Thursday, 21 June 2012

(10.30 am)

STATEMENT BY THE JUDGE

MR JUSTICE PETER SMITH:

1.0 INTRODUCTION

1. The present proceedings arise out of the collapse of what I will call collectively the Farepak group in October 2006 when all the companies in the group went into administration except Farepak which went into liquidation.
2. By the present proceedings the Secretary of State sought disqualification orders against the defendants who were directors of the relevant companies. Of those defendants two directors, possibly due to the costs of fighting these cases, Mr Hicks and Miss Ponting, chose not to contest it and submitted to undertakings.
3. The Secretary of State's evidence concluded with that of Fraser McDonald Kelly who at the time was the director of corporate banking of Bank of Scotland, which we have confusingly called throughout the trial HBOS. His evidence concluded at 10 past 6 on 18 June, I having agreed to sit to finish his evidence and the evidence of the

Secretary of State by that time. At that time I indicated to the Secretary of State's counsel that I wanted to see how he now presented his case in the light of the evidence that had evolved and particularly in the light of paragraph 54 of his skeleton, to which I shall make reference further.

4. On the morning of the 19th the Secretary of State asked for time to consider his position and at 2 pm yesterday he announced that in the light of the oral testimony and legal advice that the Secretary of State was going to discontinue the proceedings immediately against all defendants.
5. The defendants have intimated that they will seek an order for the payment of their costs on an indemnity basis and will in addition seek an interim payment on account of any costs. That application is adjourned until Friday, 28 June.
6. The decision of the Secretary of State was in my view both correct and inevitable given the evidence as it was by the close of his case and he was right to conclude in effect that there was no reasonable prospect of succeeding in his applications in reality unless he was able to break the defendants down in cross-examination.

7. Ordinarily when a case is terminated like this I would not say anything because a claimant, subject to exceptions, none of which applies to this case, has a right to discontinue proceedings under CPR39, subject to a liability to pay costs.
8. However, these proceedings have attracted a lot of publicity and have been keenly followed, with justification, by a large number of people, in excess of 100,000, who lost what has been called wrongly again throughout the trial, their deposits.
9. I should clarify that. Farepak sold hampers for Christmas and more significantly sold vouchers which could be cashed in at various retail stores. Customers paid it money over the year and then were issued with vouchers in the autumn to spend at the stores in the lead up to Christmas and the New Year.
10. In this case customers made deposits, as we call them, between January 2006 and the collapse of the group in October 2006 amounting to in excess of £35 million, maybe as much as £41 million.
11. Although they were called deposits, it is

actually a misnomer because the deposits were used by Farepak as part of its general trading money, thus all of its monies that were paid in to its account under arrangements made with the group bankers, Bank of Scotland, which we misleadingly, as I say, called HBOS throughout the trial, on a daily basis were swept into the group accounts with HBOS.

12. This practice had been in place for many years and has not been criticised by anyone apart from a Mr Johnson, the chairman of Park Group Plc, a rival. That company operates a different arrangement. When it receives deposits it basically ringfences them and when it comes to pay for the vouchers when they are redeemed it uses the money that it has collected. That was not the model of the EHR group which was based more on the more prevalent view in finance of using assets and financing other things by cheap borrowings, which we all now know are no longer as available.

13. So the monies were then swept, as I say, into the parent company, European Home Retail, EHR, as a matter of obligation to HBOS. When those funds were then credited to the account they were used

to reduce its overdraft with HBOS, thus reducing the overall group expenditure on interest on a daily basis. It also used it to pay the operating costs of different companies in the group.

14. As a result of this arrangement, Farepak became an unsecured creditor of EHR as regards all the deposits it received. It was credited with a reasonable rate of interest internally, but it was not clear on the evidence whether or not it was actually paid.

15. At the time of the collapse in October 2006 Farepak owed customers and agents some £37 million, which it could not pay. Its major asset was the unsecured debt owed to it by EHR which at that time was £33 million. EHR could not of course pay that back either.

16. The deposits were therefore all charged to the bank, HBOS, as security for its loans. The amount borrowed, and the amount outstanding to the creditors, was against a facility of £40 million which itself was reduced in late August 2006, unilaterally, by HBOS to £35 million.

17. HBOS, by means of a pre-pack in the

administration that it had negotiated in the period of September/October 2006 made full recovery of the indebtedness owed to it, save in respect of some outstanding costs to which I shall refer later.

18. The unsecured creditors have received virtually nothing. It is not clear yet how much they will receive, but it will be pence in the pound. It might even be single figure pence in the pound. This was particularly tragic for a large number of depositors who have saved over the year for their Christmases, only to find that they were not going to get the vouchers or hampers and it ruined the Christmases of thousands of families who could ill afford to have the loss of this valuable saving process. Having been in a family which suffered something similar one Christmas I can sympathise.

19. The defendants, the directors of the companies, have received a huge amount of criticism over their conduct. The depositors believed that the directors were responsible for their losses and that this trial would explain how they came to lose their money and what role the

defendants had in that loss.

20. In fact, as the Secretary of State has in effect conceded and the evidence showed, not only did the directors do nothing wrong, but they made genuine strenuous efforts to save the group and the depositors. Numerous proposals were put forward, including one, for example, by the Johnson trust who were the major shareholders behind the company, in effect to give up the worth of their shareholding. All of these proposals, which I shall summarise briefly in this note, failed over the period between March and October 2006 on the flinty ground of HBOS, which had a policy of playing hardball, of which it appeared to be proud, and conceding nothing.

21. HBOS was not prepared to provide any significant positive assistance to solve the difficulties the group came into. The reason for this was because at all times from the commencement of the troubles HBOS was fully secured and, as was shown in the outcome in October 2006, did not lose anything.

2.0 DEPOSITS RECEIVED September to October 2006

22. Further, as appears, HBOS substantially benefited from deposits that were received late in the death of the companies
in September/October 2006. During that period -- you can see this from Mrs Burns' first affidavit at paragraph 157 -- over £10 million was credited to the group's HBOS accounts. During that period the HBOS overdraft was reduced by £4 million, thus as regards that £4 million the sole beneficiary of the customers' deposits was HBOS.

23. The further £6 million was used to carry on the businesses. This also accrued a benefit solely for HBOS, because if the businesses had been stopped their worth would have diminished, but the £6 million was used to prop up the businesses which were then sold by HBOS in the pre-pack administration at prices which enabled it to obtain a full return of its loan.

24. During this period three things were stark. First, HBOS's internal documents showed that they strongly favoured an insolvent outcome and believed that would happen. They nearly had one with a company called Findel in the end

of August 2006, but that failed when Findel tried to beat them down on the price.

25. Following that, the only thing that was on the table was a rescue package involving Park. This was called Park II. For various reasons HBOS took six weeks to make a decision not to support this and then the next day they put the group into insolvency.

26. As I say, during this period HBOS were fully aware that the overwhelming likelihood was that there would be an insolvent solution. The second point is they were equally aware during this period that deposits were continuing to be received at a time when if the group went into insolvency would be lost. Third they were also aware that in effect all of the deposits that were being received in this September/October period would only benefit HBOS and nobody else. This is despite the fact that come the end of August the directors were concerned about the continued collection of these deposits and asked HBOS on at least two occasions in that period to allow them to protect future deposits in a trust, or more drastically to tell people not to give any more

money. The bank refused both proposals. This meant that the directors, unless they put the company into immediate insolvency, whilst there was a potentially viable offer to save the group on the table, were in effect obliged to continue to receive the deposits and pay them over for the bank.

27. The end result was, therefore, that during this period all the deposits were not only lost to the depositors, but it was known by HBOS that it was overwhelmingly likely they would be lost to the depositors, but those deposits benefited HBOS in the two ways that I have identified.

3.0 THE SECRETARY OF STATE’S CASE

28. Given the fact that the Secretary of State's case stopped in its tracks at the close of his evidence, I felt it necessary to do two things: first to explain why the defendants are in my view rightly to be vindicated and, second, to explain to the depositors what actually happened with their monies.

29. The Secretary of State's case was always a challenging one because of the statement made in

paragraph 54 of his opening skeleton that he had no positive case that liquidation was in fact inevitable prior to October 2006.

30. His case, therefore, was that attempts to achieve a solvent solution were possible, but the actions of the directors in their attempts not only led to that failure, but that their conduct in that exercise was so unacceptable as directors that in the view of the Secretary of State they were unfit to be directors of any companies. That requires a very strong case to establish.

31. In essence the Secretary of State's claim was that the solutions pursued by the directors between February and September, as was colloquially said on a number of occasions, were too little too late, and were pursued in succession when they should have been pursued in parallel, with the contention that had they pursued them in parallel a solution could have been formed earlier, but by September it was too late.

32. He also contended that the defendants were aware of a potential problem in the latter part of 2005 which was an underlying problem that the

company's trading was not covering the losses. However, in my view that was only a bolt-on issue and carries little real weight. The real allegations against the defendants were complaints about their conduct between February and October 2006.

33. What was particularly surprising was the fact that the Secretary of State, whilst saying what the defendants did was of such a poor quality that they were unfit to be directors, was unable to point to any other steps that they could have done to try and save the company.

34. There was, as paragraph 54 shows, no criticism of the decision to try and save the company. That carries with it, however, this difficulty which the directors faced and was a hard decision for them to make: if they want to try and save the company in a non-insolvent way the only way to do that is to continue trading. If they do not continue trading the group collapses. The important part of that continued trading is the established and uncriticised practice of continuing to receive deposits and utilise them to reduce the group liabilities to HBOS and to carry

on trading.

35. That self-evidently carries with it a risk that if the attempts to make a solvent solution fail, deposits received during the exercise would be lost. That was a judgment call that the directors had to make and it is not said by the Secretary of State, as I have said, that insolvency was inevitable until October 2006.

36. It is very easy with hindsight to say, when the problems first arose for example in February 2006, that the companies should have immediately been put into liquidation. The reality is that that would have not achieved any better result because all that would happen would have been a different set of depositors would have lost out, the overall creditors would have merely changed in name as opposed to substance and the bank would still have taken 100 per cent because it was fully secured.

37. As I say, nobody actually criticised the directors in making that decision which carried with it that potential risk to the depositors. It follows that the Secretary of State, to establish that the defendants' conduct was so bad that they

merit a disqualification, that the evidence of what happened between November 2005 and October 2006 required careful consideration and the defendants' role in that also required careful consideration.

4.0 THE EVIDENCE

38. I do urge those people who are interested in the outcome of this case and want to see it in more detail to seek to obtain transcripts of the evidence. I have already noted, for example, that there have been statements that the case collapsed due to new evidence. This is not true. All the evidence was there to be seen properly collated and put together.

39. The evidence put forward was overwhelming and in my view unnecessarily so. The lead affidavit on behalf of the Secretary of State, of Mrs Gabrielle Burns, of 11 January 2011, went to 1087 paragraphs and 435 pages. It had attached to it thousands of pages of exhibits.

40. Mrs Burns is the Head of Project Strategy Management Team and Investigation Enforcement Services. She was also one of the three

inspectors who were appointed under section 447 of the Companies Act to investigate the affairs of the companies.

41. This was the way the Secretary of State traditionally conducts disqualification proceedings: a statement by a representative of the Secretary of State prepares an affidavit or a statement summarising everything that went on and exhibiting all the relevant documents. Of course it has a number of potential problems if there is going to be a fight and has the potential in my view to be oppressive to defendants.

42. First the deponent is never a witness to the events. That person then, if he or she purports to give evidence as to events, necessarily gives hearsay evidence. That evidence is often distilled from other investigations, as happened in this case, statements that are unsigned sometimes and statements that are signed. In significant cases like this the use of hearsay evidence like that which cannot be tested unless those deponents are made available for cross-examination must be considered, in my view, in the future very carefully because it is

essential that if defendants are on the receiving end of proceedings which if successful ruin them, that they are entitled to be able properly to test the evidence.

43. In the present case the defendants in my view would have been overwhelmed in this case, but were saved from that by the clearly huge efforts of the defendants' respective teams in challenging the way in which the evidence was put forward.

44. Further, in all the affidavits large numbers of pages were included in the exhibits. It transpired during the case that many of the deponents to the affidavits did not even know what were in their exhibits. What happened was that some had given statements under the investigation. Some had given statements voluntarily, the HBOS witnesses were of that category, and some witnesses were interviewed early this year. Those witnesses were then presented with their affidavits which they perused briefly and ultimately signed. They swore to them and they of course all verified them in giving evidence in this case, but it is completely unhelpful, for example, to have a single exhibit running to 700

plus pages appended to an affidavit which a deponent does not really understand and which does not tell the defendants what is the purpose of the large exhibit.

45. This occurred in late evidence served by the Secretary of State and led the defendants to apply before the trial for an order that the Secretary of State identify which part or parts of the large exhibit they intended to refer to in respect of which allegation. I made an order and it is fair to say that led to a very pressured period, both on the Secretary of State to comply, which they did, I accept, to the best of their ability given the short timetable; and to even more pressure on the defendants with the proximity of trial, to analyse it.

46. Absent that order, however, the only way in which the defendants could have seen the relevance of the documents was to put them to each witness and ask the witness why it was included in the exhibit. I suspect that that exercise would have revealed complete bafflement by most of the witnesses because it was plain as the evidence evolved that the witnesses clearly did not

understand, to a significant degree, what was the purport of their evidence, in my view, and why things were said. This is very dangerous. In addition they had little comprehension of the voluminous exhibits

47. The courts have regularly reminded parties that the purpose of witness statements is to replace oral testimony. It is not to rehearse arguments, it is not to set out a case and whilst it necessarily has to be drafted with the collaboration of lawyers, it should not be a document created in the language of lawyers by the lawyers, because the lawyers do not go into the witness box and defend it. This is unfair to defendants, as this case showed. It is also unfair to the witnesses.

48. I had, in addition to Mrs Burns' evidence, evidence from seven witnesses who were there to the events. All of those witnesses in my view gave honest evidence. I do not believe that they were dishonest, but it turned out that in each case the emphasis given in certain vital aspects of their affidavit evidence was slanted against the defendants unfairly and in each case all of

the witnesses ultimately, in one way or another, acknowledged this, some even apologised, and some withdrew paragraphs of their evidence. This was all in the light of being confronted, as regards those paragraphs, by contemporaneous evidence which they had not been shown, or the importance of which had not been drawn to their attention, or some of which they did not even know about, in some cases even though they were contained in exhibits to their own affidavits.

49. This is not the way to produce evidence. It is, as I say, unfair both to the witnesses and more particularly to the defendants.

50. A brief list of those other witnesses is as follows:

51. Mr Oliver Hemsley, who is a chief executive officer of a finance company called Numis and who was in the scene in June 2006 possibly to provide funds to save the group;

52. Mr Peter Johnson, the chief executive officer and chairman of Park. His evidence was particularly strong in criticism of HBOS to which I shall refer later;

53. Mr Egerton-King who was chief operating

officer of the Big Group, a subsidiary of whose was appointed in April 2006 to provide vouchers to replace those which were provided by the former supplier, Choice, which had gone into administration on 31 January 2006. The demise of Choice really brought the problems of the group to a head in reality;

54. David John Farrow, who was at the time head of a team within ABN Amro specialising in finding investors who provide finance to companies which needed to raise extra finance, called in the case mezzanine finance, that is to say the finance primarily is secondary finance behind the primary bank finance provided by the mainline banks;

55. Alexander John Frederick Garton who worked for Hoare Govett, part of ABN, and who was instructed in the attempt to save the company's problems with the rights issue;

56. Martin Griffiths, who was the HBOS relationship manager with the defendants; and

57. Mr Kelly who, as I said, worked for HBOS in their high risk department.

58. In my view, for the reasons I have briefly mentioned, there are serious questions as to how

this affidavit evidence came to be assembled. This can be gone into in more detail, and I suspect will be on the costs application, but there were instances, for example, of the following. First, witnesses were only being shown selective parts of defendants' affidavits; second, witnesses were not being shown relevant documents; third, as I have already said, large exhibits were assembled without the witnesses either ever having read them or even having understood the significance of them. To give, as I think it was, Mr Kelly 700 pages and then have him sign the affidavit a week later was a daunting task by any stretch of the imagination. 700 pages is the size of a novelette and to ask him to see and analyse the significance of those documents in relation to events six years ago is a daunting task.

59. Fourth, significant paragraphs were drafted in all the affidavits which appeared to be critical of the defendants' conduct. The examples are legion and they were all exposed extensively in the skilful cross-examination of the Secretary of State's witnesses.

60. I will give only one example: Mr Kelly.

I should say for the benefit of Mr Kelly that I am not singling him out for any particular criticism.

61. Mr Kelly, like all the deponents in my view, attempted to give the evidence honestly but was drawn into giving evidence which ultimately, when faced with the realities of the situation and the contemporary evidence, he could not sustain. Thus, for example, in cross-examination he was forced to withdraw parts of paragraph 25; paragraph 47, where he alleged, wrongly he acknowledged, that Mr Rollason, one of the defendants in this case, was focusing attention on the rights issue too much to the detriment of other options; paragraph 60 where he complained about the slow progress and said that was the fault of the defendants, an allegation which he acknowledged he could not justify; paragraph 138 where he repeated what he said in an email.

62. In paragraph 138 he said this:

63. "The bank was certainly not averse to finding a solvent solution in early September 2006 and throughout. However, while the bank's message had been consistent from the very initial involvement of high risk, ie that we could not provide any

additional funding to EHR, there was a feeling that this was not taken seriously until very late in the process. As I raised in my email to Mr Angus ...*(His boss)** *on 5 September 'I wish that our stance had been taken more seriously earlier'. It would appear that company's advisors have all assumed that we would fund this gap regardless of the economic impact it would have on us and despite our constant message that we would not fund the excess. They could have fixed this problem long ago and not taken us to the brink of 1 September."

64. In fairness to the Secretary of State that comment in his email does suggest a contemporaneous criticism of the defendants in moving too slowly, one of the Secretary of State's allegations. However, it fell apart in cross-examination to such an extent that at one stage Mr Kelly told the court that he was going to withdraw that statement before it had even been reached and he withdrew it and he apologised and he said that there was no justification for that paragraph whatsoever and he said, in effect, it was an expression of anger and frustration at the

slowness of the process which he was undoubtedly frustrated about -- I pause to interject, no more than the directors would have been -- but that he lashed out against the directors unfairly.

65. Now, that was found out as a result of cross-examination and I wonder how it was not found out before, when the affidavit came to be prepared.

66. This was very damaging and it is surprising that he did not have drawn to his attention an email that he had sent at the time of the collapse. We find that reference in the transcript, Day 13, at page 230. This was an email which he sent to Mr Rollason on 9 October, the day HBOS rejected the final Park II proposal and finished the companies off as regards solvency. This email he sent to Mr Rollason:

67. "We have all spent the best part of six months looking for solutions. We have exhausted all of the obvious routes. You have done all what you could to knit together a support package with Family, shareholders, IWOOT (One of the subsidiaries) and Park Group. It simply hasn't delivered a workable plan the bank has been able

to buy in to. I have asked you whether there was any more money. Concluded there was no likelihood of a solvent solution."

68. That is not a criticism of the directors. It shows that the directors had tried their best to save the group solvently. I asked him whether that accurately summarised his view of the directors' conduct in the six months and he said:

    i. "**Answer**: Yes, I think that's very fair, my Lord."

69. I am surprised that paragraph 138 went into the affidavit and that email was apparently not drawn to his attention when he prepared the affidavit; in fact I suspect he saw it for the first time to consider when it was presented to him for cross-examination. It shows the problems that the evidence posed.

70. As I say, I am referring to Mr Kelly as an example and because as he was the last witness he is the one that is most fresh in my mind.

71. This is clearly unfair to the defendants, because the wrong case is being presented against them. It is of course equally unfair to Mr Kelly. Mr Kelly came here to give evidence as to facts.

It is hardly surprising that the detailed recollection of events six years ago is not complete, but we all know in litigation that the first port of call in any case is the contemporaneous documents: see what people said when they were not writing for posterity, ie a trial, and see whether what they say now can be consistent with what they said then, and if it is inconsistent then find out why they say something different now to what they said at the time. This is an essential part of preparing evidence and Mr Kelly and the other witnesses were clearly unprepared for the ordeal -- and it is an ordeal. Nobody knows what an ordeal giving evidence is in cases like this until they go into the witness box and endure it. It is a hard, unyielding process and can be oppressive and unfair. We try and guard against that but at the end of the day the defendants have to put their case to the people who are put up for witnesses. It is not their fault if the witness evidence is not sustainable when matched with the contemporaneous documents.

5.0 REASONS FOR FAILURE OF THE CASE

72. It failed because the witnesses who were called, who were witnesses to the events, ultimately all to a man said that they had no criticisms whatsoever of the defendants' conduct in the relevant period.

73. The way the affidavits were put together, as the cross-examination shows, caused, as I have said, possible unfairnesses and oppression, both to the witnesses and the defendants.

74. Giving secondary evidence by way of appendices to a statement or affidavit prepared by a member of the insolvency team is unhelpful and the Secretary of State, when cases are contested, should generally in my view make sure that all people who provide statements which one way or the other are found in the main statement or affidavit, should be made available for cross-examination by defendants. Generally in other cases, see for example my decision in ***Lennox Lewis v Eliades***, when a deponent or hearsay statement is put forward but there is no reason provided as to why that person cannot give evidence, the inference usually drawn is that that

person is not called because he will not support the case that is being put forward. This is something that ought to be considered in the Secretary of State's procedures.

75. It might lengthen cases as regards preparation, but for every hour spent on preparation it has huge saving times in the trial and, of course, if positive first-hand evidence is provided the defendants will know what they have to meet and it might well lead them to conclude that they cannot contest it and it might well lead to more consensual resolution of these cases. However it is important that cases have to be prepared not on the basis that it is assumed they will capitulate but on the basis that they might fight, and if they are going to be prepared on that basis they must be properly prepared: (a) so that the accumulation of documents is not oppressive, (b) so that the witnesses are given a fair opportunity to present their evidence properly according to the contemporaneous documents; and(c) the defendants are given a fair opportunity to contest the allegations made against them by witnesses.

76. The result was that by the close of the Secretary of State's evidence all of the main players who have been called in effect did not support the Secretary of State's contention that the defendants had done anything wrong. Given that, at the conclusion of Mr Kelly's evidence I told the Secretary of State, as I have said, that I wanted to see how the case was being put and, as we know, the Secretary of State discontinued.

6.0 WHAT ACTUALLY HAPPENED

77. I think that the depositors, who felt that they would understand what happened in this case, should understand what in my view actually happened. I do not think it is actually very difficult. I say that, of course, with the advantage of hindsight. It is always very easy to read a large chain of documents and see where the mistakes happened after the event; not so easy when you are doing them. I of course also have the benefit of the evidence of everybody at the time it was available and I had the benefit of a large array of lawyers to present me with

cross-examination of witnesses and, as regards the Secretary of State, to present the case in a detailed and accurate way. The Secretary of State acknowledged the burden very early on of his case.

78. What happened was that Farepak had traded in this business since the 1930s. These schemes started very much like Christmas Clubs were people banded together, saved over the year and then spent their money.

79. As time went on Farepak changed to a business model which was to use the money not to buy the vouchers but to run its business generally and it would then pay out for the vouchers when they were cashed in at Christmas out of its funding facilities with HBOS. The only person to criticise that is Mr Johnson of Park.

80. Farepak in addition had the benefit of a very favourable trading relationship with the company that provided its vouchers, Choice, because Choice did not require Farepak to pay for the vouchers until the vouchers were redeemed at the stores and the stores passed the vouchers on for redemption by Choice. This gave Farepak a huge cashflow

advantage because they collected the money in over the year and, as I have said, actually spent it on other things, but their obligation to pay did not arise until late December/early January of that year. That gave them free use of the deposits.

81. In November/December 2005 it was perceived by the former finance director, Mr Hulland, that EHR, the group, would have a deficiency of £5 million when it came to pay Choice at the end of January. He left the company on 31 December and Mr Fowler succeeded him as financial director and I think he arrived on 9 January. It must have been a very difficult time for Mr Fowler to arrive in the company and be faced almost immediately with the fact that it looked like they were going to be £5 million short.

82. There was a further complicationing factor and that was that the group had renegotiated its facility with HBOS in December -- I think the documents were actually signed on 31 December. That had a facility of £40 million. Nobody told the bank in December that it looked like £40 million was not going to be enough.

83. It is a matter of speculation as to what might

have happened if the bank had been told to lend the group £45 million as opposed to £40 million temporarily. Be that as it may, that was something that happened.

84. On 20 January Mr Rollason and Mr Fowler had a meeting with Mr Griffiths, the relationship manager, to ask for the £5 million to be able to fund the payment to Choice entirely. Having seen Mr Griffiths, I would have concluded that he gave the strong impression that the £5 million would not be a problem. However, this regularly happens with relationship managers who get too close to the customers and his strong impression is not sufficient. It turned out he was wrong. Ten days later, on the very day that payment came for issue, he was overturned by his boss, Mr Winton. The meeting to schedule the request for the 5 million was then rescheduled for 1 February. Of course that was the day after the payment was due.

85. The result was that the payment to Choice was £5 million short. Choice went into administration on the same day. That was the end of the favourable terms for the voucher system.

86. It is possible, but it is not possible to say

with certainty now, that had the payment to Choice been made it might not have gone into administration. I am aware of the fact that Choice also have another default I think of £7 million from another supplier, so it might well have been that Choice would have gone into administration in any event.

87. Not only did that mean that the supply of vouchers on favourable terms finished. It also meant that technically, for one day, EHR failed to pay its debts as and when they were due. In the events actually, over the next two or three months the group negotiated with Choice's administrators and paid the £5 million in full without needing I think more than 1 million temporary borrowing from the bank. In addition, large numbers of the retailers such as Argos and the like, who had accepted payment for goods by use of the vouchers, were left high and dry by the administration of Choice because Choice did not pay.

88. EHR, recognising the damaging effect it would have on its business if these retailers were left high and dry, came to an accommodation with all necessary retailers and they were all satisfied.

This was done over a period of several months, so the net result was that come April there was no real loss.

89. However, there were two problems that were immediately apparent to the board. The first was that the group was likely to exceed the £40 million facility when a new payment spike occurred within the next 12 months to pay for the next season's vouchers. The cashflow projections showed that that excess might be as much as £17 million, which led to Mr Kelly writing a very strong letter to the directors in April, a letter which he apologised for in giving evidence.

90. The second difficulty was the fact that with Choice out of the market, the group were going to have to find another supplier. All other suppliers of vouchers in the industry at that time required payment up front and it is obvious: why should they transfer the risk of default to them as opposed to EHR? This therefore had a large impact on the group's cashflow projections because it meant that the monies would have to be paid out a lot earlier; for example in the events it looked like they were going to have to make the payments

out in October rather than in the following year.

91. They approached the bank to discuss the problem and ultimately Mr Kelly was brought in. As I have said, he is from the High Risk Department.

92. By that time, that is to say April, the internal documentation of HBOS showed that they believed that there was a high risk of insolvency; that is why the conduct was transferred in effect to Mr Kelly.

93. Mr Kelly, when he came in, shared this view, but he did not, of course, tell the defendants. It was left to Mr Kelly to say, "They must have known we thought that because I am from the high risk department." That to my mind was one of the many non sequiturs that appeared in Mr Kelly's evidence.

94. It was made clear right from the outset by Mr Kelly that HBOS would provide no more money. They, of course, in view of their belief that there was a potential insolvency, had their solicitors, at EHR's expense of course in accordance with the terms of their security, verified that they were fully covered with their

securities. That was just dotting the Is and crossing the Tsin case insolvency ensued. An examination of the finances showed that at that time they were fully covered. This in my view coloured the approach of HBOS and basically they were going to sit there -- and I can use, for the benefit of Mr Kelly, a Glaswegian expression -- like stookies, doing nothing which involves any reduction of their recoveries.

95. HBOS is perfectly entitled to do that. It is not a charity, it runs for business. This reflects the bank's attitude. The bank was regarded as being very aggressively and Mr Kelly was almost proud of the tough stance that they took. The internal emails that passed between him, Mr Angus, Mr McMillan and ultimately Mr Cummings demonstrated the hardball approach that HBOS applied to this problem.

96. The final point that was clear was that HBOS would give the directors time to achieve a solvent solution. That time would run out in October. As Mr Kelly said in his internal emails when reporting to, or conversing with Mr Angus, then Armageddon would arrive.

97. So that was the position in April. The directors were faced with two options: either attempt a solvent solution; if that was not feasible then they would have to call an immediate insolvency.

98. All people involved in the attempt in the next six months were clearly aware that those attempts would only work if there was a fully trading entity operating during that period. If the deposits were cut off it was acknowledged that everybody knew that the whole group would collapse because it could not service the overdraft and that would mean that the financial support provided by the deposits to the other companies would collapse and that would be the end fairly rapidly.

99. It followed, therefore, that all parties were well aware that the solvent solution required, as I say, a continued collection of the deposits and a risk that if a solvent solution was not solved, deposits received subsequent to the decision to seek the solvent solution would likely be lost.

100. As I have said earlier in this statement, that would have happened earlier and would have with

all probability changed the identity of the particular losing depositors and other creditors, but leaving the bank still top of the table with 100 per cent recovery.

101. The directors were therefore faced with a difficult decision: whether or not to try a solvent solution. Of course had their attempts been successful, any solution would have saved all the deposits.

102. Everyone who gave evidence before me was willing to go along in various ways to assist a solvent solution and no one during this period ever said it was wrong to seek a solvent solution. When the Directors had insolvency advice from their solicitors, their solicitors did not advise that they needed to put the Group into insolvency.

103. The Secretary of State himself did not say that decision to seek a solvent solution as opposed to immediate insolvency was a wrong decision. That inevitably involved a possible loss to the depositors but there was no choice if that decision was made

104. Between April and October 2006 various attempts were made to provide a solvent solution.

First there was a rights issue attempt between April and early July which failed ultimately, much to the surprise of the promoters, ABN, that was quite clear.

105. Simultaneously ABN internally were retained to try and find a mezzanine finance solution. It is fair that they were handicapped in that initially, but the reason was not delay or indifference on the part of the directors, but the very understandable reason that it would affect the rights issue if it became known publicly that it was seeking mezzanine finance. That might suggest that there were difficulties about the financial Group. Mr Farrow accepted that he was frustrated about that, but said he clearly understood why the directors made that decision and he did not criticise it.

106. He himself went to ABN in Amsterdam as late as I think 13 June to seek finance within ABN and he came back the next day and he was somewhat surprised at the brush off he got in Amsterdam.

107. He then embarked on a series of attempts to find finance elsewhere and he advised the directors that they would target one in preference

to all the others and that was Goldman Sachs. Goldman Sachs' term sheet was particularly attractive because it suggested that Goldman Sachs would provide £20 million over a period of 18 months, but did not require HBOS either to dilute its debt or give up any priority, although it hinted that it would want to negotiate a bit about the sales of some parts of the businesses in the future.

108. Following that term sheet Goldman Sachs then went to due diligence. That cost the Group nigh on £200,000 because Goldman Sachs employed KPMG to do the due diligence and they charged £135,000 and, not to be outdone, the lawyers, I think, weighed in at £70,000 to draw up the documentation.

109. It all fell apart at the very last minute because Goldman Sachs, without warning, changed their offer and required HBOS to subordinate in some way, which HBOS was not prepared to do as everyone knew and appreciated.

110. A similar attempt with Numis failed fairly quickly and after that attempts were made to restructure the company and bring in Park in

late August, Park I, and then Park II which came in early September. That failed ultimately because it required HBOS to defer £5 million out of the sale of a subsidiary in February 2007 to release that as working caoital, which HBOS was not prepared to do.

111. By the end of August, at the time of Park II, the position was clearly critical. The directors were under pressure. They knew there were great difficulties; five months down the road, still no solution.

112. Further HBOS privately formed the view at that time that insolvency was not only inevitable but it was a strongly preferred view, according to Mr Kelly. They were preparing pre-packs so that they would then maximise their return as quickly as possible.

113. The directors, as I say, were worried about the deposits at that stage and, as I have already said, asked the bank to stop the deposit process, which the bank refused twice.

114. The bank took six weeks to consider Park II, which seems a long time.Mr Johnson became so concerned he wrote to the Chairman of HBOS to urge

a decision pointing out that the collapse would affect alarge number of depositors who could ill afford the loss just before Christmas. He received merely an acknowledgement . Whe he repeated this in face to face meetings his evidence was that ***HBOS would take the money and run for the hills***. (T8.45). Well they did the former; I am unsure about the latter.

115. During that period, towards the end, they revived their pre-pack with Findel and ultimately that pre-pack went into place with the rejection of the proposal of Park II on 9 October. Thus it follows that the unchanging attitude of the bank not to give anything during this period was the reason why the companies failed.

116. The bank had, as I have said, almost a pride in their strong attitude, but they went beyond that of course because they in effect forced the directors to carry on in September/October collecting deposits, that at a time when they believed there would be an insolvent solution; they had missed it in August, but they expected it to happen later. During that period, as I have said, their exposure was reduced by £4 million, of

deposits that came in in that period, and £6 million was used to carry on trading the companies, which were then sold in the pre-pack and secured a maximum return for HBOS.

117. HBOS knew that those deposits would be paid and would be lost if their expected solution went out and that the only beneficiary of those deposits would be HBOS.

118. It is striking that during the whole of the period it appears, in rough and ready terms, that further investment from the bank of between £3 to £5 million would have probably saved the Group, but the HBOS was not prepared to make it. It of course was perfectly entitled to do what it did and to continue to require the company to collect deposits, knowing full well that those depositors would not get their money back if the companies went into insolvency and knowing full well that those deposits would have benefited the bank alone.

119. This is of course in my view completely contrary to the way in which these defendants conducted themselves. They did everything, as far as I can see, possible to save the group. As

I have said, that involved at one stage the Johnson family agreeing that their shareholding could be reduced to a value of a pound in one proposal, and Mr Kelly's evidence, as set out in his email, to which I have made reference, was reflected by all of the evidence given by the people to came to give evidence on behalf of the Secretary of State who participated at the time.

120. It is a tragedy that the depositors have lost their money. That is why it happened. As I have shown, HBOS, in accordance with its contractual entitlement, collected in £10 million for its benefit.

121. When the companies went into insolvency, a distress fund was set up for the benefit of the depositors. HBOS made a £2 million contribution to that payment. As Mr Kelly said, that was an executive decision made at the highest level without reference to him. I think that means that he probably wouldn't have agreed it if he had been asked.

122. This is not a court of morality, but I would suggest that HBOS really ought to look at the collections that they took in September

and October and seriously consider whether or not they ought to make a further substantial payment to the compensation fund. It seems to me that what happened there, whilst apparently legally acceptable, might not be regarded in the public's eyes as being acceptable. I cannot force them, it is entirely a matter for them.

123. Equally, the evidence of Mr Kelly showed that the administrators currently hold around £2 million. HBOS has been incurring costs in dealing with this case. Mr Kelly said I think they were about £1 million. At present they haven't done it, but they have a right to say that the costs that they have incurred are part of their security expenses and they are therefore entitled to add the costs of this exercise to part of their security, and if they do that they will then take a further £1 million away from the unsecured creditors.

124. It is ironic that if the bank's reputation for playing hardball had been repeated by the government two years later, HBOS would not be here and that is something else that HBOS might like to think about.

125. I am therefore clear in my mind this is what went wrong. What is missing from that story is any justified complaint against these defendants.

126. Now, this might come as a surprise to the depositors, it might come as a surprise when they are told, as appears from the newspapers, that the Secretary of State's case has collapsed because of new evidence. That is not true. There has been no new evidence produced which has led to the collapse of this case. What has happened is that the witnesses, properly tested on their affidavits, revealed what they actually felt, namely that they had no complaints about the defendants.

127. I do urge the depositors to listen to what I have said and if they do not accept it they can read the transcripts and the evidence, but in my view the Secretary of State had reached the stage, on perhaps an appropriate day when we remember what happened on 18 June in a different time, that he had to call time. It would have been very difficult, almost impossible in my view, for the Secretary of State to carry on.

128. As I said at the start, it is not usual to

make a statement, but I felt strongly in this case that all the depositors would have been left with a sense of being cheated again if they did not understand why the case has collapsed against the people who have been pursued for the last five years as being the evil people who caused their losses. That is all I propose to say.

(11.45 am)