
2. 1984 - 1988: THE RESTORATION OF MGN TO PROFITABILITY

2.1 One year after RM's acquisition of MGN, steps were commenced to return MGN to profitability and by 1988, the major changes necessary to achieve this had taken place. During this period, RM as its proprietor transferred from MGN all its non-newspaper assets for use in his other businesses and began to use any surplus cash generated by MGN for the same purpose. However, from 1985, he also started to use the funds of the pension scheme in the furtherance of his other business interests. It is easiest to consider in this chapter what happened during this period under the following five headings:

- (1) RM's control over
 - (a) The management of MGN
 - (b) SDR
- (2) RM's control over the finances of MGN
- (3) RM's use of MGN in connection with his other interests: the intercompany debt
- (4) RM's control over the pension funds
- (5) Steps taken to return MGN to profitability

A list of the directors of MGN and of some other of RM's companies is set out in Appendix 3.

(1) RM's control over the management

(a) MGN

2.2 During the period in which MGN was wholly owned by RM's private companies, MGN had numerous directors, but the board as such never met to run the company^a; board meetings (generally of two directors) were held only for formal purposes, such as approving bank mandates, authorising dividends and making transfers of assets. Notice of such meetings was never given to the directors and minutes were never circulated. This was not unusual for some privately owned companies.

2.3 The fact that no notice was given of board meetings and no minutes circulated coincided with a change in the company secretary. On PPL's acquisition of MGN the company secretary had been Mr Hudgell. RM told Mr Hudgell shortly after the take over that he, Mr Hudgell, did not understand RM's ways. Accordingly on 13 September 1984, RM replaced him with Mr Alan Stephens who, as RM explained to Mr Hudgell, understood his management style. Mr Stephens was the secretary to RM's other private companies and understood that RM did not see any point

^a There is a minute that records a meeting on 6 March 1985 to pass concurrent powers of the board to a committee of four; its quorum was two, one of whom had to be RM. We were told this meeting lasted for five minutes. There was a minuted meeting on 23 July 1985 which initiated the bringing of proceedings against *Private Eye* but we were told that this was probably a discussion over one of the regular Tuesday lunches (see paragraph 2.7).

There is also a minute which records a meeting that took place in RM's sitting room in his flat at Maxwell House on 26 May 1989 (this is described at paragraph 4.30).

- in formal board meetings for his private companies and RM did not want notice given or minutes circulated^a.
- 2.4 When operating companies were established within MGN in the circumstances described at paragraph 2.49, again their boards never met other than for a formal purpose.
- 2.5 Although RM effectively dominated the management of MGN^b during the whole period of its private ownership and its board never met to run the company, there was a change in the way the management of the company was conducted between 1985 and 1988.
- 2.6 At first there had been a period of crisis management during which little was done to return MGN to profitability; RM was attracted by his personal involvement in the running of the newspapers and decisions were taken on an ad-hoc basis, generally at meetings between RM and 2 to 3 other people.
- 2.7 In October 1985, Mr Patrick Morrissey was appointed Senior Deputy Managing Director. His appointment coincided with the commencement of substantial reforms to labour practices and with the replanting of the printing business (described in paragraph 2.49). Mr Morrissey attempted to impose a management structure on MGN but did not mind that there were no board meetings as he considered RM to be a disruptive influence and found that better progress could be made without RM's presence at the meetings of the operational management because of the way RM behaved. Mr Morrissey also held meetings with the editorial staff each week. However despite this imposition of a management structure, RM continued to take important decisions himself convening meetings early in the mornings for this purpose and having so called "editorial lunches" each Tuesday, which the editors and the senior operational management were required to attend; he would often set management against the editorial staff at these lunches or pick on someone to bully. Indeed it was as a result of RM's bullying and humiliation of a colleague that one of MGN's directors, Sir Tom McCaffrey^c, resigned^d.
- (b) SDR**
- 2.8 Under the ownership of Reed, SDR had had its own board of directors (which reported generally to MGN in London), its own Chairman, Mr Webster, and its own Chief Executive, Mr Horwood.

^a We were told by Mr Hudgell that Mr Stephens explained to him his understanding of RM's style; "If the old man tells you to do something, you do it". Mr Stephens denied that he made such a remark. What Mr Hudgell described to us was precisely the way in which the company secretary of one of RM's companies had described his function to the Inspectors in 1971 as recorded at paragraph 256 of the 1971 Report; "To carry out Mr Maxwell's orders to the letter and to do nothing more".

^b KM told us that RM always required reports and paper work to exercise control; he would always demand paper, but whether he actually read what he demanded was another matter.

^c He was appointed by RM as director of public affairs in October 1984 and he resigned on 15 November 1985.

^d We were told by IM he did not regard the manner in which RM treated the executive directors as being bullying. The meetings involved robust debate and a reasonable amount of give and take on all sides; RM was immensely inspirational and tough which was what was required to compete with Mr Rupert Murdoch's News Group Newspapers Limited.

It also had one outside non-executive director, Sir Alwyn Williams^a. The acquisition of MGN by RM had less impact on SDR than the impact on MGN in London. However the bank mandates were changed, Mr Horwood was relieved of his title of Chief Executive and made Managing Director and limits of authority on expenditure were imposed.

2.9 Although RM became a director of SDR on 17 September 1984 and Chairman on Mr Webster's retirement on 20 January 1986, the company continued to be managed by its board through regular monthly meetings, with agendas and papers being sent out beforehand and full minutes being taken. RM attended his first board meeting of SDR in Scotland in January 1986 and attended two further board meetings in Scotland that year. When Scottish Daily Record & Sunday Mail (1986) Limited became the operating company it was managed by its board in the same way that SDR had been managed; RM attended only one meeting a year and this took place in London. Those meetings which RM attended were modelled on the same lines as the monthly board meetings that took place in his absence, but discussion was substantially monopolised by RM and the operational directors did not question each other or discuss matters in the same way as they did when RM was not present.

(2) RM's control over the finances of MGN

2.10 Throughout the entire period of RM's control of MGN, there were two distinct departments that dealt with the finances of MGN, each with a separate location (see Plan 1).

- The finance department of MGN. This was located at Orbit House and was headed by Mr Lawrence Guest^b who had been finance director of MGN since 1977. This department dealt with the operational activities of MGN.
- The central treasury. This was located at Maxwell House from 1987. When RM had acquired MCC it had had a treasury under the control of Mr Richard Baker^c, who in 1982 became finance director of MCC and one of RM's closest financial advisers. From 1984 the MCC treasury department became the treasury for all of RM's other companies. Thus when RM acquired MGN in 1984, the central treasury took on the role of a treasury department for MGN, dealing with all of MGN's relationships with banks and controlling the main non-newspaper assets of MGN, other than property.

2.11 This division of function meant that although the finance department of MGN collated together each day information on its bank balances and made cash transfers between SDR and MGN, its

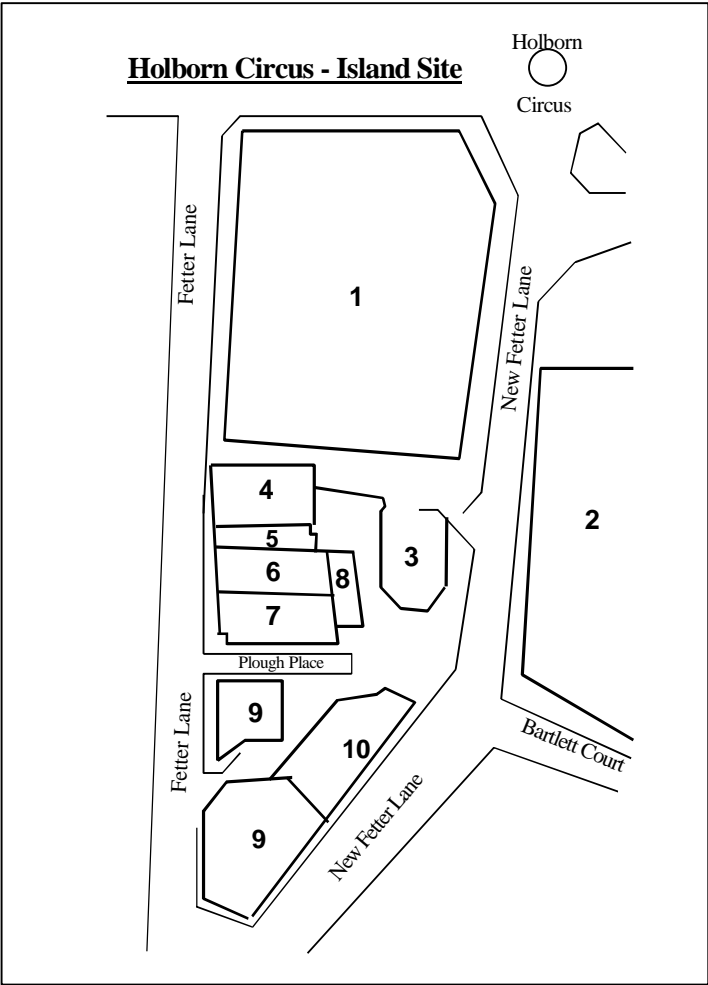
^a He had become a non-executive director prior to RM's take over; he had taken his duties seriously, reading books on the duties of non-executive directors and after RM's take over, reading the 1971/73 DTI Reports on PPL; he ceased to be a director in 1990 and was replaced by Sir Kenneth Alexander.

^b He is a chartered accountant and worked in the publishing and newspaper industry from 1962. Mr Guest's office was in the Mirror Building.

^c Mr Baker had been at the treasury of MCC since 1970; he was considered by many a very influential adviser of RM and an original thinker. He played a central role in many decisions until November 1990. The circumstances of his resignation are set out in the footnote to paragraph 9.10.

treasury function was limited to the issuing of low value cheques and obtaining RM's signature to high value cheques^a. All other transfer of funds were carried out by the central treasury.

^a The way in which RM exercised control over cheques is considered at paragraph 2.49.



Key to Plan 1

33 Holborn Circus
2: Orbit House

Plan 1 – Holborn site

- 2.12 Consequently, it was the central treasury that controlled the major movements of cash from MGN's bank accounts to other companies owned or controlled by RM and to third parties. Not only did the central treasury report to RM, but RM himself played a significant role in its operations. He received daily cash reports and decided on the priorities for the use of that cash within all the companies he controlled. He initiated various substantial payments by direct instructions to the central treasury and in many such cases, particularly where the transfers were to or from companies under his ownership or control, no documentation would be provided to the MGN finance department to enable it to record properly the purpose for which the money had been expended or received. During the audits of MGN by Coopers & Lybrand Deloitte (CLD)^a, this information had to be obtained from the central treasury.
- 2.13 Apart from this direct control over the central treasury, RM's financial power in all his companies (including MCC) was exemplified by the fact that he had sole signatory authority for an unlimited amount in respect of all the companies' bank accounts. He had had this in some of his companies in 1971 and it had been granted by the board of MCC^b, a listed company, in 1981 and introduced into MGN the day he took control as already explained at paragraph 1.21.

^a The circumstances of their appointment are considered at paragraph 4.12; we refer to Coopers & Lybrand, Coopers & Lybrand Deloitte and their predecessor and successor firms as CLD.

^b They had been surprised at the request, but had agreed.

2.14 After one incident where funds were misappropriated from MGN by an employee in 1988, RM endeavoured to make sure that his staff and the auditors were vigilant to discover fraud; his concern was summarised in a paragraph by Mr Steere, the CLD audit partner at that time, in December 1990 in instructions to his audit staff:

"The proprietor of Mirror Group plc is very sensitive to risk of loss through fraud. Once again we ask that audit staff be aware of the possibility of fraud and that any suspicious transactions are investigated by an appropriate level of [CLD] staff."

(3) RM's use of MGN in connection with his other interests: the intercompany debt

2.15 Following RM's acquisition of MGN in July 1984 it had, apart from its newspapers, a number of significant assets including approximately £37m in cash, a significant shareholding in Reuters Holdings plc (Reuters), and a long lease of the Mirror Building and interests in some other properties. In addition, MGN was a company with a strong cash flow.

2.16 From 1985 an intercompany account was used for the transfer of surplus cash and the non-newspaper assets from MGN to RM's other private companies; the intercompany account had two parts: a trading account and a "hard core account". In the case of almost every transfer of assets, no payment was made by the other private companies that received them, but the amount was charged to the hard core part of the intercompany account. It was never intended that this part of the intercompany account be repaid since it was regarded as a more efficient means of distributing assets and cash from MGN than by way of dividends.

2.17 To illustrate what happened, it is convenient to refer to the three main transfers:

- The £37m which MGN had in cash on RM's acquisition consisted of £23.3m from the intergroup debt that Reed had repaid to MGN^a, £11.4m from monies paid as a result of realisation of part of the investment in Reuters (which had occurred whilst MGN was owned by Reed) and other surplus cash. On 11 September 1984 in order to transfer this cash into PPL and to repay to National Westminster its loan to PPL referred to in paragraph 1.20, 20 million shares in MCC were transferred from PPL for £37.6m. The purchase of these shares was made by MGN's subsidiary, MGH Properties Limited. These MCC shares were subsequently sold on 29 December 1987 to another of RM's private companies, Pergamon Group plc (PG) for £48m; this amount was not paid but charged to the intercompany account. The ownership of MGH Properties Limited was subsequently transferred to what became one of RM's main private side companies, Mirror Group plc (subsequently renamed Robert Maxwell Group plc (RMG)^b) and the amount due to MGN remained outstanding.

^a This was a term of the purchase agreement - see paragraph 1.20.

^b It is convenient to refer to this company throughout as RMG.

- On 31 October 1985 the long lease of the Mirror Building was transferred to PPL for £10.9m (its net book value)^a. This sum was never paid but charged to the intercompany account.
- The shareholding in Reuters comprised "A" and "B" shares. The Reuters B shares were, subject to an orderly marketing agreement^b, freely transferable. Between December 1985 and June 1986 the Reuters B shares were sold for a total consideration of £54m^c, and from the proceeds cash transfers were made to Pergamon Holdings Limited (PHL)^d.

2.18 MGN's cash flow was used to fund ventures such as the publication of the *London Daily News*^e and the launch of *Mirror Colour Magazines* as well as satellite TV, software and other media interests. It was also used by RM for other deals and to acquire other investments in the stock market.

^a Although MGN continued to occupy it under an informal arrangement, it was leased by PPL to MCC in 1987 in connection with the financing referred to at paragraph 2.34. The informal arrangement continued with MGN's rent for its occupation being determined on a market basis.

^b The majority of the sales were made in breach of the orderly marketing agreement and the sale in June 1986 was made during the closed period when RM should not have sold as he was a director of Reuters. When this sale was investigated by Reuters, despite the fact that RM attempted to blame Mr Baker, he was censured by the board of Reuters. However no further action was taken, though the apology RM made was reported in the press.

^c The "B" shares were received by MGN and SDR at the time of the reorganisation and flotation of Reuters in 1984. They were not ascribed any value in the books of those companies. The interests of MGN and SDR in The Newspaper Publishers Association Limited and The Press Association, through which they were entitled to the "B" shares were held at a book value in MGN of £8,888 and at a book value in SDR of £1.

^d The reasons for this company's formation are described at paragraph 3.7. This company was renamed in 1991 Headington Holdings Limited.

^e Approximately £29.6m was used to fund the *London Daily News*.

2.19 The following table represents the major uses made of the assets and cash flow in the period to 1988, together with interest charged:

	Amounts transferred (£m)			Discharged by dividends (£m) ^a	Total left outstanding on the intercompany account (£m)	
	Assets	Cash	Interest		Per year	Cumulative ^b
1984	0	35 ^c	0	0	35	35
1985	11 ^d	26	6	(11)	32	67
1986	11 ^e	78	6	(15)	80	147
1987	(2) ^f	26	18	(9)	33	180
1988	15 ^g	1	23	(16)	23	203
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Total	35	166	53	(51)	203	
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Table 1 – Use of assets and cash flows 1984 to 1988

(4) RM's control over the pension funds

2.20 Until the contemplated flotation of MGN by Reed, the pension arrangements of MGN employees were within the Reed Publishing Pension Scheme. As part of the preparations for that flotation, a separate pension scheme, Mirror Group Pension Scheme (MGPS), was created for employees of MGN with a trustee company, Mirror Group Pension Trustees Limited (MGPT).

2.21 After the acquisition of MGN by PPL, RM attended a board meeting of the trustee company on 1 August 1984 and said he ought to be Chairman; he was therefore appointed a director and Chairman of MGPT. His attitude to the pension scheme is exemplified by an incident that we were told took place shortly after, when RM attended a meeting with the unions at which the question of pensions was discussed. He referred to the pension scheme as "his" fund and when a protest was made he asked Mr Hudgell to explain who owned the pension trustee company. When

^a In addition to the dividends which were paid by crediting them to the intercompany account with RM's private company that owned the shares in MGN, a dividend of £18m was paid in cash in 1986.

^b The actual cumulative figures stated above are different from the notional dividends shown in the prospectus as described at paragraph 15.29.

^c This is the net amount after a receipt of £2.875m from PPL.

^d This represents the transfer of the Mirror Building.

^e This represents part of the consideration for the sale of Reuters A shares to Funvale - see paragraph 2.39.

^f This was achieved through the use of group tax relief.

^g This represents the sale of the *Sporting Life* titles to Ivenham Limited (formerly Odhams Newspapers Limited).

Mr Hudgell^a explained that the pension trustee company was owned ultimately by PPL as the parent company of MGN, RM said "Exactly. So I own the pension scheme".

- 2.22 The board of MGPT was a board which generally stood up to RM; minutes were taken and circulated (even though often quite late). However, after an actuarial review made in September 1985^b showed that the scheme had a substantial surplus, RM persuaded the trustees^c in December 1985 to agree that enhanced benefits on pensions be part of the package enabling the survival plan for MGN (described at paragraph 2.49) to be put through. The trustees were independently advised by leading counsel that they had the power to do this and that it was proper to exercise that power in the way contemplated. RM also persuaded the trustees in July 1986 that MGPS should bear its administration expenses^d, which had previously been borne by MGN^e.
- 2.23 The administration of MGPS was carried out in conjunction with the administration of the schemes of other companies controlled by RM. Much of the work was concerned with the calculation and payment of benefits. Mr Cook, a qualified pensions administrator, was in charge of the administration^f; he had no accounting or investment training and was not responsible for investment decisions in his capacity as an administrator.
- 2.24 What is significant, even from this period, is the way the investments of the pension scheme were made and how little was disclosed about this in the accounts.
- 2.25 It is important to recall that at the time "self-investment" was a normal part of a pension fund's investment. In 1985, there were no regulations imposing any limit on self-investment; these only came into effect in 1992. However the trustees of pension funds were under fiduciary duties and since November 1986 had a duty to disclose in pension fund accounts self-investment exceeding 5 per cent. of the total value of the net assets (see paragraph 2.40). RM told us that RM believed that the company had the obligation to support the pension fund but, equally, that the pension fund was an asset of the company. Investment in related companies, loans by the pension fund to the company and purchasing buildings occupied by the company were part of the connection which RM believed to exist; the pension fund was a strategic asset of the company and was critical to the

^a He was replaced as Secretary of MGPT by Mr Stephens in September 1985.

^b Bacon & Woodrow, the consulting actuaries to MGPS, advised in September 1985 after an interim review that there was a substantial surplus; they confirmed this in their valuation on 28 April 1986.

^c We refer throughout to the directors of MGPT and the other trustee companies as trustees of the pension schemes as this was their principal function.

^d RM took the view that the surplus in the scheme should be used to benefit MGN and negotiated this as part of a package of other changes.

^e The Report of the Pension Law Review Committee chaired by Professor Sir Roy Goode QC (Cm 2342-1 September 1993) recorded at Paragraph 3.1.33 that "most employers take on responsibility for the costs of administering their scheme".

^f He first became employed by a company controlled by RM in January 1984; he was initially employed by MCC; between 1987 and April 1991 he was employed by PHL. In April 1991 he became an employee of MGN.

view that RM would take of the value of any business. KM considered RM's approach to be normal for the time; what was different was the scale on which RM caused the pension funds to make related party investments.

- 2.26 By the spring of 1985^a external fund managers, including Phillips & Drew Fund Management Limited (Phillips & Drew), Capel Cure Myers Capital Management Limited (CCM) and Montagu Investment Management Limited (MIM), had been appointed to manage most of MGPS's assets. It is necessary to explain a little about MIM, whose Chairman was Lord Stevens of Ludgate and which was at that time owned by Aetna Life & Casualty Company (Aetna).
- 2.27 In June 1984, PPL had acquired a 10.5 per cent. stake in Fleet Holdings plc (Fleet) from the Bell Group. This led to the first business meeting between RM and Lord Stevens, who was also chairman of United Newspapers plc (United Newspapers). In January 1985 RM sold PPL's stake in Fleet to United Newspapers. In September 1985 PPL bought another stake in Fleet^b and in October 1985, United Newspapers were successful in their bid for Fleet. RM and Lord Stevens subsequently became interested in Extel Group plc (Extel) and Britannia Arrow Holdings plc (Britannia Arrow) which had been previously known as Slater, Walker Securities Limited. It is necessary to deal with Britannia Arrow now and more convenient to consider Extel later (see paragraphs 3.12 and 3.14). At the end of 1985 RM acquired a substantial stake in Britannia Arrow. Funds managed by MIM had also acquired a stake in Britannia Arrow. On 27 March 1986, Britannia Arrow announced its agreement to acquire MIM from Aetna. RM's private companies increased their stake to 48.4 million shares or 20.7 per cent. by April 1988. Britannia Arrow subsequently purchased Invesco Capital Management Inc. and changed its name to Invesco MIM plc (Invesco MIM) on 31 January 1990.
- 2.28 Within the investments that were managed by MIM for MGPS, there developed from 1986 what became known as the "special portfolio"; this was a series of holdings that was not traded, in companies such as MCC and United Newspapers connected with RM and Lord Stevens^c. Lord Stevens told us that he did not recall a "special portfolio" but there were stocks such as Britannia Arrow and United Newspapers which were maintained on a separate list because MIM needed to identify these either as MIM had a director on the board or as there might be disclosure issues; the stocks had nothing to do with RM and were traded, but only after a check had been made with the company concerned. KM told us that RM hoped that by acting in these ways in relation to the transactions described in the preceding paragraphs he would be able to obtain institutional support for his own take over bids.
- 2.29 At first all the assets of MGPS (except for property and cash) were managed by these external fund managers, and overseen by an investment committee consisting of RM, Mr Guest, Mr Cook,

^a The transfer of assets from the Reed Publishing Pension Scheme to MGPS did not take place until 21 May 1985.

^b Lord Stevens told us he did not know that PPL had bought a stake in Fleet.

^c Lord Stevens fell out with RM when he would not agree to having Express Newspapers printed by RM's companies on MGN's new plant (see paragraphs 2.49 and 4.26).

Mr Bureau^a and Mr Chapman^b. However, from 1986 some assets began to be managed directly with investment decisions being made by RM^c.

2.30 It is in respect of the directly managed assets, including property and cash, that there were five significant matters.

(a) MCC shares

2.31 During 1985, MGPS acquired shares in MCC through the portfolio managed by MIM and by 5 April 1986 (the end of the accounting period for MGPS) MIM held 890,000 MCC shares; at the same date, the other external managers held 425,000 MCC shares between them. MGPS also started to build up a substantial stake in MCC as part of the assets managed directly. The first purchases were in December 1986, and at 5 April 1987, the holding was 800,000 shares; by 5 April 1988, this number had increased to 3.9 million shares^d. Investment in MCC shares continued throughout the period of RM's control of MGPS^e.

(b) Maxwell House

2.32 The property assets passed by the Reed Publishing Pension Scheme to MGPS were managed by a property department under the direction of Mr Shaw^f. In February 1986 MGPS^g bought Strand House from the WH Smith Group for £17m and costs of £155,557, with funds realised through sales of other property; at the same time it was agreed to grant a 35 year lease to PPL together with an option to buy the property at market value at any time during the currency of the lease for as long as the lease was vested in PPL. As shown on Plan 1 at paragraph 2.10, Strand House was adjacent to the Mirror Building in Holborn and had been suggested to RM as an investment opportunity as it would form a key part of an "island" site for redevelopment in central London. RM told the investment committee of MGPS^h that his companies would take up occupation of part

^a Mr Bureau was an economist who was a consultant to MGN and to certain fund managers.

^b Mr Chapman had been a printers' reader and a union representative who stood up strongly against RM. In 1987 when he was made redundant, he was appointed General Manager of Pensions of PHL, but his function was essentially liaison with employees and pensioners; he had no financial background.

^c His decisions generally had successful results and he gained much "kudos" for having made a recommendation prior to the October 1987 stock market "crash" that the managers liquidate part of their holdings.

^d The value of the combined holding was £3.37m on 5 April 1986 (at a price of 256p per share) and on 5 April 1988 was £9.28m (at a price per share of 238p per share).

^e KM told us that he had grown up with the concept that self investment was not only legally permitted but also a commercial reality due to the close link between the pension fund and the company.

^f This department grew out of the property holdings that were owned by MCC; Mr Shaw was a chartered surveyor who had been a property consultant to MCC. Initially he reported to Lord Silkin of Dulwich QC, (see footnote to paragraph 3.13) but later to RM and KM; the department managed the property interests of companies controlled by RM.

^g We were told that the purchase was agreed between RM and the Chairman of WH Smith Group.

^h See paragraph 2.29.

of the building and that he could interest Goldman Sachs^a in the remainder; the investment committee agreed to its acquisition. At that time, RM had no firm commitment from Goldman Sachs but on 5 August 1986 an agreement was made between PHL and Goldman Sachs that they would take a 5 year lease and they occupied the building at about the same time^b.

2.33 After this agreement with Goldman Sachs, Strand House was sold in November 1986 by MGPS to Pergamon Holdings Limited (PHL) for a gross price of £18 m, or a net price of about £17.8m and thereafter renamed Maxwell House^c. This price was the result of a financial calculation and no independent valuation was obtained, although Mr Shaw gave an informal confirmation of the price. Thereafter, Maxwell House was occupied partly by Goldman Sachs and partly by PHL, and the Mirror Building was sub-leased to MCC by PHL (to whom the long lease had been transferred from MGN as set out in paragraph 2.17).

2.34 On 25 June 1987, a £105m loan was obtained from a syndicate arranged by Goldman Sachs, in which seven other banks participated, secured on the Mirror Building, Maxwell House and other properties including State House, Kingsway, London. Lloyds Bank plc (Lloyds) were appointed as agents to the facility. For the purpose of this loan, Maxwell House (which had been sold by MGPS for £18m in November 1986) was valued by Savills in May 1987 at £36m (and in 1988 valued at £48.5m)^d.

2.35 Although MGPS made a small profit on this transaction, it did not obtain the large profit that should have been obtained; it is an inescapable inference that the pension fund was used to purchase the building for the ultimate benefit of RM's private companies which (we were told) did not have the resources available to pay for it in February 1986. The fact of the purchase and sale was disclosed in the MGPS accounts for the year ended 5 April 1986, but not the option granted on purchase to PPL nor the fact that it was sold to one of RM's private companies^e.

(c) Beecham shares

2.36 It was not until September 1986 that MGPS made its first significant direct equity investment. The circumstances in which this investment was made are significant because this type of transaction occurred many times thereafter.

^a References in this Report to Goldman Sachs include all entities within the Goldman Sachs group save where otherwise stated.

^b An arrangement was also made that PHL would sub-lease two floors from Goldman Sachs.

^c A manuscript note records that the price was agreed by RM on 26 October 1986 in the presence of Mr Cook.

^d The valuation was based in part on a 25 year lease of Maxwell House from PHL to MCC made in 1987 under which MCC was paying £3m a year in rent and in part on the sublease to Goldman Sachs.

^e Questions about this transaction were raised by the Association of Mirror Pensioners in 1991, but RM would not allow the figures to be released to them.

2.37 On the acquisition of the Philip Hill Investment Trust plc by MCC (see paragraph 3.10), one of its substantial holdings that RM was reluctant to dispose of was a holding in Beecham Group plc (Beecham). Mr Baker told us he told RM it was not appropriate for MCC to carry this investment^a and it was therefore decided that the pension funds of companies controlled by RM should acquire the holding of 12.46 million shares for £49.8m; MGPS, with the approval by the investment committee^b, acquired 7.92 million shares for £32.9m^c. It was from the acquisition of this shareholding that there developed a portfolio of equity holdings which were selected by RM and held as directly managed investments of MGPS and not managed by the external fund managers; many of these directly managed assets, as can subsequently be seen, were acquired from companies owned or controlled by RM^d.

(d) Reuters A shares

2.38 A similar transaction involved MGN's holding of Reuters A shares. In view of its significance a more detailed account is set out in Appendix 6, but the following paragraphs contain a summary.

2.39 Unlike the Reuters B shares referred to in paragraph 2.17, Reuters A shares were not freely transferable. However, at the end of 1986 RM's private companies (of which MGN was one) needed cash, and it was considered that a sale of the Reuters A shares would satisfy this requirement. Both because of the restriction on transferability and because RM considered these were a good long term investment, he decided to transfer the shareholding to MGPS, but as title to the shares could not be transferred to MGPS a form of linked bond was devised: the shares were sold to a subsidiary of the pension trustee company, Funvale Limited (Funvale), for £33.5m^e and Funvale received that sum from MGPS in return for a bond that was linked to the value of the

^a Lord Keith of Castleacre, then Chairman of Philip Hill Investment Trust plc and Chairman of Beecham, was concerned to see that this holding (and a large holding in another company) be placed in acceptable hands.

^b See paragraph 2.29.

^c After the purchase by the pension schemes, the following took place:

- The price on the sale to MGPS was 400p per share. No payment was made for the shares; in October 1986 MGPS acquired and paid for £10.2m of Austrian Bonds which it then transferred to MCC; this left a balance of £22m which was charged by MGPS to an intercompany account with MCC.
- On 15 December 1986, the entire holding was sold back to MCC at a price of 416p per share. This transaction was not settled in cash, but offset against the sum owing from the September purchase by MGPS and a debt due to PHL connected with the transfer to the pension funds of an interest in Reuters A shares - see paragraph 2.39.
- On 2 March 1987, MCC sold 2.368 million Beecham shares to MGPS for £13.5m (570p per share). This was settled by a cash payment to MCC.
- On 18 March 1987, MCC sold 1.828 million Beecham shares to MGPS for £9.99m (547p per share). This was settled by cash payments to MCC.

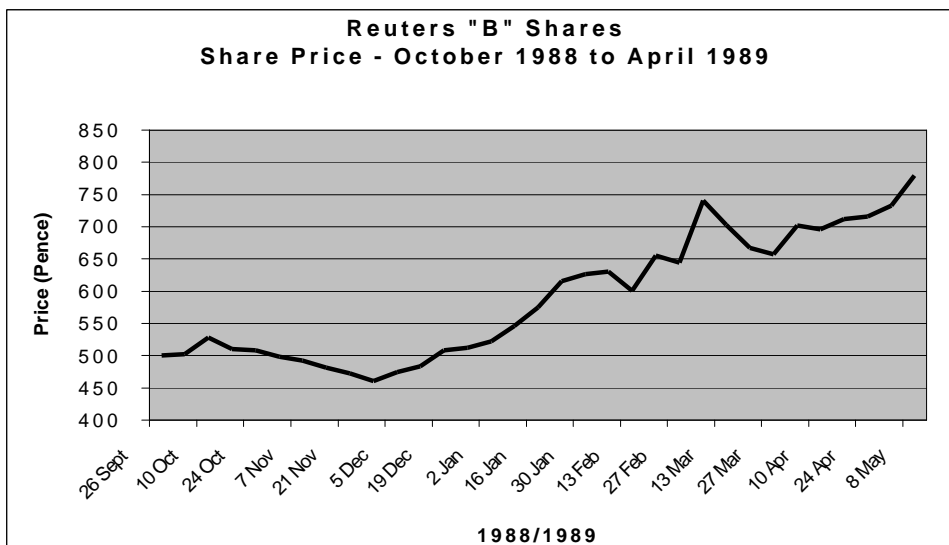
We have been unable to obtain a rational explanation for these further sales and purchases.

^d There was a considerable advantage to RM in transferring profitable long term investments from MGN or his other private companies to MGPS, as he obtained immediately the cash he needed in MGN or for his other private companies, but was able to retain an asset for the benefit of MGN (and himself) in that if the value of the pension scheme appreciated, this could reduce the likelihood of MGN having to make contributions to MGPS.

^e The price was calculated by using the market price of the B shares on 16 December 1986.

Reuters B shares^a. Mr Morgenstern of Nicholson Graham & Jones^b devised this scheme. It was disclosed in the accounts of MGPS for the year ended 5 April 1987 as "Guaranteed Linked Bond-linked to Reuters shares".

2.40 After the coming into force of regulations^c made under Section 56A of the Social Security Pensions Act 1975, added by the Social Security Act 1986, CLD (who were also the auditors to MGPS) became concerned in July 1988 as to whether this linked bond^d should be disclosed in the MGPS accounts as "self-investment". Furthermore, in the autumn of 1988, discussions took place (of which RM was personally aware as a director of Reuters) concerning the plan to convert the A shares to B shares in the Spring of 1989; this was anticipated to be beneficial to the holders of A Shares. In these circumstances a decision was made by RM in March 1989 that the linked bond arrangement would be unscrambled. An agreement was made, signed by Mr Guest on behalf of MGN and by Mr Stephens on behalf of Funvale, under which the Reuters A shares were sold back to MGN for £27.6m. The price was fixed by reference to the market price of the Reuters B shares 21 days prior to the date that the agreement bears (30 December 1988) by an arrangement mirroring a provision of the linked bond. On that date (9 December 1988) the mid-market price of the Reuters B shares was 471p; by 30 December 1988 it had risen to 517p and continued to rise thereafter in January, February and March 1989 to a high point of 741p on 6 March 1989.



Graph 1

^a Instructions were given to the external managers in mid December 1986 to sell equities to raise funds: MIM, CCM and Phillips & Drew each remitted approximately £10m to MGPS prior to 31 December 1986.

^b They had been solicitors to MGN for many years and were appointed solicitors to the trustees of MGPS in April 1985. They also acted as solicitors to RM's private companies in other transactions and on some of the reorganisations of the ownership and structure of the companies.

^c Occupational Pension Schemes (Disclosure of Information) Regulations 1986 (Disclosure Regulations), Schedule 3 paragraph 6. The regulations required the disclosure of all self-investment by a pension fund of more than 5 per cent of the total value of its net assets. They came into force on 1 November 1986 and applied to all accounts for all scheme years commencing on or after 1 November 1986.

^d It had continued to be needed as permission was sought to transfer the shares in 1987, but refused.

- 2.41 The unscrambling of the transaction was effected in order to avoid disclosure of the transactions described above to the pensioners in the accounts of MGPS and in order to ensure that any benefit accrued to RM's private companies rather than MGPS; it resulted in a loss to MGPS of £5.9m over the initial investment and the lost opportunity of benefitting from any increase in the share price.
- 2.42 RM agreed in a letter dated 16 March 1989 that when the Reuters A shares were disposed of by MGN, MGN would remit to MGPS 50 per cent. of any profit made on the resale up to a value of £6m. On 31 March 1989 Reuters issued a circular announcing the conversion of the A shares into B shares, thereby making them freely transferable; the circular pointed out that this would benefit the A shareholders. The A shares, subsequently converted by Reuters into B shares, were (i) transferred by MGN to two of RM's other private companies, RMG and Mirror Group (Holdings) Limited in 1989, at book value and (ii) then transferred on 2 April 1990 to Pergamon Group Services Limited (PGS), another private company, and (iii) subsequently sold on the open market in May 1990 through Goldman Sachs for £60.4m. This last sale produced a profit of £32.8m. Despite the undertaking given by RM on behalf of MGN, no sum was paid to MGPS. No mention of the undertaking or the subsequent sales was made in any report or accounts of MGPS.
- 2.43 This is a significant transaction because:
- The unscrambling did not take place on 30 December 1988^a and the documentation was backdated; this backdating enabled the price to be fixed by reference to the market price in December 1988^b which was substantially below the market price at the actual date of the transaction which we are satisfied took place between 9 and 16 March 1989; that price of £27.6m (together with interest) was paid by MGN to Funvale on 13 March 1989.
On that same day
 - Funvale paid the amount (£28.3m) to the pension funds.
 - £30m was transferred from the pension funds to PHL as explained at paragraph 5.25.
 - PHL paid £24m to MGN and £29m to MCC, having also received £14m from MCC.
 - Apart from RM, Mr Guest and Mr Stephens, the trustees of MGPS were unaware of what had happened, other than the linked bond investment had been sold. The accounts of MGPS for the year ended 5 April 1988 did not disclose the circumstances in which the linked bond had been unscrambled, but merely stated:

"Since the year end the Guaranteed Bond linked to Reuters Shares has been repaid".

Nothing was said in the accounts of MGPS for the year ended 5 April 1989 during which the unscrambling took place.
- What was done was for the benefit of the private companies and to the detriment of MGPS.

^a The transaction was treated in the accounts of MGN as having occurred in December 1988.

^b The linked bond provided for this to be fixed as described at paragraph 2.40.

2.44 KM told us that none of the professional advisers who worked on the Beecham and Reuters A shares transactions advised that the pension funds ought not to be used in such a way; rather, they worked to find a route by which the commercial objective (the generation of profit or cash) could be achieved^a.

(e) Use of cash and CLD's view on this during the 1988 audit.

2.45 Apart from these four significant transactions involving RM's companies, MGPS began from 1985 to lend pension scheme monies on an unsecured basis to MGN and other companies^b. This type of transaction, which became of great significance later, began in 1985 with a short term loan of £20.7m by MGPS through MGN to PPL and MCC to assist in the purchase by MCC of the scientific journals business (described in paragraph 3.6). The document containing a summary of the main points arising on the audit for MGN for the year ended 31 December 1985 for the attention of the partner (CLD called these documents MAPs) stated:

"Pension Fund Loan of £20.706m

This loan was made from the MGN pension trustees and transferred via intercompany loan accounts to PPL (£12m) and [MCC] (£8.706m) in order to fund the purchase of PPL journals business by [MCC]. The loan has subsequently been repaid with interest of £7,000."

Mr Walsh^c, the audit partner, marked this "Noted".

2.46 However during 1986 and 1987 funds^d were lent on a fairly regular basis by MGPS without any form of security being provided to MGPS for the loan of these trust monies. At each year end of MGPS, the balance was reduced to nil. CLD's knowledge of this at that time was as follows:

- The MAPs for the audit of MGN for the year ended 28 December 1986 stated:

"It came to our attention on 25/6/87 that there had been a circular transaction to remove MGN's liability to the pension scheme just before the year end (and hence in the accounts) by replacing it with a liability to PHL; the amount involved was £5.5m. Subsequent to the balance sheet date the process was reversed (29/12/86). The effect in MGN's accounts was to decrease the balance owed by PHL on the intercompany accounts (part of debtors) and decrease the amount owed to other creditors - we understand from Robert Bunn that the reasoning is "political" (i.e. not to show borrowing from the pension scheme) even though the identity of the creditor does not need to be shown and the pension fund receive a proper

^a KM told us that RM's approach to advisers was "You are part of my problem, you are part of my solution". The approach was to solve problems, not to stand back and consider whether what was being done was correct.

^b There was also an arrangement under which funds on deposit at the bank for the pension scheme were notionally aggregated with funds borrowed by other companies controlled by RM from the bank and interest was paid to the bank solely on the net balance. The monies saved by these companies through this arrangement were then paid over to MGPS. This was of benefit to MGPS as it received interest at the rate those companies paid to borrow and there was no mixing of the funds of the pension scheme with the funds of those companies in the bank accounts. This continued until August 1991.

^c Mr Walsh had been a partner in CLD since 1970 and was the senior audit partner for RM's private companies after the retirement of Mr Corsan in 1986 (see paragraph 4.14).

^d For example between 24 September 1986 and 29 October 1986 and between 22 December 1986 and 8 January 1987 over £20m was lent by MGPS to MGN; over the entire period 24 September 1986 to 5 February 1987, the amount lent remained in excess of £10m.

rate of interest. At our request the substance over form has prevailed and the transactions have not been recognised in the accounts (or indeed in group accounts)."

Mr Walsh marked this "good". He told us that this referred to the transaction not being recognised in the accounts.

- The MAPs for the audit of MGN for the year ended 27 December 1987 stated with respect to interest of £992,000:

"MGN "borrows" money from the pension scheme and pays out interest based on the market rates - prescribed by Pergamon. This has been a long standing arrangement."

Mr Steere, the audit partner for MGN that year, marked this:

"This has been agreed".

Mr Steere told us that he understood that there was an agreement between MGPS and MGN to borrow money on an arms-length basis and pay arms-length rates of interest.

- Although a small number of documents on the audit files for MGPS for the years ended 5 April 1986 and 5 April 1987 (the accounting year ends for MGPS) contain references to money being on deposit with MGN, it is uncertain whether the audit team for MGPS were aware that money was being lent to MGN; the audit partner for the years ended 5 April 1986 and 5 April 1987, Mr Glyn Thomas, told us he was not aware of money being lent.

2.47 During the MGPS financial year ended 5 April 1988 loans had at times exceeded £19m which represented the 5 per cent. limit for disclosure of "self-investment" (based on the net assets at the year end)^a. During the audit of MGPS, for the year ended 5 April 1988, CLD considered whether they should require disclosure of these unsecured loans to be made in the MGPS accounts. This was resisted by Mr Bunn^b, at the instigation of RM; CLD accepted that, provided that at the year end there were no amounts outstanding, any loans during the course of the year did not have to be disclosed^c. Although the pension scheme funds continued to be lent to the private companies on an

^a During the year the cash book had not been kept up-to-date and after the year end it was discovered that cash transactions in excess of £162m had not been recorded in the cash book. Entries were made in March 1989 to correct this.

^b Mr Bunn was a finance director for the private side with responsibilities also at MCC.

^c In April 1989 a draft management letter was prepared by CLD to be addressed to the directors of MGPT listing the weaknesses in controls and procedures discovered by them in the course of the audit of the MGPS accounts for the year ended 5 April 1988. The schedule to the letter drew attention to the loans under the following heading:

Self-Investment

"The SORP describes self investment as an investment in the business of the scheme employer and any connected companies and persons. At the year end if there is any self investment in excess of 5 per cent. of the value of the net assets of the scheme, then this should be disclosed in a note to the accounts. During our audit we noted that overnight deposits had been made with [MGN]; at times these exceeded £19m which represents 5 per cent. of the year end net assets."

Their draft recommendation read:

unsecured basis throughout the period to 5 April 1990 and thereafter to November 1991, this fact was never disclosed in any of the pension scheme accounts^a, because we were told by CLD the loans were reduced to nil at the end of each year of the pension scheme accounts; nothing was said to the trustees of MGPS (other than RM) about the loans^b. The use of pension fund assets for loans was thus concealed by “window dressing” the accounts. The independent members of the trustees of MGPS who were not told of these arrangements by the managers never learnt of them from the accounts.

2.48 RM always paid close attention to accounting dates in relation to the presentation of information, the notes to the financial statements and issues of disclosure, as Mr Bunn and CLD knew. KM told us that RM did that, in relation to the loans of cash to his private companies, not because he thought there was anything wrong in the loans but to avoid journalists writing about it, to avoid stirring the pension members’ group into more action and to diminish self investment at the balance sheet date. He also stated that RM would avoid disclosure if he could, as it was a concept completely alien to him. That was part of his wish to present the best possible image at all times and never to show weakness about anything or any hint of a problem. RM’s approach was to exploit the ability to present balance sheets in the best possible light; he would describe it as “managing his balance sheet” whereas others called it “window dressing”.

(5) Steps taken to return MGN to profitability

2.49 A major transformation in the profitability of MGN was achieved in the period 1985 to 1988. There were three principal areas where changes were effected:

"Whilst no disclosure is necessary for the 1988 accounts since the deposits were repaid before the year end, we recommend that the amounts of self investment are carefully monitored to ensure that there are no arrangements in place at the year end which would require disclosure. In addition the situation should be reviewed to consider whether the lack of disclosure is against the spirit of the SORP."

A manuscript note by Mr Cowling, the audit partner, against this passage reads "Reconsider" and against the first line . "Not sure whether on reflection want to say this" and against the last sentence "words". This letter was never sent.

Mr Cowling had joined CLD in 1977, qualifying as a chartered accountant in 1980. He was made a partner in the firm in October 1988 and became the audit partner for the Common Investment Fund, London & Bishopsgate International Investment Management plc, London & Bishopsgate Holdings plc and First Tokyo Index Trust plc as well as for MGPS and Maxwell Communication Works Pension Scheme.

The reference to the SORP is a reference to "Statement of Recommended Practice No 1 - Pension Scheme Accounts" issued by the Accounting Standards Committee in May 1986.

^a The Disclosure Regulations were the Occupational Pension Schemes (Disclosure of Information) Regulations 1986 and required the accounts to "show a true and fair view of the financial transactions of the scheme during the scheme year and of the disposition, at the end of the scheme year, of the assets... and liabilities...." CLD first told us that they considered that a "financial transaction" means an item that alters the amount of the fund. They later submitted an opinion of leading counsel to the effect that the regulations only required a summary of the results of the transactions that had taken place during the year be shown. The opinion expressly mentioned the fact that it did not deal with the circumstances where self-investment in excess of 5 per cent. existed for a substantial part of the year, was eliminated before the year end and resumed shortly after the year end.

^b Mr Guest told us he was unaware of these loans.

- 2.50 MGN became a newspaper publishing company as the printing was (in consequence of the changes described) contracted out to BNPC, a wholly-owned subsidiary of the listed company, MCC. The new presses acquired by MCC's subsidiary, BNPC, were financed through leasing arrangements and the building works to house the presses were financed by an intercompany loan from MCC to BNPC. The price paid by MGN to MCC under the arrangement for the printing was calculated at MCC's cost of production plus a fee of £10m - £12m, even though MGN organised and financed the supply of the newsprint and provided some management. In 1988 this basis of charging was altered to a cost per copy basis with the price being fixed by RM to produce a return to MCC of 15 per cent. (before interest charges) on the capital employed at BNPC.
- 2.51 Two other important technological changes were the introduction of direct inputting equipment (enabling the editorial staff to create pages for printing in the Editorial Department and directly transmit them to the printing presses) and the introduction of inserting plant which enabled the paper to be expanded by the insertion of pre-printed pages and supplements.
- 2.52 Less needed to be done at SDR (which always made a profit during RM's ownership) as new plant had been introduced at Anderston Quay^a in 1971 but RM did ensure that the labour force was reduced by 25 per cent. and did see to the removal of the "Spanish customs".
- 2.53 The effect of these changes was to improve greatly the profitability of MGN.

^a

See plan 3 in paragraph 6.73.