proven incompetence is of a sufficient to degree to warrant a finding of unfit conduct, paragraph A7 of the Judgment of Jonathan Parker J in Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker and others (No 5) [1999] 1 BCLC 433 @483-4[84] is particularly relevant (it was approved on appeal in Re Barings plc, Baker v Secretary of State [2000] 1 BCLC 523 @ 535)[85]:

"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) 4 BCC 415 at 419, [1988] Ch 477 at 486 per Browne-Wilkinson V-C), incompetence "in a very marked degree" (see Re Sevenoaks Stationers (Retail) Ltd [1990] BCC 765 at 780, [1991] Ch 164 at 184 per Dillon LJ) and "really gross incompetence" (see Re Dawson Print Group Ltd (1987) 3 BCC 322 at 324 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

[83] Authorities Bundle A2/9.

[84] Authorities Bundle A2/6.

[85] Authorities Bundle A2/8.

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."

89. The Court is also reminded of Park J's words in Re Cubelock Ltd [2001] BCC 523 @ paragraph [124] of his Judgment, namely that:-

"...it should not be forgotten that the statutory question is not whether a director's conduct deserves criticism. It is the more precise question of whether his conduct 'makes him unfit to be concerned in the management of a company'. The allegation against Piero Cassandro is that he ought to have realised that, although he was a non-executive director, he should have participated in the affairs of Cubelock more than he did. Let me assume that he should. I have difficulty in seeing how that leads to the conclusion that he is unfit to be concerned in the management of a company."

90. Moreover, as the Court of Appeal took pains to emphasise in Re Barings plc, Baker v Secretary of State [2000] 1 BCLC 523 @ 535[86] (paragraph 35), it follows from the nature of the penalty that "*where the allegation is incompetence without dishonesty it is to be demonstrated to a high degree".*

91. Thus, even assuming without in any sense accepting, that the conduct of the EHR Non-Executives were to have fallen short of the standard of competence or diligence which might generally be expected, even that would not be enough to make them liable to disqualification. So Jonathan Parker J.: "*the mere fact that a director may have fallen short of the standards of competence or diligence which the City may expect (and which, in certain circumstances, the law may require) does not necessarily mean that he has shown himself to be "unfit" for the purposes of the Act*"; in Re Barings plc [1999] 1 BCLC 433[87] @ paragraph A11, citing with approval the unreported Judgment of Lloyd J in Re Atlantic Computers plc[88] on 15 June 1998 to the same effect.

(iii) the particular position of non-executive directors

92. Whilst all directors, whether executive or non-executive, owe the same legal *duties* as

[86] Authorities Bundle A2/8.

[87] Authorities Bundle A2/6.

[88] Authorities Bundle A2/3.

directors of the company that should not lead one to think that that means that what is expected of each director is the same. In assessing whether a director's conduct in carrying out his duties was incompetent to such a high degree as to render him unfit, there is no doubt that regard must be had to the nature of the particular role which was assigned to him. It is conspicuous that the SoS's evidence and argument does not properly recognise this. As Jonathan Parker J said in Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker and others (No 5) [1999] 1 BCLC 433 @484[89]:

> "*the Court will assess the competence or otherwise of the respondent in the context of and by reference to the role in the management of the company which was in fact assigned to him or which he in fact assumed, and by reference to his duties and responsibilities in that role. Thus the existence and extent of any particular duty will depend upon how the particular business is organised and upon what part in the management of that business the respondent could reasonably be expected to play (see Bishopsgate Investments Management Ltd v Maxwell [1993] BCLC 1282 @ 1285b per Hoffmann LJ). For example, where the respondent was an executive director the Court will assess his conduct by reference to his duties and responsibilities in that capacity.*"

93. Similarly, in Re Westmid Packing Services Ltd; Secretary of State v Griffiths (No 3) [1998] 2 All ER 124 @130b[90], Lord Woolf MR held that whilst a total abrogation of responsibility is obviously unacceptable, a *"proper degree of delegation and division of responsibility is of course permissible, and often necessary".* This is most particularly and obviously so in a publicly quoted company, where adherence to the Combined Code requires in the interests of good governance that the non-executives should not become involved in the running of the business themselves (see further paragraph 95 below).

94. So, in this case, since the EHR Non-Executives were appointed non-executive directors, the Court must assess their conduct by reference to their duties and responsibilities in that capacity. In his book entitled *Principles of Corporate Insolvency Law*[91], Professor Roy Goode relevantly describes a non-executive director in the following terms: "*an outsider brought on to the board by virtue of his general standing or business acumen*

[89] Authorities Bundle A2/6.

[90] Authorities Bundle A1/24.

[91] 2011 edition, at 14-08, p648: Authorities Bundle A4/15.

and devoting only part of his time to the company's affairs (primarily by attending board meetings and reading the relevant papers)". As such, "*A non-executive director cannot be expected to have the detailed knowledge of the company's affairs required of an executive director*"[92].

95. As we say, EHR was a company listed on the Stock Exchange and as such it complied with the Combined Code on Corporate Governance; the relevant version throughout 2005 and 2006 being the 2003 edition. Although, as is recognised by the Combined Code and accepted by the EHR Non Executives, all directors have the same legal duties as directors of the company, the Combined Code states in paragraph 1 of Schedule B[93] (under the heading "*Guidance on liability of non-executive directors: care, skill and diligence")*:

> "*the time devoted to the company's affairs is likely to be significantly less for a non-executive director than for an executive director and the detailed knowledge and experience of a company's affairs that could reasonably be expected of a non-executive director will generally be less than for an executive director. These matters may be relevant in assessing the knowledge, skill and experience which may reasonably be expected of a non-executive director and therefore the care, skill and diligence that a non-executive director may be expected to exercise.*"

96. Each of the EHR Non-Executives will give evidence of their respective compliance with the expectations of, and guidance for, non-executive directors outlined by the Combined Code. In particular, in compliance with the 'Guidance on the Role of the Non-Executive' set out in the Combined Code's Suggestions for Good Practice from the Higgs' Report[94], the EHR Non-Executives 'supported the executives in their leadership of the business while monitoring their conduct'.

97. That the law recognises that there are different expectations of non-executives, in fulfilling their duties as directors of companies, is also demonstrated by the following authorities:-

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[92] @14-09, p649.

[93] Authorities Bundle A4/16.

[94] Authorities Bundle A4/17.

(1) Re TLL Realisations Ltd, Secretary of State v Collins [1988] All ER (D) 651[95], a case pursuant to the CDDA 1986, in which Lloyd J held:

"*I accept that, in principle, a non-executive director is entitled to rely on what the executives, in particular the finance director, tells him without calling for the company's books to check. However the non-executive must consider and assess what he is told critically and objectively*".

(2) Re Stephenson Cobbold Ltd [2001] BCC 38[96], another disqualification case in which Peter Leaver QC (sitting as a deputy High Court Judge) materially held:

"In my judgment, Mr Henstock and the other non-executive directors were entitled to rely upon the fact that Ledger was responsible for keeping the books and preparing monthly management accounts and upon Mr Mead's explanations at the monthly board meetings as reassurance that the financial side of SC was being run properly. In expressing that view I am not intending to derogate from the responsibilities that Mr Henstock had as a director of SC. A director cannot shrug off his responsibilities by claiming that he relied on others: see, e.g. Re Kaytech International plc, Potier v Secretary of State for Trade and Industry [1999] BCC 390, per Robert Walker LJ. To do so would amount to an abdication of a person's responsibilities as a director of a company. However, each case must be judged on its own facts, and on the facts of this case I do not consider that Mr Henstock's reliance upon Mr Mead was an abdication of his responsibilities."

(3) Equitable Life v Bowley [2003] EWHC 2263, [2003] BCC 829 @ 836[97] (paragraphs 35 to 41). Whilst the application brought by the non-executive directors for summary judgment that they be excused from any liabilities in respect of Equitable Life was unsuccessful, Langley J pertinently held:

"There is a considerable measure of agreement about the duty owed in law by a non-executive director to a company. In expression it does not differ from the duty owed by an executive director but in application it may and usually will do so."

He considered that the extent to which a non-executive director may reasonably rely on the executive directors to perform their duties is "*plainly 'fact sensitive*'".

[95] Authorities Bundle A2/5.

[96] Authorities Bundle A2/7.

[97] Authorities Bundle A3/7.

(iv) the significance of advice

98. It is a theme of the SoS's case (see further at paragraphs 158ff. below) that the EHR Non-Executives failed to take appropriate advice.

99. Assuming the SoS does not say that by taking advice a director can delegate to an advisor or absolve himself from responsibility, the question arises what is the significance of an alleged failure to take advice. Of course, it may or may not be (depending on the particular issue which arises) a defence to an allegation of unfitness that the director acted in accordance with professional advice which he sought and received. But not taking advice cannot in itself be culpable, if by his conduct he is not otherwise unfit.

100. The EHR Non-Executives' conduct was not such as to make them unfit. In any case as a matter of fact, EHR took extensive advice from brokers & corporate financiers; from accountants and from lawyers. So the allegation cannot in any case be made out on the facts.

(v) allowing for the difficulties of balancing whether to cease trading or continue – 'the real and unenviable dilemma'

101. As Park J pointed out in paragraph 281 of his Judgment in Re Continental Assurance Company of London plc (No 4), Singer v Beckett [2007] 2 BCLC 287 @409[98] (a wrongful trading claim case):

> *"An overall point which needs to be kept in mind throughout is that, whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down and go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma. On the one hand, if they decide to trade on but things do not work out and the company, later rather than sooner, goes into liquidation, they may find themselves in the situation of the respondents in this case – being sued for wrongful trading. On the other hand, if the directors decide to close down immediately and cause the company to go into an early liquidation, although they are not at risk of being sued for wrongful trading, they are at risk of being criticised on other grounds. A decision to close down will almost certainly mean that the ensuing liquidation will be an insolvent one. Apart from anything else liquidations are expensive operations, and in addition debtors are commonly obstructive about paying their debts to a company which is in liquidation.*

[98] Authorities Bundle A3/1.

Many creditors of the company from a time before the liquidation are likely to find that their debts do not get paid in full. They will complain bitterly that the directors shut down too soon; they will say that the directors ought to have had more courage and kept going. If they had done, so the complaining creditors will say, the company probably would have survived and all of its debts would have been paid. Ceasing to trade and liquidating too soon can be stigmatised as the cowards' way out."

102. The SoS makes particular reference in his skeleton to Re Uno Plc, Secretary of State v Gill [2004] EWHC 933 (Ch), [2006] BCC 725[99]; and it may be necessary in due course to make detailed submissions on that case, since the unsuccessful allegations made there contain a number of similarities with the allegations made here. For the moment we draw attention to three aspects.

103. First, the charge made against the defendants in Re Uno plc was that in the period 8 November 1999 until 7 March 2000, they had caused or allowed the companies to trade at the risk of cash paying customers (whose payments were used as working capital), 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, such cash paying customers would receive either the goods they ordered or a full refund. The SoS sought permission to amend the charge so as to introduce an allegation of causing or permitting the company to continue to trade at unreasonable risk. The Judge (Blackburne J.) refused permission:

"*In my Judgment, that ought not to be permitted, not least because, in common with counsel, I have considerable difficulty in understanding what is an unreasonable risk if it is not in substance that there was no reasonable prospect of avoiding an insolvent liquidation, which is the very matter which, ..., the Secretary of State made clear was no part of her case.* "

104. Secondly, after considering the parties' various submissions in relation to whether the charge, as framed, could constitute unfit conduct, Blackburne J. concluded (at paragraph 144):

"..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, ie 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

[99] Authorities Bundle A3/9.

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 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. The point was put with succinctness in Secretary of State for Trade and Industry v Creegan [2001] EWCA Civ 1742; [2002] 1 BCLC 99 where the relevant ground of unfitness alleged was that the defendants caused the company to trade while it was insolvent without a reasonable prospect of meeting creditors' claims. In the course of his judgment, Sir Martin Nourse (with whom the two other members of the court agreed) stated (at 101, [4j]):

> *"It is well established on the authorities that causing a company to trade, first, while it is insolvent and, secondly, without a reasonable prospect of meeting creditors' claims is likely to constitute incompetence of sufficient seriousness to ground a disqualification order. But it is important to emphasise that it will usually be necessary for both elements of that test to be satisfied. In general, it is not enough for the company to have been insolvent and for the director to have known of it. It must also be shown that he knew or ought to have known that there was no reasonable prospect of meeting creditors' claims."* "

105. Thirdly, accordingly, the Judge identified the relevant question as "*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*".[100] He reminded himself that "*to qualify for disqualification, the conduct complained of must ordinarily be either dishonest or otherwise lacking in commercial probity or display incompetence to a marked degree*"[101]. And he concluded that not only could the defendants' conduct not be characterised as unfit but it would be an injustice to brand their conduct as meriting disqualification[102].

[100] At paragraph 149.

[101] At paragraph 153.

[102] At paragraphs 164-5.

106. To similar effect is Secretary of State v Hickling (aka Re Moonlight Foods (UK) Ltd) [1996] BCC 678[103], where Judge Weeks QC held @ 692D:

> "*To attempt to trade out of insolvency does not necessarily connote unfitness. The charge should be better framed as 'trading without reasonable prospect of meeting creditors' claims' or, as Edward Evans Lombe QC prefers, 'taking unwarranted risks with creditors' money (Re Synthetic Technology Ltd [1993] BCC 549).*"

In that case, the directors, aware that the company was in financial difficulties, consulted an accountant who made forecasts that the directors thought they could rely upon. They also sought advice from solicitors as to whether to continue trading. It was submitted that the directors should have realised that the projections were unreliable because they had not been tested against management accounts. However, as in the present case, no lack of probity was suggested and the Judge held that the conduct of the directors in continuing to trade based on what, with hindsight, may be seen to be inadequate information was not sufficient to justify a finding that they were unfit.[104]

107. The SoS's evidence and argument places particular emphasis on the position of Savers as creditors of FFG. No one is contesting the distress which was no doubt caused by Savers losing the £300 on average which they paid to FFG, and their not receiving their vouchers or Christmas hampers in return. But it is nevertheless important that a properly principled approach is taken when considering the position of Savers for the purpose of these proceedings. Six short points are made at this stage:-

(1) Savers were creditors of FFG, not EHR, and it is primarily for the directors of FFG to address (and to have addressed) the position of FFG's creditors, including Savers.

(2) Savers' money was not trust money. So absent the Bank's consent (which it refused) the money was caught by the sweep and was subject to the Bank's charge. As we understand it, no allegation is (or could be) made by the SoS that the money could have, or should have, been kept separate.

[103] Authorities Bundle A1/17.

[104] At 692G.

(3) The relevance of the fact that Savers were making prepayments is dealt with in Re Uno above; as is the phrase "taking advantage of" which was used in Re Uno, and is used by the SoS in this case.

(4) The SoS draws an analogy between Savers and Crown moneys which is also bad, and is dealt with at paragraph 108 below.

(5) As we have said at paragraph 63 above, to the extent it was relevant at EHR level to give consideration to whether creditors of subsidiaries might or might not get paid, that consideration is of broader scope than simply looking to the position of FFG and its creditors as a whole, or Savers in particular. If the group as a whole failed, then it was not just Savers or other creditors of FFG that might not get paid.

(6) We are not sure what the SoS means by his repeated reference to the likely "*socio-economic profile*"[105] of Savers. But if the proposition is that there should be some positive discrimination in favour, or special treatment, of people with a particular socio-economic profile, either in terms of the attitude of the Court or in terms of what is to be expected of directors when considering the position of creditors, that is wrong in law. It is, of course, well established that the ordinary company law obligations of directors in circumstances where a company is insolvent, or on the verge of insolvency, is to have regard to the interests of the creditors of the company *as a whole.* But preference cannot properly be given to any individual or class of unsecured creditors*;* in this regard, the EHR Non-Executives refer to and will rely upon Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [2002] EWHC 2748 (Ch), [2003] 2 BCLC 153[106] @ paragraph [74] and Re Pantone 485 Ltd [2002] 1 BCLC 266[107] @ paragraphs [67] –[70], [73]. That is not because the law is itself insensitive, or expects directors to be insensitive, to the effect on creditors - particularly individual creditors - of their not being paid. It is because it is impossible properly to know or measure the consequences (economic, emotional or otherwise) which may be caused to one creditor or type of creditor relative to the consequences for any other creditor or type of creditor of their not

[105] See e.g. paragraph 76 of the SoS skeleton.

[106] Authorities Bundle A3/3.

[107] Authorities Bundle A3/2.

being paid. No more is it possible to weigh relative to the position of Savers the hardship or distress caused to employees, agents or others caused by the failure of any particular business within the EHR group. That is why the law requires directors to stop trading where there is no reasonable prospect of avoiding insolvent liquidation, but does not (and should not) discourage them from trying to save the business where that appears reasonably possible (and here it is accepted that it was).

108. Although the SoS seeks to draw an analogy between Savers and cases where directors are regarded as 'unfit' by reason of their having caused or allowed a company to continue to trade by means only of taking inappropriate advantage of the forbearance of the Crown to pursue recovery of outstanding tax, such an analogy is misconceived. In the tax cases, disqualification orders have been made because of the lack of commercial probity involved in continuing to trade by means of the non-payment of *outstanding* tax liabilities (without the agreement of HMRC) where there is no real prospect of the company avoiding insolvent liquidation[108]; they do not concern the acceptance of ordinary on-going trading receipts for goods/services to be provided at a future date in circumstances where (a) ongoing liabilities were being met and (b) the directors genuinely and reasonably believed that their actions would be likely to result in those prospective obligations being duly met by the recipient company.

109. Whilst much is made by the SoS of the Savers' profile, both in his evidence and in the Skeleton Argument, for the reasons set out above the defendants were not permitted to prefer them. Moreover, as Park J stated in Re Cubelock Ltd[109] (@ paragraph 54), after referring to the fact that he imagined that many of the company's creditors were "*seriously disadvantaged*":-

"*It is a sad fact that companies do fail from time to time, and when they do there are almost always deserving creditors who suffer. [However,] Sympathy for the*

[108] Mere non-payment of tax liabilities alone will not justify the making of a disqualification order; see e.g Re Dawson Print Group Ltd [1987] BCLC 601 @ 604 (Authorities Bundle A1/6) and Blackburne J's account of his own Judgment in Re Structural Concrete Ltd [2001] BCC 578 @ paragraph 147 in Re Uno plc [2004] All ER (D) 345 (Structural Concrete is in Authorities Bundle A1/12; Uno in Authorities Bundle A3/9).

[109] Authorities Bundle A2/9.

misfortune of the creditors is not a justification for disqualifying the directors. "

(vi) the importance of avoiding hindsight in assessing directors' conduct

110. In assessing whether any particular director's conduct was such as to make him unfit to be concerned in the management of a company in line with the authorities referred to above, it is also well-established that the Court must take care to avoid doing so with the benefit of hindsight. In particular, that which might, with the benefit of hindsight, have turned out to be the wrong decision will often have been a reasonable commercial judgment in light of the facts known at the material time.

111. The EHR Non-Executives refer to and rely upon the following :

(1) Re Living Images Ltd [1996] 1 BCLC 348 @ 356[110], where Laddie J. warned:

"I should add that the court must also be alert to the dangers of hindsight. By the time an application comes before the court, the conduct of the directors has to be judged on the basis of statements given to the Official Receiver, no doubt frequently under stress, and a comparatively small collection of documents selected to support the Official Receiver's and the respondents' respective positions. On the basis of this the court has to pass judgment on the way in which the directors conducted the affairs of the company over a period of days, weeks or, as in this case, months. Those statements and documents are analysed in the clinical atmosphere of the courtroom. They are analysed, for example, with the benefit of knowing that the company went into liquidation. 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 director, 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."

(2) Secretary of State v Goldberg [2003] EWHC 2843 (Ch) @ [47], [2004] 1 BCLC 597 @ 613[111], in which Lewison J stated: "*In reaching its value judgment about a person's fitness or unfitness to be a director, the court must beware of hindsight. As with any critical evaluation of a person's decisions, the court must confine itself to what he knew or ought to have known at the time the decisions were made*."

[110] Authorities Bundle A1/16.

[111] Authorities Bundle A3/8.

(3) Official Receiver v Dhaliwall [2006] 1 BCLC 285 @291[112], where Recorder Mithani held (at paragraph 22 of his Judgment):

"I also accept that the defendant believed that the last payment that would be made to Vanguard would have been sufficient to discharge the indebtedness of Vanguard to all its creditors. Although that proved not to be the case, I consider the defendant to have been justified in the present case in holding that belief. It would be falling into the trap of being 'too wise after the event' (see Re Living Images Ltd [supra]) for me, in the circumstances of this case, to hold otherwise."

(4) Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker and others (No 5) [1999] 1 BCLC 433 @497[113], in which Jonathan Parker J reminded himself:

"*Thirdly, in assessing the conduct of Mr Tuckey (and of the other respondents) there is in this case a particular risk of applying the wisdom of hindsight. The collapse of Barings was a commercial catastrophe of epic proportions, and that fact alone makes it, perhaps, easier in the instant case than in others to fall into the error of looking at what happened prior to the collapse in the light of the collapse itself. That is not the correct approach. I have to put aside completely the wisdom of hindsight and judge the conduct of the respondents in the context of the circumstances which existed at the time****"***

(5) Secretary of State v Walker [2003] EWHC 175 (Ch) [2003] 1 BCLC 363[114], where, on a successful appeal against a disqualification order made by Registrar Baister, Peter Smith J summarised the relevant law in the following terms (@ paragraphs 47 to 50 of the Judgment):

"*The question is not whether or not the director's conduct deserves criticism. It is the more precise question of whether his conduct makes him unfit to be concerned in the management of a company (Re Cubelock Ltd [2001] BCC 523 at [124] per Park J).*

Where, as in this case, the allegation is solely based on incompetence the burden is on the Secretary of State to satisfy the court that the conduct complained of demonstrates incompetence of a high degree and the burden is a heavy one, the reason being for that is the serious nature of a disqualification

[112] Authorities Bundle A3/10.

[113] Authorities Bundle A2/6.

[114] Authorities Bundle A3/4.

order: see Jonathan Parker J in *Re Barings plc (*No 5*) [1999] 1 BCLC 433 at 483–484, approved by the Court of Appeal [2000] 1 BCLC 523*.

This is also to be found in the decision of Lawrence Collins J in Re Bradcrown Ltd [2001] 1 BCLC 547 at [10].

The purpose of this high test of course is to avoid applying issues of hindsight against businessmen who make decisions often under circumstances of great pressure. It seems to me that, with respect to the registrar, the actions of the appellants during the period 15 December to 29 December, whilst they can be criticised for not seeking advice, are not of such a high standard of incompetence as to lead to a conclusion that they are unfit to be involved in the management of a company. It is very easy to submit that they should have specifically asked advice as to the transactions but when one looks at the overall pattern of their conduct from 22 September 1998 they do not to my mind appear to have the badge of grossly incompetent directors."

112. Accordingly, the Court must guard carefully against judging the conduct of the Defendants in light of the knowledge that, despite the directors' various endeavours to obtain re-financing for the group, FFG, and consequently EHR, subsequently failed. It must consider their conduct only in the light of the information reasonably available to the directors at the material time(s).

113. In summary therefore:-

(1) Unfitness consists in

(i) Some misfeasance or other breach of duty, sufficiently serious to make the director unfit to be concerned in the management of a company. Just establishing a breach of duty is not sufficient.

(ii) Some significant lack of probity.

(iii) A high degree of incompetence, not just incompetence. Establishing grounds for criticism is plainly not enough. Nor is merely being negligent or otherwise falling below what otherwise might have been expected.

(2) No breach of duty or lack of probity is alleged against the non-executives in this case. What therefore needs to be shown is incompetence to a high degree.

(3) In the case of a non-executive, what is to be expected of him is critically conditioned by:

(i) his role & responsibilities within the company;

(ii) the role & responsibilities of others;

(iii) what he knew and was told by others;

(iv) what he is expected to have known or discovered.

(4) So the correct question in relation to the EHR Non-Executives is whether, given their roles and responsibilities within the company, and what they knew and should be expected to have known, did they show a high degree of incompetence?

114. How then does the SoS try to establish what he needs to establish? In the SoS's skeleton argument, he appears to do so by reference to 8 specific "charges" which are analysed below.

115. Before embarking on that analysis, however, it is relevant to observe that it is an unfortunate feature of this case, particularly so far as concerns the EHR Non-Executives, that the case apparently being made has changed from the s.447 report, through Burns 1 and Burns 4; and that even by the time of the skeleton (a) the way that the case now appears to being put is different in a number of respects, and has not been foreshadowed in the evidence; and (b) the diffuse nature of the skeleton even now makes it difficult to be sure precisely what is being alleged. In order to attempt to identify the case now being made against the EHR Non-Executives, and briefly to address it in this opening skeleton, we have tried to distil the charges from the SoS's skeleton, and to identify the skeletons' main passages which appear to make that charge, before briefly giving the EHR Non-Executives answer to them. If we have misunderstood or missed something, we expect to be told during openings.

C. The specific "charges" as put in the SoS's skeleton & the EHR Non-Executives' brief responses to them

November 2005 to January 2006

116. A single allegation ("the 1st charge") appears to be made against the EHR Non-Executives in relation to this period. It appears to be said that:-

(1) A "cash crisis" at the end of January 2006 should have been foreseen by the directors of EHR; and

(2) They failed to prevent that cash crisis, and should have approached the Bank earlier.

117. The basis upon which it is said that the EHR directors should have foreseen the cash crisis is that:-

(1) each of the EHR directors '*was aware (at least) that cash requirements were close to EHR's facility limit;*'[115] and

(2) therefore it was incumbent upon them to '*take steps (including calling for and examining the forecasts, and requiring detailed explanations from management) to ascertain at the very least:*

(i) *How close the Group was to the limit of the facility was expected to be, and when; [sic] and*

(ii) *How much it was expected the Bank would be prepared to cover and what was the basis of that expectation.'* [116]

118. All of this, of course, draws no distinction between the executive directors and the EHR Non-Executives. In seeking to establish what the directors knew or ought to have known, the SoS relies upon forecasts and other communications passing between members of the finance team and (before January 2006) Mr Hulland, the then Finance Director, and (after December 2005) Mr Fowler. The EHR Non-Executives were not party to any of this communication within management, and the SoS makes no case that they were.

119. The SoS appears to acknowledge that,[117] but endeavours to make the case against the EHR Non-Executives on the ground that *'there was enough to put any director who did*

[115] Paragraph 156 of the SoS's Skeleton.

[116] Paragraph 142 of the SoS's Skeleton.

[117] Paragraph 135 of the SoS's Skeleton: although, since the SoS has no case that they did know of any of these communications, the EHR Non-Executives might be forgiven for objecting to the way the skeleton describes the EHR Non-Executives as "claiming" not to have been aware of the forecasts.

not know the precise forecast position on sufficient notice of a potential problem such that he should have asked relevant questions and found out the position.'[118]

120. The imprecision of this language, supported by no particulars, will not do. It fails properly to address, or obscures, what it is the EHR Non-Executives in fact knew and were told, and what it is said by the SoS they should have done as a result and why.

121. The cash-flow position was reported on and discussed at each of the relevant EHR board meetings during this period (with the benefit of board packs[119] containing reports from the CEO and Finance Director). What the EHR Non-Executives knew and were told is dealt with by each of them in their evidence[120]. It does not appear to be challenged. In the briefest summary:-

(1) At the board meeting on 30 November 2005, they were told

(i) that the cash position was well within the facility; and

(ii) current cash projections showed that the business would be close to but within its borrowing limit in February 2006.

(2) On 21 December 2005 (3 weeks later), they were told:

(i) The debt position was better than forecast.

(ii) Management were carefully reviewing cash requirements (in particular over the key January/February period) and a cash conservation exercise was required.

(iii) It was anticipated that the facilities would be substantially utilised but not breached.

(iv) In any event, the Bank had indicated that it would make available temporary additional funds if needed.

[118] Paragraph 141 of the SoS's Skeleton.

[119] See footnote 121 below.

[120] Gillis/42-66 @ AFFS5/1/15-21; Johns/60-73 @ AFFS5/2/16-19; Munn/70-80 @ AFFS5/3/21-24; Thompson/124-5 @ AFFS5/4/34-36.

(3) At the board meeting on 25 January 2006, they were told[121]:

(i) Borrowing levels from 30 January 2006 were highlighting a potential need for additional facilities.

(ii) Cash conservation measures included extending supplier payment terms and processing all payments over £10,000 through a Group clearance procedure.

(iii) An additional £5m had been requested from HBOS as a "safety net" and initial indications were that this would be delivered.

122. It was for the executive directors and management to monitor and control EHR's cash-flow requirements and to report to the board as a whole what it needed to know in that connection. The EHR Non-Executives were entitled to rely upon what they were told without calling for the company's books and records to check the information for themselves (*TLL supra*). What they were told gave no indication of a "cash crisis". On the contrary, the message was not one of potential crisis at all: it was that cash was *"tight",* but that the management were aware of and taking appropriate steps to keep within the facility, and in case it was needed had approached HBOS for an additional temporary facility which was anticipated would be forthcoming. This was also the message conveyed by the 2nd February memo[122] (see below at 134ff.).

123. It is against that background that the Secretary of State needs to explain (but does not, and cannot) what more it is said the Non-Executives should have done and why.

[121] There is a suggestion in the skeleton argument of Mr Gilodi-Johnson at footnotes 37 and 49 (to paragraphs 64 and 79 respectively) that (i) the board packs available to the boards of each of the subsidiaries were sent up to the EHR board for the EHR board meetings; and (ii) that it would therefore have come to the attention of the EHR board on 25 January 2006 that FFG, at FFG's 9 January 2006 board meeting, had considered the possibility of borrowing money from Home Farm Hampers. In fact, although packs relating to the individual subsidiaries were prepared for the EHR board at this time, those packs did not contain the same material as was in the packs for the subsidiaries' boards; and the pack relating to FFG which the EHR board received (D13/5/369-468) did not contain anything referring to the possibility of FFG borrowing from Home Farm Hampers.

[122] CHRON3/5/166-170.

February and March 2006

124. In substance two allegations against the EHR Non-Executives appear to be made in relation to this period. The allegations are spread over a number of paragraphs of the SoS's skeleton, but they appear to be that :

(1) the EHR board should have (i) instigated investigations into the reasons for and likely consequences and implications of the collapse of Choice and the consequent need for a new voucher supplier, and (ii) should further have required immediate financial modelling of those implications, which would have enabled an informed decision to be made "a lot sooner" as to what to do ("the 2nd charge");[123] and

(2) it was unreasonable for the board to leave the issues of borrowing levels and possible solutions until a board meeting at the end of April ("the 3rd charge").[124]

The 2nd charge

125. This charge appears principally to be concerned (for reasons explained below) with a time-period of one month in February 2006, and with an alleged failure to carry out appropriate financial modelling then. The principal points made in support of this charge seem to be:-

(1) the Defendants should have known that there was *"(at the least)"* a very high risk that payment terms would change in relation to any substitute supplier of vouchers;

(2) the funding spike, or a serious risk of such a spike, should have been foreseen by them *'early on after the collapse of Choice';*

(3) they should have realised urgent steps were needed to address the position;[125]

(4) they should have required appropriate financial modelling and a clear report as to what the effect of the collapse of Choice would mean. [126]

[123] Paragraph 178, 193-4 and 205 of the SoS's skeleton.

[124] Paragraph 205.2 of the SoS's Skeleton.

[125] Paragraph 204 of the SoS's Skeleton.

[126] Paragraph 178 of the SoS's Skeleton.

None of these points draw any distinction between the executive and non-executive directors.

126. The reason why this charge appears in reality to be confined to February 2006, and with an alleged failure to start appropriate financial modelling then, is that the SoS appears to accept in his skeleton (as on the evidence he is bound to do) that the precise impact of the Choice collapse could not have been calculated with accuracy in February/March[127]. Of course, from the 1 March 2006 board meeting the EHR board was alive to the problem presented by a change in payment terms for vouchers[128]; and detailed financial modelling had been done and the precise impact of the collapse of Choice had been calculated by the beginning of April. So on one view, once it is accepted that detailed modelling could not have been done before April, this charge and the proposition that decisions could have been made "a lot sooner" fall away.

127. But in order to make something out of it, the SoS goes on in the same paragraph (202) of the skeleton to say, nevertheless, that projections on various bases could have been prepared so that the position, said to have been understood only in April, was one that in February could have been foreseen with some certainty. He then adds: *"In this context see the evidence of Mr Faull"*.

128. This laconic sentence is the only treatment of Mr Faull in the skeleton. Mr Faull "bolts together" on a rough-and-ready basis two separate financial documents prepared at completely different times, under different Finance Directors, on different bases and for different purposes; and not surprisingly he comes up with inaccurate, and potentially misleading, figures. No explanation is offered of what it is said Mr Faull's calculations relevantly show, or of what it is said the EHR Non-Executives should have derived from, or done as a result of, some similar rough-and-ready calculation. It is hoped this will be explained by the SoS in opening.

129. Subject to any such explanation, the argument of the SoS seems to be missing the point of:-

[127] Paragraph 202 of the SoS's Skeleton. The use of the word "perhaps" in this paragraph is merely trying to break the force of the concession being made.

[128] C1/5/86-9.

(1) the purposes of the financial calculations required and undertaken at the time;

(2) what was in fact happening in February 2006; and

(3) what the EHR Non-Executives knew, and should be expected to have known, in February about the consequences of the collapse of Choice on 31 January.

130. As to the first, the EHR Non-Executives understood that the effect of FFG having to pay on the issue of the vouchers rather than on their redemption meant that that would bring payment forward to the Autumn, the same time of year when Kleeneze and other businesses needed cash to buy stock for the run up to Christmas[129]. No rough-and-ready calculation such as Mr Faull's was needed to tell them that. But no approach to the Bank or any other source of funding could credibly be made on the basis of figures such as Mr Faull's. Detailed and careful "bottom-up" modelling was required to identify robustly the additional sums required and the timing of the requirement. That was what was done.

131. As to the second, the 2nd February memo sent to the EHR Non-Executives immediately after Choice's collapse (as to which see further below) identified that either FFG had to acquire Choice itself from the Administrator, HBOS having indicated that it was prepared to consider an additional working capital facility, or it had to find an alternative voucher supplier for 2006 and beyond. So far as the EHR Non-Executives were and are aware that is what was investigated by management during February. The memo made clear that the executives and management were addressing the consequences of the collapse of Choice.

132. As to the third, the SoS says that "*the significance of Choice to the Group [was] ... so significant that [it was] or should have been known to all the directors of each of EHR and FFG [and]…it was, or should have been, fairly obvious that ... a highly likely outcome of the Choice collapse was that the same sort of creditor (sic) terms would not be available as before …"*[130]

[129] Munn/93-94 @ AFFS5/3/26-28; Gillis/77-78 @ AFFS5/1/23-4; Johns/78-80 @ AFFS5/2/21; Thompson/137 @ AFFS5/4/39.

[130] Paragraph 209 of the SoS's Skeleton.

133. It is not a matter for this skeleton to address what was or should have been obvious to the executives and management as "highly likely". The relevant question is whether it should have been obvious to the EHR Non-Executives immediately after the collapse of Choice that it was highly likely that the same terms would not be available as before. There is no reason why it should have been obvious, on two grounds:

(1) First whether the terms were going to change, depended on any view upon how the acquisition of Choice from the Administrators and/or negotiations with alternative suppliers played out.

(2) But, secondly and in any event, the EHR Non-Executives were entitled to take the detailed characteristics of the market in which FFG was operating from those responsible for running EHR and FFG. Based upon what they were told, the EHR Non-Executives' understanding before February 2006 was that there was nothing unique or unusual about the time when payment had to be made to Choice for the vouchers it issued to FFG[131]. And there is nothing illogical or surprising about those payment terms, so as to call into question the possibility of their being obtained elsewhere. The SoS talks of "credit[or] terms". But a multi-retail voucher is only a piece of paper, and there is no significant carrying cost for the issuer between the time when he issues the voucher to FFG, and the time when the retailer asks the issuer for payment. Since the retailer can only ask for payment on or after redemption, there is no obvious reason why any supplier, or the market as a whole, should stipulate for payment for the voucher on issue, when redemption may be months away. For in the meantime, between issue and redemption, the issuer is not really advancing any credit. As for February 2006 itself, the 2nd February Memo does not draw attention to any risk (let alone it being "highly likely") that the time for payment might change if FFG went with an alternative voucher supplier. And the SoS points to nothing else which he says should have alerted the EHR Non-Executives.

134. Before moving on from the 2nd charge, it is convenient to deal with one other matter. There is interwoven into the SoS's argument relating to the Choice payment terms a

[131] See their evidence at: Thompson/118 @ AFFS5/4/32; Munn/64 @AFFS5/3/19; Johns/222 @AFFS5/2/44; Gillis/69-72 @AFFS5/1/22.

different theme. That theme appears to be that as result of the receipt of the 2nd February Memo the EHR Non-Executives should have:-

(1) Appreciated that there was a £5.6m funding "*hole*"[132]; and

(2) Instigated immediate modelling of whether the deficit of £5 million would be repeated or worsened in a year's time.[133]

A related contention made later on is that there was *'every reason'* to believe that there would be a cash flow crisis in relation to the Christmas 2006 savings cycle which would be at least as bad as that in January[134]. And this then leads, still further on, to the SoS saying:

> *"... the funding problem which had emerged well before 31 January 2006 [was] so significant that [it was] or should have been known to all the directors of each EHR and FFG… [and] it was, or should have been, fairly obvious that:*
>
> i. *Even leaving aside any change in credit terms afforded by any replacement voucher provider a funding gap, as experienced in January 2006, would be highly likely to recur in relation to the Christmas 2006 savings cycle"*[135]

135. This again appears to be a point limited to the month of February. It also appears to be somewhat theoretical. For, on any view, from March 2006 events had moved on and EHR was in fact proceeding on the basis that it was likely there would be a change in payment terms; and modelling on that changed basis was taking place. But the SoS's contention is in any case a bad one. Three short points are made at this stage.

136. First, we have already dealt above (in paragraphs 121ff.) with what the Non-Executives knew about the cash-flow crisis before the 2nd February memo.

137. Secondly, the 2nd February memo does not say there had been or was a cash crisis, or that there was or had been a "funding hole" of £5.6m (or any sum).

[132] Paragraph 192.1 of the SoS's Skeleton.

[133] Paragraph 197 of the SoS's Skeleton.

[134] Paragraph 203 of the SoSs' Skeleton.

[135] Paragaph 209 of the SoS's Skeleton.

138. Thirdly, everyone knew that January and February were the months when the cash requirement peaked, and it was plain that the pressure on cash at the end of 2005 and the beginning of 2006 had been greater than management had forecast. But that did not mean that similar or greater pressure would (still less was highly likely to) occur in the same period in 2007 or that urgent modelling was required in February 2006. The reason for the pressure on cash flow at the end of 2005 and the beginning of 2006 had been a period of poor trading, in which in particular Kleeneze had committed itself to acquiring significantly more stock than it had sold[136]. It was not self-evident that that would reoccur in a year's time; but if it did, one obvious way to avoid the cash pressure occurring the following year was to keep the acquisition of stock within stricter limits. The immediate timing point however is that, were it not for the collapse of Choice and its repercussions, EHR and its subsidiaries were anyway about to embark in March and April 2006 upon their annual cycle of budget planning; and these were matters to be considered and addressed in detail then. In the meantime the cash flow circulated on 2nd February indicated that, pending that planning process (and indeed beyond), there was no immediate cash flow pressure.[137]

139. Mr Faull seems to have done a "quick and dirty" calculation by way of illustration of what could have been done in February. No explanation is given in the SoS's skeleton of what the point would have been of the EHR Non-Executives doing a similar exercise.

The 3rd charge

140. The allegation that issues of borrowing levels and possible solutions were left until a board meeting at the end of April 2006 is wrong. Following the discussion which took place at the 22 March 2006 board meeting, management were left to finalise the fully-modelled figures. The next monthly EHR board meeting had long before been scheduled for 27 April 2006; but the directors were asked to stand by to deal with the figures and to be flexible about dates.[138] On 24 March 2006 an EHR board meeting was provisionally fixed for 10 April 2006. The fully-modelled figures with a funding paper

[136] Thompson/123@ AFFS5/4/34; Munn/79 @AFFS5/3/24 and the Board Pack for EHR Board Meeting on 25.1.06 @ D13/2.

[137] CHRON3/5/170.

[138] Munn/103 @ AFFS5/3/29. Gillis/83 @ AFFS5/2/24-25.

were circulated to the board on 7 April; and the board meeting, at which decisions were taken, took place on 10 April accordingly.

April to August 2006

141. It is in this period that the allegation, dealt with in the Introduction to this skeleton, of doing too little too late, and in particular of considering funding options one by one rather than in parallel, is made and to which we have referred above. This charge ("the 4th charge") also appears to have a number of disconnected strands attached to it as follows:-

(1) It is said the directors had insufficient knowledge and information to justify them taking the course they did[139].

(2) It is said that too little weight was given to the fact that there was a very serious risk, which was or should have been obvious to all involved at the time, that none of the various funding options would be carried into effect, either at all or in time.[140]

(3) It is said that the directors should have explored funding options earlier and with greater urgency[141].

(4) It is said, several options in parallel should have been pursued given ever-increasing deposits coming in from FFG Savers.[142]

(5) It is said that there should have been, but was not, rigorous testing and and/or critical evaluation on the part of the non-executive directors[143].

(6) It is also alleged that the other directors relied on Mr Rollason to get on with things, and, increasingly, accepted his reports that various options were realistic at

[139] Paragraph 55 of the SoS's Skeleton.

[140] Paragraph 275 of the SoS's Skeleton.

[141] Paragraph 284 of the SoS's Skeleton.

[142] Paragraph 284 of the SoS's Skeleton.

[143] Paragraph 229 of the SoS's Skeleton.

face value.[144]

142. The real burden of the case appears to be, as we have said above, not that the refinancing efforts which were made should not have been made, but that all available options should have been attempted in parallel and more quickly. The strands identified above, as we understand them, are all directed towards making out that case, although it is far from clear precisely what is meant by each of them, what the evidence for them is, and what it is said should have happened instead. At this stage, however, a few brief points are made in relation to the last two. First it was for the executives and management rather than the EHR Non-Executives to carry out the necessary tasks to progress the various funding options and to report to the board accordingly. But, secondly, it is clear from the evidence that the EHR Non-Executives did supervise and evaluate, and did not simply take at face value, the efforts being made. By the summer three EHR board meetings each month were occurring. The proposition that the EHR Non-Executives did not evaluate and took at face value what Mr Rollason said does not seem to have been advanced in evidence or suggested before. Thirdly, it is particularly unfortunate that no proper explanation of, or evidence for, each of these points is identified in the skeleton, because as we have said it is *not* the SoS's case that the funding options pursued were unrealistic, could not have succeeded and should not have been pursued. So it is difficult to follow exactly what criticism is being made of the EHR Non-Executives.

<u>September 2006 to October 2006</u>

143. The same charge appears to be being made during this period ("the 5th charge") as is made by the 4th charge above in relation to the period before September. It appears again to be an allegation of doing too little too late, although the formulaic way of putting the matter in paragraph 300 of the SoS's skeleton does not make the position at all clear.[145]

144. The criticism seems to be that the only options being pursued at this point were variants of the Park proposal promulgated by EHR which were complicated and depended on

[144] Paragraph 229 of the SoS's Skeleton.

[145] Paragraph 229 of the SoS's Skeleton.

various contingencies[146].

145. The point is not easy to follow, and it may be that there is a misunderstanding as to what was happening in this period. We have briefly described in paragraphs 58ff. above (but for more detail please see our chronology) what was happening in September and early October. Park II was a solvent solution. The Bank took until the second week of October to decide. It is not suggested by the SoS that there were any other options then available. It has never been suggested, and is presumably not suggested now, that EHR should have taken Park II off the table and denied creditors the solvent solution which it offered. What criticism is being made in this period is therefore entirely obscure.

Other allegations

146. Three further allegations appear to be made, which do not appear to be tied to any particular time period:

(1) A charge that the EHR board failed to ensure that the FFG board was "operating properly" ("the 6th charge");

(2) A charge that little or no weight in the decision-making processes of the EHR board was given to the vulnerable nature of FFG Savers and to the fact that such Savers were making prepayments to FFG ("the 7th charge")

(3) A charge that appropriate advice was not taken ("the 8th charge").

The 6th charge

147. In paragraph 108 of the SoS's Skeleton this is expressed as a '*failure to ensure that the board of FFG was operating properly*'. Paragraph 56 of the skeleton, which reflects the way it was put in Burns 1[147], suggests that what is being said is that the EHR board failed adequately to safeguard EHR's investment in FFG as one of its subsidiaries.

148. But we do not deal with that way of putting the matter, because it is plain from the SoS's skeleton argument that the substance of the charge has now changed and

[146] Paragraph 299 of the SoS's Skeleton.

[147] See e.g. Burns1/65 @ AFFS1/2/28.

developed substantially (perhaps in order to attempt to address an otherwise unintelligible suggestion made in the SoS's evidence that the EHR Non-Executives should have made sure that the FFG board saw the 2nd February memo[148]). The charge now advanced is that three (non-exclusive) minimum "duties" are alleged to have been owed by the EHR Non-Executives, namely[149]:

(1) To ensure that the board of FFG was properly aware of the factual position from time to time;

(2) To ensure that the board of FFG was considering the position from the perspective of FFG and in its best interests; and

(3) To ensure that any conflicts of duty were being properly addressed.

149. No doubt the SoS will explain in opening the actual (as opposed to theoretical) conflict which is said to have arisen; and why, if there was such a conflict, it was not a matter for the directors who had the conflict rather than any matter for the EHR Non-Executives who did not (it being the case of course, that the majority of the board of EHR did not have a conflict). No doubt the SoS will also explain in opening the legal and factual bases of this charge. For at first blush the SoS's submissions are very puzzling as a matter of law. They are also particularly troubling as a matter of procedure and evidence.

150. As to the law, no authority at all is cited for the propositions advanced. They appear to be positive duties said to be owed by a non-executive director of one company to act in the best interests of another company, to which by definition he owes no duty. The positive "duty" seems to extend to the non-executive making himself aware of what the directors of that other company do and do not know, and to identify and supply to them what information he holds which it might be in the interests of that other company for them to be told. It also appears to extend to his making himself aware of what the directors of the other company are doing, so as to supervise them and make sure they are complying with the duties which they owe to that other company. And all of this apparently applies when (or perhaps especially if) there is a conflict between the

[148] Burns1/395 @ AFFS1/6/155.

[149] Paragraph 57 of the SoS's skeleton.

interests of the non-executive's company and the interests of the other company, with the result (it seems) that he must look to the interests of the other company even if that is contrary to the interests of his own company. Absent some explanation, this appears to be an unprincipled attempt to make the EHR Non-Executives liable for the conduct of the FFG directors acting as such.

151. Just as importantly, as a matter of procedure and evidence, this way of putting the case (assuming, without accepting, it is properly arguable in law) has never been foreshadowed before. It is plain that this is not just an argument of law, and that the SoS's case depends on the facts. For, the SoS goes on in his skeleton to say it should have been obvious for the EHR directors to check that the conflict between EHR and FFG's interests had been dealt with; and that the FFG directors were receiving appropriate advice or that they were at least considering the position properly. The SoS then alleges that it could not be reasonably assumed by the EHR Non-Executives that the FFG directors were *au fait*, or dealing with, the funding gap position. And then the SoS's says that the cogent reason[150] for this is that in the information received by the EHR directors about FFG as a group company, there was no reference to the position of FFG's board on the funding gap issue.[151] So without ever addressing the point in evidence before, or giving the EHR Non-Executives the opportunity to deal with it, the SoS is trying to make an evidential case that the EHR Non-Executives in fact failed to do or address their minds to certain things; and as a matter of fact proceeded on an unsafe assumption or otherwise had no justification for the way they acted. But if the charge turns (as the SoS appears to think it does) upon what the EHR Non-Executives did or did not think about the position of the FFG board, they will have something to say about it, and if necessary will ask to give evidence about that in chief.

152. So, if this charge is to be pursued, the SoS should seek permission to do so in opening, with a proper explanation of why this charge is arguable in law, and a proper identification of the facts relied on and where the evidence for them is to be found. If permission were to be granted, it should be on the footing that the EHR Non-Executives are given an opportunity to deal with the facts and evidence relied on.

[150] Although in truth what follows appears to be a non-sequitur.

[151] Paragraph 226 of the SoS' Skeleton Argument.

153. At the moment however the submission of the EHR Non-Executives is that this charge is misconceived and the SoS should not be allowed to be pursue it.

The 7th charge

154. It is a recurrent theme of the SoS's skeleton that the particular vulnerability of Savers was given little or no weight in the decision-making processes of the two boards. For present purposes we are concerned with the decision-making processes of the EHR board.

155. This appears to have two aspects. First it appears to be relied on as a particular factor which made it important to proceed with the refinancing as quickly as possible, and in support of the proposition that in the circumstances too little was done too late. We have made submissions about the correct approach to the Savers issue in paragraph 107 above. The EHR Non-Executives were aware and not insensitive to the fact that continued trading of the Group meant that liabilities were being incurred to Savers by FFG as well as liabilities being incurred to other creditors by other group companies. But it was right to try to rescue the group, and to try to achieve a solvent solution. And if the too little too late charges are not otherwise good (which they are not), the particular vulnerability of Savers does not serve to make them good.

156. The second aspect ("the 7th charge") is that (at paragraph 76 of the Skeleton) it is submitted by the SoS that in the same way that taking advantage of undue forbearance on the part of the Crown *"and not providing working capital"* (sic), can be capable of amounting to unfit conduct, so can taking advantage of those who make pre-payments.

157. The charge, put in this way, is principally a matter for the directors of FFG, whose creditors Savers were. But, as we have said above[152], the analogy with tax due to the Crown is not in any event a good one.

The 8th charge

158. There is a recurrent theme in the SoS's skeleton, and also a final section of the skeleton, by which it is alleged that appropriate advice was not taken.

[152] See paragraph 108 of this skeleton.

159. There is an assertion that after the resolution of EHR's board to seek legal advice on 31 May 2006, EHR failed to seek legal advice on whether or not an announcement to the market should be made before ABN referred the matter to Macfarlanes on 5 June[153]. This latter point (even assuming it were correct) cannot be laid at the door of the EHR Non-Executives. But in any case, it does not seem to be advanced as a ground of unfitness (see paragraph 271 of the SoS's skeleton), so it is not dealt with further. Apart from that, there appear to be three main points.

160. First, in the last paragraph of the skeleton, the SoS says that although it is right to say that advisers were consulted on various issues from time to time, overall strategic advice was never properly taken. What overall strategic advice is intended to mean is not explained or particularised. It is not obvious what sort of adviser gives "overall strategic advice". This is not something which has been canvassed in the evidence. It is an unsupported and vague assertion and should be rejected.

161. Secondly, the SoS says at paragraph 290 of the Skeleton that it seems also that the Group at no time developed (or monitored the development of) an insolvent back-up plan, but left that to the Bank, with news of proposals filtering back to the directors in a disorganised manner. Again this is an allegation that has not been properly developed in the Affidavits; the evidential basis for it is not identified properly in the SoS's skeleton; and whether and if so why it is a charge against the EHR Non-Executive is not clear. It is in any case wrong on the facts. It seems to be an allegation relating to August 2006. But at that time Mr Rollason was taking advice on behalf of EHR about insolvency from Ernst & Young and Macfarlanes.

162. Finally a remarkable allegation is made for the first time in relation to advice given by Macfarlanes[154]. It is said that EHR, through Mr Rollason, did not give Macfarlanes accurate instructions and that Macfarlanes did not take sufficient care that they were advising on the accurate facts. None of this is foreshadowed in the evidence. It is relied on to support a submission that the Defendants (including apparently the EHR Non-Executives) cannot claim they could properly rely on the advice given by Macfarlanes for the purposes of deciding to continue to trade.

[153] Paragraph 259 and 266 of the SoS' Skeleton.

[154] Paragraph 265 of the SoS's skeleton.

163. Even assuming (without in any sense accepting) that any of this could otherwise be substantiated on the facts, in order to make this case out against the EHR Non-Executives it would have to be shown that they knew that Macfarlanes advice could not be relied on. That involves showing that they knew that incorrect instructions had been given to Macfarlanes; and/or that Macfarlanes were negligent in giving their advice. There is absolutely no evidence for any such thing. And there is no attempt in the skeleton to even address those points. This allegation, if it really is being pursued against the EHR Non-Executives, should be rejected as baseless.

D. Conclusion

164. The SoS cannot make out any of the charges against the EHR Non-Executives. He does not and cannot show that any of them are unfit or that it is right to make Disqualification Orders against them.

165. The Disqualification Claim against the EHR Non-Executives should be dismissed.

PAUL GIROLAMI QC
CATHERINE ADDY

18 May 2012

Maitland Chambers
7 Stone Buildings
Lincoln's Inn

Tel: 020 7406 1200
Email: cjaddy@maitlandchambers.com

Schedule 1 to the CDDA 1986 – Matters for determining unfitness of directors:

"Part I Matters applicable in all cases

1 Any misfeasance or breach of any fiduciary or other duty by the director in relation to the company[, including in particular any breach by the director of a duty under Chapter 2 of Part 10 of the Companies Act 2006 (general duties of directors) owed to the company].

2 Any misapplication or retention by the director of, or any conduct by the director giving rise to an obligation to account for, any money or other property of the company.

3 The extent of the director's responsibility for the company entering into any transaction liable to be set aside under Part XVI of the Insolvency Act [1986] (provisions against debt avoidance).

4 The extent of the director's responsibility for any failure by the company to comply with any of the following provisions of the Companies Act 2006—

(a) section 113 (register of members);

(b) section 114 (register to be kept available for inspection);

(c) section 162 (register of directors);

(d) section 165 (register of directors' residential addresses);

(e) section 167 (duty to notify registrar of changes: directors);

(f) section 275 (register of secretaries);

(g) section 276 (duty to notify registrar of changes: secretaries);

(h) section 386 (duty to keep accounting records);

(i) section 388 (where and for how long accounting records to be kept);

(j) section 854 (duty to make annual returns);

(k) section 860 (duty to register charges);

(l) section 878 (duty to register charges: companies registered in Scotland).

5 The extent of the director's responsibility for any failure by the directors of the company to comply with the following provisions of the Companies Act 2006—

(a) section 394 or 399 (duty to prepare annual accounts);

(b) section 414 or 450 (approval and signature of abbreviated accounts); or

(c) section 433 (name of signatory to be stated in published copy of accounts).

Part II Matters applicable where company has become insolvent

6 The extent of the director's responsibility for the causes of the company becoming insolvent.

7 The extent of the director's responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part).

8 The extent of the director's responsibility for the company entering into any transaction or giving any preference, being a transaction or preference—

(a) liable to be set aside under section 127 or sections 238 to 240 of the Insolvency Act [1986], or

(b) challengeable under section 242 or 243 of that Act or under any rule of law in Scotland.

9 The extent of the director's responsibility for any failure by the directors of the company to comply with section 98 of the Insolvency Act [1986] (duty to call creditors' meeting in creditors' voluntary winding up).

10 Any failure by the director to comply with any obligation imposed on him by or under any of the following provisions of the Insolvency Act [1986]—

(a) paragraph 47 of Schedule B1 (company's statement of affairs in administration);

(b) section 47 (statement of affairs to administrative receiver);

(c) section 66 (statement of affairs in Scottish receivership);

(d) section 99 (directors' duty to attend meeting; statement of affairs in creditors' voluntary winding up);

(e) section 131 (statement of affairs in winding up by the court);

(f) section 234 (duty of any one with company property to deliver it up);

(g) section 235 (duty to co-operate with liquidator, etc).”

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 2nd, 5th, 6th and 9th DEFENDANTS

K&L Gates
One New Change
London EC4M 9AF