9. JANUARY TO APRIL 1991: EVENTS CONCERNING RM'S OTHER INTERESTS

Summary of the position of RM's interests at the end of December 1990

9.1 By the end of December 1990, the position of RM's interests can be summarised as follows:

- **MCC** Although MCC had repaid the first tranche under its main borrowing facility, it still had a substantial debt and its share price was weak. There was perceived to be a need to make further disposals and to reduce the debt. Because of prevailing trading conditions there was also concern about MCC's operating profitability, but MCC still retained the strong cash flow of the scientific journals business although attempts were being made to sell that business.

- **The private side** This held a number of different businesses, some property, a 64.2 per cent. stake in MCC and some other quoted holdings[a], but carried a debt burden which was £1,105m[b] at the end of December 1990 and about £1,075m[c] at the end of January 1991. In addition the private side had extensive undisclosed borrowings and liabilities in respect of the cash borrowed from the pension funds and in respect of FTIT and pension fund shares being used as collateral for loans from banks.

- **MGN** Its business had been modernised, it was profitable and was producing a strong cash flow that was still being used to help the private side. However it had assumed a heavy debt burden through the £360m facility in addition to the equipment leases of £150m.

9.2 The events of early 1991 can be grouped under four topics:

(1) The dealings by RM in MCC shares and the MCC share price
(2) The private side debt, its asset disposals and need for collateral
(3) The audit of the CIF
(4) Events at FTIT.

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[a] The most significant of these were that part of the holding in Scitex the private side had retained (4.192 million shares valued at $63.42m (or £32.86m), together with Central TV and TF1.

[b] Including the overdraft of $135m (£74.4m) from MSTC referred to at paragraph 6.29 and borrowings from Lloyds of £52.8m through LBI and LBH's accounts referred to at paragraph 6.32 which had been passed to other private side companies.

[c] The private side had repaid the Lloyds overdrafts and a significant part of the MSTC overdrafts, but had obtained new loans.

(1) The dealings by RM in MCC shares and the share price

9.3 It is necessary to refer briefly to the market in MCC shares and the MCC share price primarily because:

- The performance of its share price was perceived to be important to the ability to market MGN shares.
- The level of that price and the ability of RM to sell MCC shares was also critical to the review of the finances of the private side undertaken by CLD and described in Chapter 16.
- RM expended a further £105m[a] to purchase MCC shares in the period to 30 April 1991 both openly through BIT and secretly through other entities; three of these entities were used to purchase MGN shares after the flotation. In consequence at 30 April 1991 the disclosed holding of RM, his family, their companies and the Maxwell Foundation in MCC rose to 68 per cent.; RM also had acquired through the other entities and Mr Aboff a further 8 per cent.[b] and thus controlled some 76 per cent. of MCC. The expenditure on these purchases placed a considerable strain on the finances of the private side which was attempting to reduce its debt burden by the sale of its other assets.
- The sale by MCC of the scientific journals business announced in March 1991 was significant as it was MCC's main cash generative business in the same way as MGN was the main cash generative business of the private side.

Further details about the transactions in MCC shares and the market in 1991 are set out in Appendix 7, but the main events can be briefly summarised.

9.4 As referred to at paragraphs 6.17 and following, RM's interests had acquired a substantial number of MCC shares in the autumn of 1990.

9.5 On 30 November 1990, after the delivery of the shares under the second "option" referred to in paragraph 6.17, Goldman Sachs still held on their books 28.6 million MCC shares; because of this and other significant exposures to RM and his companies amounting to $160m, Mr Sheinberg was asked by the Management Committee of Goldman Sachs to reduce the exposure. Mr Sheinberg told us that the MCC shareholding was the only item within the exposure which was readily marketable; he therefore told RM Goldman Sachs wanted to sell its MCC shareholding. On 4 January 1991 RM (through BIT) entered into a third "option" contract with Goldman Sachs in the form of a put option under which Goldman Sachs could require BIT to purchase a further 30 million MCC shares on 15 February 1991 at a price of 162.105p per share; it was exercisable in whole or in part. The "option" was notified by MCC to the Stock Exchange immediately though the price announced was 152p[c]. The premium paid by Goldman Sachs to BIT was 4p per share at

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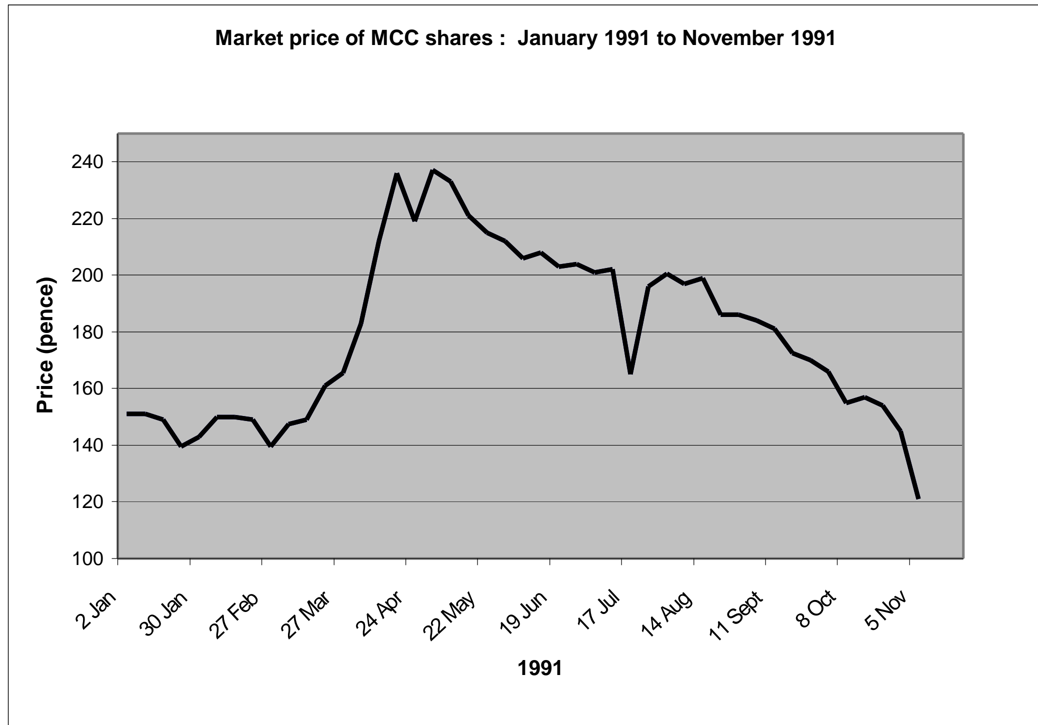
[a] This sum excludes the purchases from the pension funds on 26 April 1991 referred to at paragraph 9.8. The settlement of some of the purchases in the period to 30 April 1991 took place in May 1991.

[b] In addition BIM held on 30 April 1991 2.3 per cent.; the reduction from 6 per cent. referred to in paragraphs 6.18 to 6.23 was in consequence of the transactions on 26 April 1991 referred to in paragraph 9.8.

[c] The price notified to the TSA by Goldman Sachs was a strike price of 152p and an exercise price of 162.105p. These terms are synonymous to any person active in the market. The Stock Exchange was initially only notified of the strike price of 152p and that is what was announced but were subsequently supplied with a copy of the

a time when the market price was around 150p[a]. The announcement made by MCC was misleading as it concealed from the market:

- the true price paid for the shares.
- the fact that RM was paying a somewhat higher price than the conventional pricing of an option would justify and a price that was higher than he might have found it convenient to explain.
- the true nature of the agreement reached was not an option, but a method of enabling RM to defer payment until February1991.



Graph 3

9.6 The "option" was exercised by Goldman Sachs and 30 million shares acquired by BIT at a cost of £48.6m on 19 February 1991. Goldman Sachs borrowed some shares to settle this transaction. It was announced that the effect of the exercise of the option took the shareholding of the Maxwell Foundation to 38.14 per cent. of MCC. This took the combined holding of RM, his family, their companies and the Maxwell Foundation to 68 per cent. During December 1990 and from January

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contract that gave the exercise price of 162.105p. As explained in Appendix 7, the records of the Stock Exchange do not record, and no one involved can recall, what consideration was given to the price differential.

[a] The premium paid cannot be explained on the basis of ordinary option pricing which would have required a premium in the order of 12p. The price of 162.105p at which RM was to buy the shares was calculated in a similar way to the price calculated for the second option - the market price plus the cost of carrying the shares until 15 February 1991, repayment of the premium and profit (on this occasion the profit was much smaller). As it was clear that the option would be exercised, this was again in effect a deferred sale; indeed, a term of the agreement indicated such, as there was to be an adjustment in the price if the shares were paid for earlier by BIT. In effect the price would be reduced to reflect the lower carrying cost on a pro rata basis (see Appendix 7 – paragraph 11.7).

to March 1991 the share price of MCC had remained relatively depressed as the graph above and that in paragraph 6.11 show.

9.7 In the period between January and 30 April 1991 Goldman Sachs was involved in two types of sales of MCC shares

- sales where it acted on an agency basis; and
- sales, from its books, of shares purchased in the market by Mr Sheinberg who continued to buy shares, particularly in late March and in April 1991.

The sales of shares by Goldman Sachs to the entities set out in the following paragraphs were sales to entities who in fact acted for RM. We were told by KM that the deals and prices were all negotiated and agreed between Mr Sheinberg and RM as part of a strategy described in paragraph 9.14; that RM believed that the use of the entities was sufficient to make it legal.

9.8 The main transactions were the following:

- On 11 January 1991 Goldman Sachs carried out on an agency basis the sale of 2.285 million MCC shares from IBF (whose subsidiary Jupiter Participations had bought the shares in September and October 1990 through a French broker as referred to at paragraph 6.18) and the purchase of those shares by Dr Rechsteiner for £3.4m. This was the first of several occasions on which Mr Sheinberg dealt with Dr Rechsteiner. Dr Rechsteiner was acting for Corry Foundation at the request of RM.
    - Mr Sheinberg told us that when Dr Rechsteiner was suggested as a purchaser he did not think that RM would introduce him to someone who was not legitimate or good for the money. However to exercise due diligence he enquired of RM whether anything was reportable and was told there was nothing[a]. Dr Rechsteiner was expecting the call. Mr Sheinberg told him how many shares he had for sale and what the price was. Dr Rechsteiner agreed to this purchase. Mr Sheinberg did not make any agreement with RM.
    - KM told us that this transaction and the subsequent transactions involving Dr Rechsteiner were dealt with in the same way as the sales to TIB and IBI. RM and Mr Sheinberg would do the deal and then arrangements would be made for it to be effected through Dr Rechsteiner.
- On 8 February 1991 Goldman Sachs sold 2 million MCC shares from its books to Jupiter Participations for £3m.
- On 9 April 1991 Goldman Sachs purchased 2 million MCC shares from Jupiter Participations for £3.72m and sold that stake to Lakeport Nominees Ltd for £3.8m. Lakeport Nominees Ltd were a nominee company of Coutts & Co (Lausanne) SA who

[a] The confirmation of the transaction with Dr Rechsteiner who was buying the shares said he had to provide only £128,723. The confirmation sent to the seller (IBI/Jupiter Participations) said they were to "deliver to Barclays Bank ... for the a/c of Goldman Sachs - N.Y. .. for the a/c of Werner A. Rechsteiner the sum of £3,293,750 pounds sterling for value January 14, 1991". It would have been difficult to explain why IBI/Jupiter Participations, as the seller, was passing £3.293m to Goldman Sachs for the account of Dr Rechsteiner unless IBI/Jupiter Participations were making a loan to Dr Rechsteiner. The sum of £3.293m was in fact paid by PHL to IBI who then paid Goldman Sachs.

9.8 continued

were acting for Blackmore Trust on the instructions of Mr Emson[a]. Mr Emson told us he had been asked by RM to buy the shares for the benefit of a trust and, as the transaction was said to be urgent, he agreed to use Blackmore Trust pending the transfer to another trust. The shares were paid for by PHL who transferred the funds to Robert Fraser Group which then remitted them to Lakeport Nominees Ltd. The evidence of Mr Mitchell of Coutts & Co was that Mr Emson asked him to buy the shares and that the price would be 190p. Thereafter Mr Sheinberg rang him and told him that he understood he was interested in purchasing MCC shares at 190p and the trade was agreed[b].

- After selling 5 million MCC shares from its books to TIB on 26 February 1991[c] and then repurchasing that stake onto its books on 3 April 1991[d], Goldman Sachs sold 5 million shares from its books to TIB on 17 April 1991 for $21.1m. TIB is the company referred to at paragraph 4.49 and the shares were purchased on the instruction of RM or KM and paid for by funds remitted to Dr Rechsteiner largely from RMG[e].
- On 24 April 1991 Goldman Sachs sold from its books 14 million MCC shares to TIB at a price of £30.95m and 3 million MCC shares to Servex AG (Servex) for £6.63m.
  - Mr Sheinberg's evidence was that he had accumulated a position of 20 million MCC shares by mid-April 1991 and told RM he wanted to sell; RM at first declined to buy. KM told us that RM's companies were in a period of extreme illiquidity as they were awaiting the proceeds of the sale of the scientific journals business of MCC (referred to in paragraph 9.10); however, Mr Sheinberg would have made it clear that he had to reduce his position and that, if RM could not find a friend to buy at a price that would not rock the market, then he would have to find a buyer at a price that did and put the share price under pressure.
  - Mr Sheinberg told us that he never made any such statement, but that later, on 24 April 1991, RM and KM telephoned him and asked if he was interested in selling and that he had said that he would sell. KM's evidence was that RM would not have telephoned,

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[a] Mr Emson was the Chief Executive of Robert Fraser.

[b] Mr Mitchell's evidence was that Mr Sheinberg had telephoned again on 16 April 1991 and asked if he was interested in buying a further 5 million shares. He refused, but soon after Mr Emson rang to ask him to make the purchase; Mr Mitchell again refused. Mr Mitchell's evidence was that he considered Mr Sheinberg was premature in his telephone call and was supposed to have called after Mr Emson had arranged the transaction. Mr Sheinberg said that he had spoken to Mr Mitchell only once and that was on the occasion of the purchase by Lakeport Nominees Limited of 2 million MCC shares. He denied making any second or other call to Mr Mitchell.

[c] This sale was re-booked as a sale on 15 March 1991 at a slightly increased price but with an extended settlement date.

[d] This purchase was part of a series of sales by BIT of other shares including parcels of Scitex and Quebecor (beneficially owned by the CIF); Mr Sheinberg told us he believed BIT was the seller of the MCC shares but the documentation reflects a sale by TIB.

[e] Funds were also derived from a sum of £2m that PHL had transferred to Dr Rechsteiner on 12 October 1990.

but Mr Sheinberg would have kept up the pressure to buy; in conversations such as this, Mr Sheinberg would have asked RM whether he was

9.8 continued

taking up the shares or whether they were being taken up by the "man in the mountains", a reference to Dr Rechsteiner[a].

- Subsequent to the telephone conversations between RM, KM and Mr Sheinberg, Mr Freedman[b] acting on the instructions of RM called Mr Sheinberg who made the sale to TIB of 14 million shares. This sale took TIB's holding to 19 million shares, just below the 3 per cent. at which disclosure would have been required; Mr Sheinberg told us that he might, as a matter of good customer relations, have mentioned to Mr Freedman that if TIB's holding went over 19 million TIB might have to report it.
- Mr Sheinberg told us he then had a further conversation with RM and KM and at their suggestion spoke to Dr Rechsteiner and sold 3 million MCC shares to him on behalf of Servex[c].
- As explained at paragraph 20.20, £11m of MGN monies were used after the flotation in part payment for these shares[d].

- On 26 April 1991 Goldman Sachs carried out on an agency basis the sale by MGPS and MCWPS of 12.5 million MCC shares each and the purchase of 16 million shares by Servex (for £35.4m). The purchase by Servex took its holding to 19 million MCC shares, again, as in the case of the purchases by TIB a few days earlier, to just below the 3 per cent. at which the holding would have been reportable. The balance of 9 million shares was purchased by Yakosa Finanzierungs AG (Yakosa)[e] (for £19.92m). The reasons for this transaction and the disposition of the proceeds are dealt with in paragraph 13.15; it was carried out to reduce the holding of the pension funds to avoid disclosure during the flotation of MGN. Because the transaction was effected as an agency transaction through Goldman Sachs, New York, the transaction was not reported on the screens of the Stock Exchange (just as had been done in the sale by the CIF of MCC shares in March 1990 as set out in paragraph 5.20) or otherwise disclosable[f]. Mr Sheinberg told us he chose to do it as an agency transaction in New York to avoid undue publicity for Goldman Sachs consistent with his trading philosophy; on an agency transaction there was no market disclosure as there was no market trade. Dr Rechsteiner was acting on the instructions of RM; the shares bought by

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[a] Mr Sheinberg denied he ever used this phrase and told us it was ridiculous to think that he would have referred to a peson he knew only as a lawyer in Zurich who acted for UBS or the Swiss Central Bank as "the man in the mountains".

[b] As explained at paragraph 4.49 he was a lawyer who had acted for RM for many years.

[c] Dr Rechsteiner was acting for Akim Foundation on the instructios of RM. Akim Foundation was one of the Foundations acquired or founded for RM as set out at paragraph 1.10; the circumstances in which TIB was said to be the nominee of Akim in connection with the purchases by TIB in 1989 are set out at paragraph 4.49.

[d] The balance of £26.59m was provided from RMG.

[e] Yakosa was owned by PHA, which is another Liechtenstein entity referred to at paragraph 3.23.

[f] Mr Sheinberg checked with his compliance department about the reportability by Goldman Sachs of such a trade; he was told that as the trade involved more than 3 per cent. of MCC it would be reportable if done with Goldman Sachs as a principal, but not as an agent. That was because as an agent Goldman Sachs would not become the owner of the shares.

Servex were acquired for Akim Foundation and those by Yakosa for Nessi Foundation, one of the foundations acquired or founded for RM as set out at paragraph 1.10.

9.9 There were other relevant transactions in MCC shares in the period January to 30 April 1991:

- During January 1991 Mr Aboff[a] purchased for RM 550,000 MCC shares at a cost of £796,704 but sold 540,000 for £770,259. He purchased a further 100,000 MCC shares on 1 March 1991 for £142,067. Further disposals totalling 100,000 MCC shares were made at the end of April 1991.
- Between 17 and 26 April 1991 Mr Emson sold in the market on behalf of a client 500,000 MCC shares, part of that client's holding. RM was not pleased and told Mr Emson that in future he (RM) would find a purchaser for any MCC shares that his client might want to sell. This happened in July 1991 as set out at paragraph 21.4.

9.10 There were two announcements on 28 March 1991 of events[b] that significantly affected MCC:

- RM would be resigning as Chairman and Chief Executive of MCC as from 1 July 1991 and Mr Peter Walker would take over as Non-Executive Chairman[c], with KM as Chief Executive. KM told us that the origin of the idea of RM resigning as Chairman of MCC was to be found in Sir Michael Richardson's advice that, for marketing reasons concerning the MGN flotation, RM ought not to be Chairman of both MGN and MCC[d].
- MCC had agreed to sell its scientific journals business to Elsevier . Discussions with Elsevier had been taking place during the second half of 1990 and a price of £440m (subject to adjustments) was agreed. The sale was explained in a circular to MCC shareholders as having been made because an attractive price had been offered and because there was difficulty in the then economic climate of achieving satisfactory prices on the disposal of non-core businesses[e]. The banks were told, and this was the understanding of the directors of MCC, that the proceeds would be used to repay early the next tranche of the $3 billion facility that MCC had taken out in order to acquire Macmillan and OAG and would be used to reduce MCC's overdrafts[f].

9.11 Those who considered the sale had different views as to its significance and what it meant to the future of MCC; some thought that it showed a determination on RM's part to solve the debt

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[a] He had purchased a substantial number of shares in the autumn of 1990 as explained at paragraph 6.19.

[b] On 19 February 1991 it was announced that Mr Baker had taken early retirement. This was not noted to be an event of significance at the time. His retirement came about because in November 1990 he had had a serious disagreement with RM over RM's unsuccessful attempt to "improve" MCC's interim statement after it had been approved by the board; as a result RM required him to retire or resign.

[c] Mr Peter Walker had insisted on freedom to choose the board but had agreed that RM and KM could sit on the board to represent the family's interest.

[d] See paragraph 11.26.

[e] RM told Sir Michael Richardson that the disposal was part of a plan to concentrate on MCC's operations in the US.

[f] A significant part of proceeds of sale were used by the private side in the summer of 1991 as set out at paragraph 21.4.

problems of MCC; others considered that if he had to sell the business upon which his success had been built, MCC was in a difficult financial position. The development of the scientific journals business had been achieved by RM organically (rather than through acquisition) by the creation and development over time of new scientific titles; it had been very profitable. The cash flow from those titles had been used by RM to fund his various acquisitions but that cash flow had been lost to the private side when Mr Baker had convinced RM to transfer this business to MCC[a]. Although the sale to Elsevier provided a large cash sum to MCC, it deprived MCC of significant cash flow[b]. KM worked extensively on the negotiations for the sale of this business; but it was RM who agreed the price with the Chairman of Elsevier[c].

9.12 From about 1 March 1991, when the MCC share price stood at 140p, the price rose to 174p at the end of March 1991, to 185p on 9 April 1991 and to a closing peak of 239p on 15 April 1991. Although this rise in the share price is of specific relevance to the review of the private side finances in connection with the flotation described in Chapter 16, it was generally seen by the market as being "helpful" to the prospects of a successful flotation of MGN. Many in the market considered that the price was rising because Goldman Sachs were buyers and wondered why.

9.13 When RM was asked why the MCC share price was rising he said that he was much admired in the United States where bankers and institutions were buying shares. This was accepted as a plausible explanation, given that Goldman Sachs were seen in the market to be the principal buyers.

9.14 KM told us that:

- RM was obsessed with the share price.

- During 1990 and 1991 RM and Mr Sheinberg would speak daily, whether RM was in London, New York or on his yacht[d]. Mr Sheinberg told RM that he would mop up shares in the market, enforce physical delivery by short sellers and so cause the price to rise. This would get rid of the bears and, in Mr Sheinberg's phrase "reduce the liquidity of the stock in the market", thus improving the share price. They agreed on this strategy and, if RM heard there was a bear raid on MCC shares, he would at once telephone Mr Sheinberg. KM recalled

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[a] As set out at paragraph 3.6.

[b] The sale of the scientific journals business and the flotation of MGN (which were the core cash generative businesses of RM's entire interests) were very significant events as they had been significant cash sources for MCC and the private side respectively.

[c] IM told us that RM put KM in charge of the sale because he (RM) could not bring himself to be involved in the disposal of "his real baby". However, the price being offered from a major competitor was astonishingly high and, despite his reservations, RM would not allow there to be any sacred cows.

[d] KM told us that RM did not have time for many friends as his lifestyle and his addiction to his business did not give him time; however, within the context of RM's relations with bankers, he was very close to Mr Sheinberg and they had drinks together – RM did not have drinks with everybody. Mr Sheinberg told us that his only relationship with RM was their trading relationship; he had drinks with RM on perhaps three occasions between 1986 and 1991.

conversations between RM and Mr Sheinberg when the talk was of driving the share price up to £4, £5, even £10.

- RM believed Mr Sheinberg when he said he would do this as he believed Mr Sheinberg was assisting him as his client. When KM questioned this, RM told him he knew nothing and that "the great Mr Sheinberg knew everything" as was his belief from the many deals done since 1986. RM did not regard this to be a wrongful manipulation of the market but, rather, using a market maker to counteract those who were manipulating the price of MCC share downwards.

9.15 KM also told us that RM had understood that if he was paying cash for shares, then all those shares were to be bought in the market and there was a commitment to that effect. Mr Sheinberg never told him he was borrowing stock to settle transactions[a]. If RM had known that Mr Sheinberg had met his delivery obligations under sales agreed with RM (even if carried out by entities connected with RM) by borrowing shares[b] and not by buying them in the market, contrary to the strategy that he had agreed with RM, he (RM) would, KM told us, have "shot him" and ended the relationship.

9.16 Mr Sheinberg said that this was wholly untrue.

- He explained to us that he believed that there were short positions on MCC shares in the market (which he had also believed was the case in October 1990)[c] and he could make a substantial profit by acquiring MCC shares and "squeezing" those who held a short position. He thus was an active purchaser of shares and the price rose in consequence.
- There never was any agreement with RM to cause the price to rise.
- He always followed his own trading strategy and never described it to RM.
- It would have been irrational for him to commit himself to a fixed trading strategy.
- He may have spoken to RM about the share price going to £4, £5 or even £10, but that was in the context of what might possibly happen if there was a large short position.
- He did not speak daily to RM.

9.17 We have carefully examined the evidence in relation to short positions and have set it out in Appendix 7. Although there were in October 1990 rumours of a "bear" raid on MCC for which there was some substance, the short positions in the market were not material. We are satisfied from our enquiries that in the period between January and April 1991 there was no evidence of a bear raid or any material short positions. Therefore, in the period during which the MCC price rose prior to the flotation of MGN, there was no basis in fact for Mr Sheinberg's evidence that he could make substantial profits from those who held a short position.

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[a] See for example, the settlement of the third option referred to in paragraph 9.6.

[b] Goldman Sachs accepted that some of the shares were borrowed. Furthermore, some of the shares which they delivered in settlement of the Baccano purchase of MCC shares (see paragraph 21.4) were shares pledged to them by BIT as collateral for a margin loan (see the footnote to paragraph 21.11).

[c] A prosecution was brought against Mr Peter Marks of Branston & Gothard for making a false statement about MCC to Goldman Sachs on 12 October 1990 but this was unsuccessful (see Appendix 7 paragraph 9.8).

9.18 We set out at paragraph 22.82 (after we have considered the further transactions in MCC and MGN shares), our views as to what in fact was happening and the way in which the market was being misled and manipulated.

9.19 As set out in Appendix 7, the Stock Exchange did try and investigate the second and third options between December 1990 and July 1991[a], but it did not discover the wider picture of the market in MCC shares.

(2) The private side debt, its asset disposals and its need for collateral

9.20 By the end of 1990 the banks were becoming concerned about their exposure to RM's companies and in particular the private side. In December 1990 KM[b] raised with both National Westminster and Midland Bank a proposal for a "jumbo" facility for the private side companies. The objective of this proposal was to persuade the banks who were lending to the private side on a bilateral basis to join into one overall facility with pooled security; the only assets to be left out of this arrangement were the newspapers and the Holborn site. That facility was then to be repaid by an orderly asset disposal programme, the advantages to the private side companies being that all the banks would have to act together (thereby removing the risk that one bank which had strong security would interfere with the orderly disposal programme by seeking to enforce its security) and that there would be time to sell the assets and not face the risk of "fire sale" prices. KM told us that the idea for a jumbo facility came from Mr Anselmini who had pointed out that various of the private side facilities had surplus collateral and that it would be sensible to spread the collateral evenly among all lenders. The asset disposal programme included a proposed disposal of MCC shares targeted to raise, during the course of 1991, £200m[c].

9.21 The proposals for a jumbo facility were further developed in January 1991, but there was a reluctance on the part of those banks which had strong security to participate and little progress was made; the proposal had been abandoned by March 1991.

9.22 During the period in which work was progressing on the flotation, the general perception amongst the bankers to RM's companies remained that it was essential for the asset disposal programme of the private companies to continue and the debt to be reduced, but that banks would continue to renew their facilities whilst this happened. This, generally, proved to be the case and it was the exception for banks to refuse to renew or rollover facilities. There was, however, one significant facility that required renewal in June 1991 which was not straightforward. This was the facility

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[a] A further enquiry was undertaken in 1992 as set out in Appendix 7, paragraph 19.4.

[b] KM chaired two committees - one for the RMG group and one for MCC that managed the disposal programme and the borrowings.

[c] IM told us that KM came increasingly, more particularly from 1991 onwards, to play a role in the disposals programme and also in relation to debt management.

referred to at paragraph 2.34 which was secured on the Holborn site and for which the agent was Lloyds. The renewal is considered at paragraph 21.30.

9.23 Although an asset disposal programme was in progress, RM nonetheless continued to acquire other interests. In March 1991 RM acquired, through RMG's subsidiary Maxwell Newspapers Inc, control of the *New York Daily News*[a]. Although a substantial payment was made to the private side on this acquisition, it was appreciated that the business could not be "turned round" without the injection of further funds. KM told us that RM seriously considered whether the *New York Daily News* should be included in the flotation as he was very confident that it would be turned around during 1991 and it would provide MGN with an international dimension.

9.24 The private side had continued with its asset disposal programme, disposing during January and February 1991 of its 10 per cent. stake in TF1[b] for £62m and its stake in Central TV for £24.6m. The bank borrowings of the private side had decreased from about £1,105m[c] at the end of December 1990 to about £1,075m at the end of January 1991 and then decreased to about £1,050m at the end of February.

9.25 On 25 March 1991, the private side raised further funds by selling the 20.7 per cent. stake in Invesco MIM which it had agreed to transfer to the CIF by documents dated 29 June 1990 (see paragraph 6.5) but which had continued to be used as collateral by the private side[d]. The shares were sold by Goldman Sachs under a profit sharing agreement and realised a total of £35m; £33.87m was paid to the CIF and on the same day as this was received, £35m was paid by the CIF to RMG and debited to the intercompany account. The shares had declined in value by £27m over the period they had been transferred into the CIF. The disposal of this holding was notified to Invesco MIM as a disposal by BIT of the shareholding of PHL[e].

9.26 Although by the end of March 1991, the bank debt of the private side had been reduced to about £990m[f], it rose during April and by 30 April 1991 it was about £1,030m. The shares[a] owned by the private side that could be used as collateral were:

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[a] IM told us that, although questioned in some quarters at the time, this was an astute investment that served to give RM a tremendously positive profile in the USA which helped in the marketing of the MGN float.

[b] The stake was sold partly as the result of a breakdown of relations within TF1 between RM and Mr Bouyges and partly to realise the investment. IM told us that RM was more comfortable with newspapers than television. The sale was effected through Goldman Sachs.

[c] Including the overdraft from MSTC and other borrowings from Lloyds on LBI's proprietary trading account.

[d] KM had a meeting in March or April 1991 with Mr Johnson and Mr Engineer of Invesco MIM in connection with this sale; they did not know and were not told that the shares had been sold to the CIF in June 1990. They were told by KM that the holding was being sold as it was peripheral to their strategy as a media group and they were disposing of all such holdings. KM introduced them to Mr Sheinberg as the person who was handling the sale.

[e] This was reported in the press as a sale by RM's private companies.

[f] Over this period bank loans were rearranged and some bank borrowings repaid; the net reduction appears to have been covered by obtaining the release of £10m cash collateral and replacing it with shares and through borrowings from the CIF and MCC.

- the 68 per cent. [b] stake in MCC (worth at 185p per share £814m and at 239p per share, £1,052m)
- the Scitex holding (valued at £43m)
- the holdings in Ansbacher (£5.7m)
  Central & Sheerwood (£3.6m)
  Guinness Mahon (£2.5m)
  Singer & Friedlander (£7.4m)
  and other small holdings (£15.6m).

As some banks would not take MCC shares, the fact that the private side had only comparatively small holdings of other assets in comparison to its debts, necessitated continued use of shares from the CIF and pension funds; by 30 April 1991 shares to the value of approximately £270m were being so used. In addition cash continued to be borrowed from the CIF and the amount remained in the order of £100m[c].

(3) The audit of the CIF

9.27 The position of the private side was exacerbated by the discovery by the independent directors of FTIT of the use being made by LBI of the shares in the FTIT portfolio. Before outlining what happened and its specific relationship to the flotation of MGN, it is necessary to refer to the audit of the CIF for the year ended 5 April 1990.

(a) Related party connections in the investments

9.28 In the course of the audit, the following investments of the CIF were identified as Maxwell-related in the document containing a summary of the main points arising on the audit for the attention of the partner (MAPs). It was noted that the investments amounted in value to £100m.

- MCC
- IBI KM a director (see the footnote to paragraph 5.21)
- Euris SARM a director (see paragraph 3.19 and paragraph 5.28)
- OAG subsidiary of MCC

Mr Cowling (the partner in charge of the audits of all the Maxwell pension funds, the CIF, LBI and FTIT) annotated the MAPs with the comment:

> " Forward to scheme accounts. Disclosure" "20 per cent. of funds"

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a Three loans included in the private side debt were secured on property.

b This excludes the purchases made by the offshore entities.

c The payment of £35m made by the CIF to the private side on the day of the receipt of the proceeds of the sale of Invesco MIM shares is included in the figure of £100m. The amount of £100m is however exclusive of the debt of £108m which was meant to have been discharged by the agreement to transfer the shares in Invesco MIM and Scitex by documents dated 29 June 1990 but which were never delivered to the CIF or re-registered, though the value of the Scitex shares (£75m) is included within the figure of £270m in respect of the value of the shares being used as collateral.

> "NB above does not include normal working capital balances with employer companies".

Mr Cowling has told us that this reference to disclosure was a reference to disclosure in the scheme accounts as opposed to the CIF accounts.

9.29 Mr Cowling told us that disclosure was discussed with Mr Cook and that he was told that unless there was legislation which required disclosure, there was to be no disclosure[a]. Mr Cook did not recall such a conversation but told us that it might well have taken place as Mr Cowling's recollection accurately reflected the general policy on disclosure imposed by RM. Mr Cowling annotated the MAPs:

> "No requirement to do so in these accounts, but will be done in participating schemes. I have told them of our views but cannot force disclosure".

This was in fact done and the investments were listed in the investment report included within the report and accounts of the participating schemes, but without reference to the related party connections, as it was CLD's view that the SORP and Disclosure Regulations did not require such disclosure.

(b) Loans of cash

9.30 The loans of cash[b] by the CIF to the private side companies (referred to at paragraph 5.26) were considered during the audit and noted in the MAPs.

9.31 We were told that CLD examined the loans made by the CIF to the private side and that they ensured that all movements in the bank statements were picked up and that interest had been paid; they verified that all loans had been repaid by 5 April 1990. The MAPs noted that £937,000 interest had been earned.

9.32 Papers provided to CLD showed that a further £20m had been paid to the private side on 20 May 1990 (as in fact had happened - see paragraph 6.5), but we were told by CLD that at the time they did not appreciate that there had been a further loan so soon after the year end. They also read the board minutes that recorded the purchases of the Scitex and Invesco MIM shares, but we were told that this was considered as a transaction that would be accounted for in the next accounting period[c].

9.33 The MAPs also noted an adjustment that had been made to the accounts because LBH had borrowed cash from the CIF portfolio in 1989 to pay for a large stock purchase, the funds had

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[a] Mr Cowling told us that if there was something which he really felt ought to be disclosed, he would have pressed until he achieved it.

[b] These were referred to as "deposits" in the MAPs.

[c] The minutes only referred to the quantities of shares and not their value; they did not identify the party from whom the shares had been acquired.

been placed on deposit overnight, and the interest received on this deposit had not been credited or paid over to the CIF portfolio. Mr Cowling annotated the MAPs:

> "LBH is another client of the fund manager in this sense. The transactions were designed to be arms length at commercial rates - hence the above adjustments."

(c) Related party dealings

9.34 The purchases of shares by the CIF during the year ended 5 April 1990 from related parties were noted in the review of investments on the MAPs:

- The October 1989 parcel (see paragraph 5.28)
- The March 1990 parcel (see paragraph 5.28)

The MAPs also referred to[a]:

- The arrangement with IBI entered into on 21 December 1989 (see paragraph 5.21)
- The sale of the shares in Marceau Investissements to PHL in September 1990 (see paragraph 6.26)

9.35 Mr Cowling told us that the fact there were related party dealings between the CIF and RM's companies was not something that had to be reported on; that he was concerned as an auditor to see that the transactions were at an appropriate price and were of a normal nature[b]; that the disclosure requirements had been specifically drawn up and did not require disclosure of the sources from which investments had been acquired.

9.36 CLD considered whether the transaction with IBI was an attempt to reduce the holdings for the purposes of disclosure of BIM's holdings in MCC in MCC's accounts for the year ended 31 March 1990. The CIF audit team was told by the MCC audit team that the reduction did not have a material effect on the disclosure in MCC's accounts. CLD also noted in the MAPs the disposal of 7.9 million MCC shares on 26 March 1990 (referred to at paragraph 5.21).

9.37 In their management letter on matters arising from the audit which was drafted (and provided to BIM in draft) in February 1991, CLD commented that shares purchased from MCC and PMT had not been registered in the name of BIM; they recommended that this be done as soon as possible[c]. We were told they were given no explanation as to why this had not been done.

(d) Use of shares by the private side as collateral

9.38 In view of the important consequences to MGN and its pension schemes resulting from the use of the shares as collateral, a detailed account of this aspect of the audit is set out in Appendix 12, but

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[a] The sale of the shares in Marceau Investissements was in the valuation section of the MAPs. CLD also noted in the MAPs the sterling and dollar loans to Robert Fraser (see paragraph 5.29) and noted in other audit papers that the sterling loan note had been sold to PHL on 29 June 1990 and the proceeds had been debited to the intercompany account with PHL.

[b] See also paragraph 5.8.

[c] The letter was sent on 20 June 1991.

a summary is necessary here. CLD's knowledge of the use being made of the shares of the CIF and of FTIT that they had acquired during the audit of LBI, LBH and FTIT for the year ended 30 December 1989 has been summarised at paragraph 5.41. During the course of the audit of the CIF to 5 April 1990 (which took place between September 1990 and February 1991) it came to the attention of CLD that BIM had earned income categorised as "stocklending fees". This was examined and, in response to an inquiry from CLD, a letter dated 9 January 1991 was sent to CLD by Lehmans (who had provided the financing described at paragraph 5.39 on the basis of collateral provided through LBI). The letter attached what was in fact a list of shares from the CIF portfolio valued at $76.9m[a] entitled:

> "Outstanding loan detail report - collateral"

and a portfolio of US Treasury Bills to the value of $51.9m entitled:

> "Outstanding loan detail report - bonds".

Lehmans said in the letter

> "At the request of [BIM] we write to confirm as per the attached statements those outstanding positions as at 5 April 1990.
>
> We have held these securities as collateral or loaned them in connection with the stocklending arrangement made between [BIM] and [Lehmans] using [LBI] as its agent.
>
> As at 5 April 1990, we held no other certificates, cash or any other assets for [BIM]".

This letter was sent by Mr Haas of Lehmans who amended a draft response prepared by BIM[b].

9.39 An explanation of this letter was sought by CLD from BIM and LBI; CLD were told that there was an arrangement under which the Treasury Bills were lent by Lehmans to RMG and were used by RMG to raise finance whilst the shares provided by BIM were held by Lehmans as collateral for the Treasury Bills; BIM received a fee for providing its shares as collateral. The

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[a] These were relatively small parcels of readily marketable "blue chip" US securities, such as shares in AT & T and Boeing, (comprising half the value of the portfolio) and a block of MCC shares (comprising the other half).

[b] A detailed account is given at paragraphs 5.8 to 5.10 of Appendix 12.

rationale for the transaction was recorded in the MAPs[a] in the following terms:

> "The reason for this route is that [RMG] only has three large investments and Lehman have a maximum of any one stock that can be given as collateral. Therefore BIM's portfolio was used."

CLD had identified what in fact were the essential features of the arrangement involving Lehmans through which the shares of the pension schemes had been used as collateral for financing for the benefit of the private side.

9.40 CLD made inquiries of LBI as to what counter security RMG had provided and were given by LBI a list of that counter security as set out at paragraph 5.45.

9.41 Mr Cowling[b] was concerned about this transaction. He first consulted more senior partners at CLD, Mr Walsh and Mr Lamb. Mr Lamb told the counsel to the Accountants' Joint Disciplinary Scheme that he had only the vaguest recollection of the meeting[c], but thought his advice would have been that Mr Cowling should find out the facts and ensure that there was disclosure in the accounts. Mr Cowling then telephoned Mr Cook on 4 February 1991 and his note of the conversation records the following:

> "I said that I was concerned over the quality of the collateral and whether the arrangement represented in effect, a loan of pension fund assets to [RMG] as the treasury bills which were subsequently obtained from [Lehmans] by [RMG] were discounted for cash."

9.42 Mr Cowling told us that he then attended a meeting with Mr Cook during the course of which Mr Trachtenberg, who was responsible for organising the programme at LBI, was asked over the telephone to give an explanation. He did so and subsequently confirmed this in writing by a letter dated 15 February 1991. This letter said that the explanation previously given of the Lehmans transaction had been an error, that Lehmans held the CIF's shares and the Treasury Bills for BIM and that the list of the counter security provided to CLD was being used for entirely different purposes. The letter did not make commercial sense and was in fact untrue[d]. The Treasury Bills had in fact been sold for cash which was used by the private side.

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[a] The MAPs described the transaction in these terms:
> "Lehman Brothers 'lent' USD Treasury bills to [RMG]. [RMG] used these bonds to raise finance. Value of bonds $51.8 million.
> The collateral for this arrangement with Lehman Brothers is part of BIM's LBI portfolio and 12 million MCC shares held by BIM centrally. Value as confirmed by Lehman Bros at 5/4/90 $76.9 million.
> [RMG] have lodged collateral with LBI (now held by Morgan Stanley) for the stock provided as collateral to Lehman Brothers.
> LBI confirmed that, at 5/4/90, the value of collateral held by them on BIM's behalf was in excess of $100 million.
> In terms of the above arrangements BIM receive "stocklending" fees from [RMG] on the value of stock provided to Lehman Brothers as collateral".

[b] He had known from his work as audit partner for FTIT, LBI and LBH for the year ended 31 December 1989 that the shares of the CIF and FTIT had been used as collateral for loans to LBI and the funds had been loaned to the private side as referred to at paragraph 5.41.

[c] By the time of his interview with us, some four years later, he had no recollection of the meeting on that day.

[d] Millett J described the letter in his judgment in *Macmillan v. BIT* (10 December 1993) as "a masterpiece of ambiguity and *suggestio falsi*". Neither Mr Trachtenberg nor KM gave evidence at the trial in that case.

9.43 Mr Trachtenberg accepted in his evidence to us that the letter was untrue. He told us that, in the light of his explanations to CLD of the true position in relation to the use of pension fund stock as collateral for loans to the private side (as set out in paragraph 9.39) CLD had raised concerns with the fact that pension fund stocks were being used in this way. He thought that the letter had been written by him after further discussion with CLD and Mr Cook in an attempt to explain the transactions in a way which would enable the arrangements with Lehmans to continue. He was fairly certain that the text of the letter would have been discussed in draft with CLD and Mr Cook, as the letter was intended to meet a requirement that the transactions be disclosed separately. He had no doubt that CLD fully understood the Lehmans transactions[a] and the letter merely restated the position for the purposes of the audit.

9.44 Mr Cowling told us that he understood from Mr Trachtenberg's explanation and this letter that the Treasury Bills had not been passed to RMG but that Lehmans held not only the CIF shares but also the Treasury Bills. He required written confirmation from BIM (which he subsequently received in a letter prepared by CLD but signed by Mr Cook and KM) that the transaction between BIM and Lehmans had involved no third parties. He was told that the fee income (which could only have arisen if the securities had been "lent" to third parties) was also an error that should be reversed. On the basis of these explanations and without further enquiry, Mr Cowling told us he was satisfied that as at 5 April 1990 there had been no use of pension fund shares for the benefit of the private side and he signed the audit report on the CIF accounts[b] on that basis. As explained at paragraph 5.39, this was not in fact the case.

(4) Events at FTIT

9.45 At the same time as the audit of the CIF was being conducted, CLD were also conducting the audit of FTIT for the year ended 31 December 1990[c]. As described at paragraph 5.40, LBI had been using the shares in the FTIT portfolio in exactly the same way as it had been using the shares of the CIF as collateral for loans; an explanation was provided to a member of CLD's staff (recorded in a note dated 7 February 1991[d]) that shares were "lent" from the FTIT portfolio to provide the

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[a] After the death of RM, Mr Trachtenberg gave a similar account of the rationale for the transaction, as set out in paragraph 9.39 to a team from CLD appointed to investigate.

[b] A note to the accounts drafted by Mr Highfield described the transaction as follows:
"**Collateral Swap Programme**
During the year, [LBI], as manager of part of the Fund's investments, entered into a Collateral Swap agreement with [Lehmans], on the Fund's behalf. Under this arrangement, securities are deposited with the money broker in exchange for (in this case) US Treasury Bills. These bills can either be lent onwards, sold and the cash placed on deposit, or used as collateral for other transactions. In this way, an additional margin can be made while retaining full rights and entitlements (including dividends) relating to the securities deposited. As at 5 April 1990, securities to a market value of £46,825,000 were held on deposit by [Lehmans], and Treasury Bills to the value of £31,600,000 had been issued in exchange."

[c] During this phase of the audit, no attempt was made by CLD to carry out any work on counter security or to verify independently that it existed.

[d] The text of the note (which Mr Cowling told us he did not see) reads as follows:
> "FTIT lend stock to LBI and the Mirror who use the stock as collateral for various loans taken out with brokers (Nomura, Crédit Suisse, Morgan Stanley, etc).

private side with collateral for its bank loans; this explanation was essentially the same as the first explanation provided to CLD on the audit of the CIF. CLD had identified again in early 1991 what were in fact the essential features of LBI's similar arrangement to use the shares in the FTIT portfolio under its management as collateral for loans for the benefit of the private side.

9.46 At the same time as the audit of FTIT was being conducted, the level of its income from "stocklending" came to the attention of Mr Woolland of Rowe & Pitman who were the brokers to FTIT. He examined the draft accounts in relation to special liquidation provisions and became concerned that the level of "stocklending" income might jeopardise the tax status of FTIT. Legal advice was then sought from Ashurst Morris Crisp and leading counsel. On around 20 February 1991, in the course of obtaining that advice it was discovered by both Rowe & Pitman and Ashurst Morris Crisp that the "lending" of FTIT's shares was not conventional stocklending but the "lending" of shares to LBH and RMG. Ashurst Morris Crisp and Rowe & Pitman immediately became concerned about the propriety of this "stocklending"[a] and among those informed was one of the directors of FTIT, Mr Willett[b] who had not known of this prior to that time but was at once very concerned as he understood the implications. KM's evidence to us was that he first learned of a potential problem at FTIT from Mr Tapley[c] in early 1991; he was extremely annoyed to be told of the problem after it had arisen. RM felt extremely let down by the LBI management[d]. Mr Tapley's evidence was that he had not been involved in the use made of shares in the FTIT portfolio and had not withheld information from RM or KM but had tried to deal with the issues[e]. At about the time of the FTIT board meeting on 26 February 1991 KM had a meeting with RM and Lord Donoughue at which it was agreed that FTIT would be offered an indemnity in relation to tax, as something for the board to fall back on[f]. At the board meeting on 26 February 1991 discussion concentrated on the legal advice concerning the possible effect on the tax status of FTIT. KM recalled that many directors wanted the "stocklending" programme to

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In order not to be exposed to the risk of default on these loans LBI and Mirror also place collateral with FTIT, greater than the value of the stock lent by FTIT. This collateral usually takes the form of shares in group companies such as MCC.
The whole exercise is necessary because the outside brokers usually require a diversified portfolio of share certificates as collateral (which FTIT has) rather than one big holding in a Maxwell Company."

In addition in a document for the attention of Mr Cowling dated 12 February 1991, it was stated
"In order to finance their activities, LBH have historically borrowed share certificates from FTIT to use as collateral in securing funds provided by their brokers".

a They were also concerned that the transaction would be within the Stock Exchange's "Class 4" rules with respect to related parties.

b He was a former partner in Grieveson, Grant & Co and employed by RM as a financial consultant on a part-time basis.

c Mr Tapley had joined LBI as managing director in 1990; his previous experience had been in fund management.

d Since the autumn of 1990 there had been serious differences at LBI between Lord Donoughue and Mr Tapley on the one hand and Mr Trachtenberg on the other. These are outlined in Appendix 8.

e For an example of the action taken by Mr Tapley see Appendix 8 paragraph 8.8.

f KM was of the view that the indemnity offered was more for PR purposes than because it was likely to have any financial value. KM told us that Mr Tapley was present at the meeting but Mr Tapley denied this.

continue. However, the board of FTIT resolved that the programme be terminated but it appeared that not all the members of the board were then aware of the "lending" to LBH and RMG.

9.47 By the beginning of April 1991, the shares used as collateral for loans for the benefit of the private side were returned from the banks and this source of collateral ceased to be available. KM's evidence was that he had discussions with MSTC concerning the return of the stock and also personally intervened in the process of the stock being returned to ensure this was done promptly. One of the consequences of this was that replacement collateral was needed for a Yen loan amounting to £9m from Daiwa Europe Bank plc which had been made to LBI on 11 March 1991; £4.225m was taken from the LBI managed portfolio of the CIF to provide cash collateral for this loan.

9.48 In early March 1991, IMRO were contacted by Mr Carson in relation to stocklending. The issues raised by Mr Carson and discussed with IMRO at a meeting on 11 March 1991 were very general questions about IMRO rules, as reflected in the exchange of letters between Mr Carson and IMRO[a]. IMRO were first told something about an issue arising out of the relationship between FTIT and LBI in July 1991.

9.49 Ashurst Morris Crisp were instructed to carry out an investigation which revealed that a very high proportion of FTIT's shares had been "lent" for the benefit of LBI, LBH and RMG. The directors of FTIT not connected with RM or his companies and Mr Willett[b] maintained that they had only authorised conventional stocklending of the type described by us at paragraph 5.30 (which was to be through Morgan Stanley as brokers) and not "lending" to LBI, LBH and RMG, but KM told us RM disputed this[c]. Further investigations and inquiries had been carried out by 24 April 1991[d] by which time the independent directors, Mr Willett, Rowe & Pitman and Ashurst Morris Crisp were concerned that there might be a need to make an announcement to the Stock Exchange, in particular if the board were to require the resignation of LBI[e] or describe what had happened at FTIT.

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[a] Mr Carson explained in a letter to IMRO that investments were deposited with LBI's eligible custodian and lent only in return for counter security.

[b] KM told us that Mr Willett had been extremely unhappy at what had gone on. He had expressed concerns to KM about the events of FTIT and had used the analogy of someone taking a car without the owner's consent and then returning it undamaged; it was still taking something that did not belong to you.

[c] Mr Trachtenberg (who had been the Company Secretary at FTIT) told us that he was certain that the whole of the FTIT board (Lord Donoughue in particular) was aware of the lending to the private side companies – the directors had been told about it in writing (most notably in the form of schedules which showed who the borrower was) and orally on several occasions. Lord Donoughue has always denied this and the documentation supports his evidence that he did not know of lending to the private side until January 1991. Mr Willett and the other independent directors have always denied they knew of lending to the private side and the documentation supports their evidence. KM told us that it was his view and RM's at the time that what had happened had been authorised.

[d] By April 1991, Mr Trachtenberg had been suspended from LBI; on 19 April 1991, Lord Donoughue wrote to KM pressing for Mr Trachtenberg to be suspended from all positions in LBH until the dispute with FTIT was resolved. On 23 April 1991, Lord Donoughue also sought the resignation of Mr Andrew Smith.

[e] Their concern was heightened by the fact that the results of FTIT for the year end had normally been announced at the end of February and Rowe & Pitman was receiving inquiries as to the position.

9.50 The advisers to FTIT and its independent directors were also aware that the flotation of MGN was imminent and that were any announcement to be made or were LBI to be dismissed as managers to FTIT, this might adversely affect the flotation[a]. It was therefore decided at a meeting on 24 April 1991 that Rowe & Pitman and Ashurst Morris Crisp should visit the Stock Exchange.

9.51 Accordingly on 25 April 1991 a meeting was arranged with Mr Fryer and Mr Miller, senior officers of the Stock Exchange. Ashurst Morris Crisp and Rowe & Pitman took with them a file containing the reports that had been made available to the board of FTIT and other information relating to the "loan" by LBI of FTIT's shares to LBH and RMG. They explained to the Stock Exchange that LBI had been engaged in unauthorised "lending" of FTIT's securities and provided them with a schedule showing the significant amounts involved; the values varied over the period but for example, over £50m was shown as "lent" in June/July 1989 and £37m - £38m was "lent" in the last three months of 1990. The Stock Exchange were also told that the shares had been "lent" to "Mirror Group". Mirror Group plc was the name by which RMG was known at this time, but the Stock Exchange understood this to be a reference to MGN.

9.52 The file of reports was offered to the Stock Exchange but was declined. There is a difference in recollection as to why this occurred[b]. After Rowe & Pitman and Ashurst Morris Crisp left, Mr Fryer asked Mr Miller to look through the latest draft of the MGN prospectus to see if it contained anything concerning the matters about which they had been told. The draft prospectus was examined and nothing found. The group of persons at the Stock Exchange who were examining the MGN prospectus were not informed of any of this and nothing was said by the Stock Exchange to any of the advisers concerned on the MGN flotation. Thereafter, Rowe & Pitman kept the Stock Exchange informed of events concerning FTIT but nothing further was asked by the Stock Exchange or said by Rowe & Pitman in relation to the impact these events might have upon the flotation of MGN.

9.53 KM told us that the visit to the Stock Exchange was evidence of the very serious deterioration that had occurred during March and April 1991 in the relationship between FTIT and LBI. RM

[a] Mr Russell of Titmuss Sainer & Webb who were acting for LBI had advised RM that the actual use made of FTIT's shares had not been authorised by the independent directors of FTIT; although they had authorised "stocklending", they had not known that the shares had been "lent" to RM's companies and had they known they would not have approved of this, certainly not without proper counter security arrangements. RM's principal concern, Mr Russell believed, was to avoid a scandal that might affect the flotation of MGN. Titmuss Sainer & Webb in fact prepared a draft disclosure document to give Samuel Montagu notice of the dispute between LBI and the board of FTIT; it drew attention to the fact that LBI was the manager of a part of the CIF. Mr Russell told us that he had no recollection as to what was done with this document.

[b] Mr Woolland of Rowe & Pitman told us that Mr Fryer had asked if they were making a formal complaint about "Mirror Group" and asked whether Rowe & Pitman would authorise them to speak to the advisers to MGN about what they had told the Stock Exchange in confidence. Mr Woolland told us that he replied that they were not in a position to give that authority but were there to speak about FTIT. Mr Fryer told us that he had asked whether the matter in any way concerned the MGN flotation and that he was told that the matter was quite separate and had nothing to do with the flotation and the papers were not complete. He therefore declined to take the papers. Mr Sparrow of Ashurst Morris Crisp told us that they had concluded prior to the meeting, that they had insufficient information to make a formal complaint but felt the Stock Exchange should be made aware of the position; accordingly they replied to a question from Mr Fryer as to what their purpose was in coming to see the Stock Exchange, by saying simply that the Board of FTIT was concerned that the Stock Exchange should be made aware of the problems at FTIT.

considered that there was a vendetta against him by Ashurst Morris Crisp[a] as FTIT's professional advisers, though we are satisfied that there was no such vendetta. RM's reaction was to fight as he was not at all embarrassed about what had happened at FTIT; his view was that either the board of FTIT accepted that LBI had had back office problems or made an allegation of fraud. KM tried to find a middle course, which led to rows with RM, but Ashurst Morris Crisp would not consider an approach to IMRO as a means of resolving the dispute.

9.54 The independent directors of FTIT and Mr Willett resolved at a board meeting on 30 April 1991 (the day of the publication of the MGN prospectus) that LBI should resign immediately and that this should be announced. The board meeting then adjourned and when it reconvened later that day the board was informed that one of RM's private companies had appointed a merchant bank and intended to make a bid for FTIT at its full asset value. The board were requested not to make an announcement nor force the resignation of LBI[b]. The board suspended the resolution for 24 hours to allow the offer to be prepared. KM told us that the bid was his idea[c]; he thought that it might at least buy some time and would lessen the impact on the MGN flotation. RM was, however, very much against it in spite of the imminence of the MGN flotation and took some time to agree; he only finally agreed during the adjournment of the board meeting.

9.55 The Board met again on 1 May 1991 and resolved to recommend the offer in principle. The board did so as the proposed offer was attractive and in the best interests of the shareholders of FTIT; an announcement was made on 1 May 1991 that an offer was to be made on the basis of the full asset value of FTIT. It was not however until the bid documents for FTIT were published on 4 July 1991 that any of the advisers to MGN (other than CLD) or the general public became aware that LBI had been involved in the "lending" of FTIT's portfolio of securities and that there were allegations that this had not been properly authorised[d]. Mr Willett, as a director of FTIT, was aware from 21 February 1991 of the "lending" of the shares of FTIT to LBH and RMG, the fact it had not been authorised and subsequently of the reason why the bid was being made; he appreciated the impact that these facts would have on the flotation of MGN. Although he was a member of the MGN prospectus drafting committee (referred to in the footnote to paragraph 8.3),

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a The origins of the antagonism between RM and Ashurst Morris Crisp we are told related to matters connected with affairs which had given rise to the DTI Reports of 1971/73 when there had been a confrontation between a partner in the firm who was acting for Rothschild and RM.

b RM had made it clear to Mr Trachtenberg that he would be made the scapegoat in respect of FTIT as he wanted to protect himself and the flotation.

c Mr Russell of Titmuss Sainer & Webb told us he had discussed a bid with KM on 29 April 1991.

d The disclosure made on the bid was expressly approved by leading counsel (instructed on behalf of the independent directors) in terms which it was felt sufficiently disclosed the transactions but which did not discourage RM and his private companies from proceeding with the bid. A note to the accounts stated:

> "During the year ended 31 December 1900 and except to a small degree during the year ended 31 December 1989 the Company's programme of securities lending was conducted by LBI with its holding company, London & Bishopsgate Holdings plc, and with an associated company although the manner and terms of the securities lending programme should have been approved by a resolution of the Board."

Leading Counsel advised that, if this disclosure was made, the independent directors of FTIT could not be criticised for not having given the full facts or for not having informed the regulatory authorities or the press. An article in the *Daily Mail* on 6 July 1991 observed:

> "The First Tokyo Index Trust bid was originally announced on 2 May as the [MGN] flotation was in full swing. What a tangle there would have been if these details had emerged then."

Mr Willett considered that the information he had was confidential to him in his capacity as a director of FTIT and that there was nothing to suggest to him that similar unauthorised activities were occurring in relation to the CIF; it was also in the interests of the shareholders of FTIT that the matter be resolved without the publicity that would have arisen from a dispute at that time, so he considered he should say nothing about it to those concerned with the flotation of MGN. KM (who was present at the Board meeting on 30 April 1991) told us that despite the fact that the FTIT board had been extremely hostile they had nonetheless accepted the position.

9.56 Mr Cowling was also involved in further investigations into the use of FTIT's shares after most of the audit work had been completed:

- On 10 April 1991 Mr Cowling wrote a letter to the board of LBI setting out the information that CLD had concerning stocklending transactions relating to FTIT; the letter included the following:

  > "On various occasions during the last two years we have had discussions with LBI senior management concerning the collateral associated with the stock lending transactions and the arms-length nature of the transactions. In particular we received oral representations from Mr Trachtenberg, a director of LBI and former Compliance Officer of the company for regulatory purposes, that all stock lending was fully collateralised and that the fees arising had been negotiated at normal commercial rates. We have obviously no reason to doubt assurances from such an individual. . . .
  > [The contents of this letter are] based on information contained in our files and from discussions with staff involved."

  In fact the files contained a statement in the 1989 MAPs "Lending to LBH, no collateral given" and a note of a meeting on 20 February 1990 which recorded information then given by Mr Trachtenberg that "LBH does not necessarily provide collateral". Mr Cowling's explanation was that he prepared the letter in a few hours in a rush because of other commitments and it was not possible for him to review the files in the time available.

- On 22 April 1991, Mr Cowling met with KM. They discussed the counter security available in respect of the loan of stocks by FTIT; Mr Cowling's note of the meeting records that:

  > "[KM] acknowledged that the directors were uncomfortable about the evidence to support the collateral position and that in future they would still wish to pursue stocklending activities, provided this was supported by proper systems."

- On 25 April 1991 Mr Cowling consulted Mr Lamb (whom he had earlier consulted about the transaction involving Lehmans as set out at paragraph 9.41) about information provided by Ashurst Morris Crisp about the use of FTIT's stocks by LBI and the accounting treatment of the income derived from that use. He reported Mr Lamb's views to Mr Walsh, as he considered that the potential problems could give rise to "some flack" from RM; Mr Walsh needed to be aware of this, as it potentially affected the relationship between CLD and RM. Mr Walsh recalled little of this matter.

Although Mr Cowling had been aware since the audit of LBI and FTIT for the year ended 31 December 1989 (as set out at paragraph 5.41) that the shares had been used by private side

companies as collateral for loans, he told us that he was unaware until 13 May 1991 of the fact that this was alleged to be unauthorised[a].

9.57 Clifford Chance had been asked to advise LBI from 1989 on certain specific points.

- Mr Trachtenberg sought advice from Clifford Chance in September 1989 about regulatory requirements in the course of which stocklending was mentioned as an activity of LBI[b].
- On 3 November 1989[c], Mr Trachtenberg sought specific advice from an assistant solicitor at Clifford Chance, Mr Osborne, on lending the stock of a client and depositing the counter security for the stocks lent with an associated company of the client. Mr Trachtenberg told us that he telephoned Clifford Chance specifically in order to seek advice about the Lehmans transaction, of which he had only just learned (see paragraph 5.38). Clifford Chance advised that provided the agreement was wide enough and the stocks were deposited with an eligible custodian, this was permissible and that they were:

> "not aware of any IMRO requirements restricting the [counter security] for the stocks loaned from being put on deposit with an associated company of the client, when it is at the request of the client and the expected yield on that deposited will be greater than that obtainable in the market place."

- Further details of two types of transaction were explained to Mr Osborne between 3 and 22 November 1989 - what he understood to be conventional stocklending and an arrangement whereby the counter security for the stocks lent was subject to a "repo" agreement[d]. On the latter, Mr Trachtenberg appears to have told Mr Osborne that the counter security would be a Treasury Bond. Mr Osborne advised that for the use of the counter security for a "repo" transaction:
    - the investment management agreement had to cover the "repo" and the IMRO client money regulations had to be disapplied or otherwise the cash received for the counter security would be deemed client money and subject to segregation.
    - title in the counter security had to pass to the client so that he could execute the "repo" and the stocklending agreement had to provide for this and the return of comparable securities or cash.

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a Mr Cowling continued to be involved. On 6 June 1991 he had a meeting with Mr Trachtenberg to discuss what counter security there had been. Mr Trachtenberg told him counter security had been provided by way of shares owned by the private side which he had kept in a fire proof cabinet; that he had monitored it on a spreadsheet, but had overwritten it as the position had changed. After that meeting RM complained to Mr Brandon Gough who asked Mr Walsh to deal with it. Mr Walsh reported to Mr Gough that RM had believed Mr Cowling was using as a basis for his meeting with Mr Trachtenberg questions prepared by Ashurst Morris Crisp who were conducting a vendetta against him.

b Mr Trachtenberg told us that this advice was sought primarily on behalf of Mr Andrew Smith who wanted to set up an LBI Inc entity in London approved by the TSA.

c This was at the time the financing with Lehmans referred to at paragraph 5.39 was being negotiated by LBI with Lehmans.

d A "repo" is a form of financing transaction; it generally involves the sale of securities (such as Treasury Bills) with an agreement to repurchase securities of the same type at an agreed price at a future date.

- that the cash or replacement counter security obtained through the "repo" had to be separately identifiable as forming part of the client's funds under management as it remained the client's security for the stocklending.

Mr Osborne's evidence was that the party to the stocklending agreement was never identified, but he understood it to be a client of LBI. Neither the borrower nor the associated company of the client was ever identified.

9.58 In June and July 1990, LBI sought further advice from Mr Osborne and a tax specialist at Clifford Chance in connection with regulatory requirements for stocklending and on the tax position. We were told by Mr Carson that Clifford Chance prepared a draft for a stocklending agreement between LBI as managers of FTIT and RMG (referred to at paragraph 6.26) and provided tax advice; he was certain that Mr Osborne must have known that the stocklending was with RMG[a]. Mr Osborne's evidence was that, although he and the specialist in tax advised LBI in June and July 1990, he did not draft the agreement and was unaware of the party to whom the stock was lent[b].

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[a] We were told by Miss Maxwell that she recalled being told by Mr Carson in 1990 that the agreement had been drafted by Clifford Chance; this evidence shows that Mr Carson had made this point long before the discoveries consequent upon RM's death in November 1991.

[b] We were told by Clifford Chance that the agreement did not conform to their standard form and contained terms as to the retention by the lender of title to the shares and the distribution of dividends which they would not have inserted into a stocklending agreement as it would have meant that the agreement was not an arrangement that the Inland Revenue would have accepted for tax purposes under section 129 of Income and Corporation Taxes Act 1988. We enquired whether there was a fee note which covered this period; we were provided with a fee note that was expressed to cover the period between 11 May 1991 and 19 November 1991, but that the analysis of the bill showed it covered the work done in June and July 1990 though it did not describe it. No copy of the draft of this agreement exists, but the signed agreement bears the reference "SCC/LBI"; Mr Carson told us that the final version of that document was produced by him, albeit on the basis of a Clifford Chance precedent; the agreement contained references to the management agreement between FTIT and LBI and to board resolutions which Clifford Chance have told us they did not see. Mr Trachtenberg told us that his recollection was that Clifford Chance produced a draft agreement which Mr Carson then had typed on his own word processor so that he could make various amendments.

9.59 On 25 March 1991, Mr Barlow, a partner at Clifford Chance (not on the flotation team) was asked to advise LBI. On being given to understand that the stocklending agreement between FTIT and LBH contained customary market terms for stocklending agreements between parties operating at arm's length[a], he advised that LBI was permitted to enter into it under the terms of its agreement with FTIT.

9.60 In the course of the work done by Clifford Chance on the flotation, Mr Barlow was asked to look at the terms of the revised management agreement between LBI and BIM which had taken effect on 1 January 1991. Nothing was brought to his attention that indicated the shares of the CIF had been used in a similar manner to those of FTIT. However he did notice that the agreement between LBI and BIM expressly disapplied the client money rules. He raised the question as to whether this was permissible, but he did not know of the earlier discussion between Mr Trachtenberg and Mr Osborne when disapplying the client money rules had been raised.

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[a] Mr Carson told us that he thought that Clifford Chance had a copy of the stocklending agreement, but the only stocklending agreement we have seen is the one between LBI as managers for FTIT and RMG.