

	<p><b>Determination Notice</b></p> <p><b>Under Article 91 (2)(d) of the Pensions (Northern Ireland) Order 2005</b></p> <p><b>The Desmond &amp; Sons Limited 1975 Pension &amp; Life Assurance Scheme</b></p> <p><b>(the “Scheme”)</b></p>	<p>The Pensions Regulator case ref:</p> <p><b>TM5656</b></p>
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### **Introduction**

1. The Determinations Panel (the “Panel”) met on 22 and 23 April 2010 by way of an oral hearing to consider whether to impose a Contribution Notice (a “CN”) on the following individuals:
  - Mr Dennis Desmond
  - Ms Annick Desmond
  - Dr Stephanie Desmond
  - Mr Donal Gordon

(collectively referred to as the “Targets”)
  
2. On 27 April 2010 the Panel gave notice of its decision to issue a CN against two of the above named Targets namely Mr Desmond and Mr Gordon. Mr Desmond was ordered to pay the sum of £900,000 and Mr Gordon was ordered to pay £100,000 because the Panel was satisfied that the conditions set out in Article 34 of The Pensions (Northern Ireland) Order 2005 were met.
  
3. Other than the Targets the other parties that were considered to be directly affected were:
  - The Financial Assistance Scheme (“FAS”)
  - The Trustees of the Scheme (the “Trustees”)

4. At the oral hearing Ms Raquel Agnello Q.C. and Mr Thomas Robinson represented The Pensions Regulator (the “Regulator”). Mr Richard Hitchcock represented the Trustees and Ms Sarah Asplin Q.C. and Mr Fenner Moeran represented the Targets. The FAS took no part in the proceedings before the Panel.
5. At the outset of these reasons we would like to record our thanks to all of the parties for complying with the directions in this case and for assisting the Panel in reaching its determination.

### **Preliminary**

6. Before the oral hearing began the Targets submitted a detailed response to the Warning Notice refuting the Regulator’s case and explaining why no CN ought to be issued. That response was sent to the Trustees in redacted form. The Chairman of the Panel made it clear that the Panel would not take account of any material which was not first made available to all the directly affected parties. The Targets decided not to provide the Trustees with a full version of their response. Therefore the Panel only considered the redacted version of the Targets’ response.

### **Outline**

7. The Scheme was established in 1969 as an occupational pension scheme which provided final salary benefits. The sole participating employer was Desmond & Sons Limited (“Desmonds”) which was at all material times a healthy and solvent company. Desmonds was a clothing manufacturer and its sole customer was Marks & Spencer plc (“M&S”). However, it did not have a contractual relationship with M&S and its relationship with M&S was principally based on the loyalty and trust that had developed over the course of a 60 year business relationship.
8. However, that relationship came to an end on 3 February 2004 when representatives of M&S announced to Mr Desmond, at a dinner, that M&S wanted to deal directly with the factories that supplied Desmonds thereby cutting Desmonds out of the picture. We accept that the M&S proposal must have come as complete shock to Desmonds and was a wholly unwelcome surprise.

9. Some 4 months later, on 3 June 2004, the Targets caused Desmonds to enter a Members' Voluntary Liquidation (an "MVL"). The use of the MVL lies at the heart of this case and was described by the Regulator and Trustees as a "loophole" because it allowed Desmonds to be treated legitimately as an insolvent company for the purposes of calculating its debt to the Scheme pursuant to Article 75 of the Pensions (Northern Ireland) Order 1995 (the "1995 Order"). The net effect of this arrangement was that as a result of the MVL the Scheme's liabilities were calculated by reference to the Minimum Funding Requirement ("MFR") rather than the more expensive buyout valuation of the Scheme's liabilities.
10. As a result of the MVL the Targets were able to realise significantly greater value from the liquidation of Desmonds, some £26 million in total, and the Scheme suffered a funding shortfall of £10.9 million on the buyout basis. The members stand to receive some 53% of their full benefits from FAS.
11. The Regulator and the Trustees allege, amongst other things, that the main purpose of exploiting the MVL loophole was to prevent the recovery of a buyout basis debt which might have become due pursuant to Article 34 (5) (a) (i) or to prevent a debt becoming due on the buyout basis pursuant to Article 34 (5) (a) (ii) otherwise than in good faith.
12. In summary the Targets countered this allegation by stating that they had done nothing to prevent a debt becoming due since the MVL triggered such a debt. Further that the MVL had arisen not out of any desire to short change the Scheme but as an inevitable result of M&S's decision to cease business with Desmonds which was, having considered all reasonable alternatives, the only option open to the Targets.
13. We ought to say at this stage that we have relied on Article 34 (5) (a) (i). We therefore did not consider Article 34 (5) (a) (ii) and accordingly we make no findings as to whether the Targets have acted "otherwise than in good faith".

#### **Article 34**

14. Article 34 came into force on 6 April 2005. It is part of the avoidance provisions designed to prevent employers from abandoning schemes thereby protecting the schemes themselves and the Pension Protection Fund. Pursuant to Article 34 the Panel may, if it satisfied that it is reasonable to do so, impose a liability on the Targets

equivalent to the Scheme's entire deficit calculated in accordance with Article 75 of the 1995 Order. Article 35, which came into force on the same day as Article 34, sets out the basis by which the debt referred to in Article 34 is calculated. However, we deal with Article 35 in more detail below.

15. Part of the requirements of Article 34 are that the Scheme must be an occupational pension scheme and that the Targets are "associated or connected" with Desmonds. The Targets did not dispute either of these requirements and therefore we do not need to consider these aspects of Article 34.

16. The material parts of Article 34 are as follows:

*"(3) The Regulator may issue a contribution notice to a person only if-*

*(a) the Regulator is of the opinion that the person was a party to an act or a deliberate failure to act which falls within paragraph (5),*

*(b) the person was at any time in the relevant period-*

*(i) the employer in relation to the scheme, or*

*(ii) a person connected with, or an associate of, the employer,*

*(c) the Regulator is of the opinion that the person, in being a party to the act or failure, was not acting in accordance with his functions as an insolvency practitioner in relation to another person, and*

*(d) the Regulator is of the opinion that it is reasonable to impose liability on the person to pay the sum specified in the notice.*

*(5) An act or a failure to act falls within this paragraph if-*

*(a) the Regulator is of the opinion that the main purpose or one of the main purposes of the act or failure was-*

*(i) to prevent the recovery of the whole or any part of a debt which was, or might become, due from the employer in relation to the scheme under Article 75 of the 1995 Order (deficiencies in the scheme assets)*

*(7) The Regulator, when deciding for the purposes of paragraph (3)(d) whether it is reasonable to impose liability on a particular person to pay the sum specified in the notice, must have regard to such matters as the Regulator considers relevant including, where relevant, the following matters-*

*(a) the degree of involvement of the person in the act or failure to act which falls within paragraph (5),*

*(b) the relationship which the person has or has had with the employer (including, where the employer is a company within the meaning of paragraph (11) of Article 4 of the Insolvency Order, whether the person has or has had control of the employer within the meaning of paragraph (10) of that Article),*

*(c) any connection or involvement which the person has or has had with the scheme,*

*(d) if the act or failure to act was a notifiable event for the purposes of Article 64 (duty to notify the Regulator of certain events), any failure by the person to comply with any obligation imposed on the person by paragraph (1) of that Article to give the Regulator notice of the event,*

*(e) all the purposes of the act or failure to act (including whether a purpose of the act or failure was to prevent or limit loss of employment),*

*(f) the financial circumstances of the person, and*

*(g) such other matters as may be prescribed.”*

17. Article 34 therefore requires the Regulator to satisfy the Panel, on a balance of probabilities, that the following statutory conditions are satisfied:

- (i) each of the Targets were a party to the act in question;
- (ii) one of the main purposes of the act was to prevent the recovery of the whole or any part of a debt which was, or might become due, from Desmonds in relation to the Scheme pursuant to Article 75 of the 1995 Order;
- (iii) the act first occurred on or after 27 April 2004 and before any assumption of responsibility of the Scheme by the Pension Protection Fund;
- (iv) it is reasonable to impose a liability on the Targets to pay the sum or sums specified in the CN.

### **The Issues**

18. Having regard to the statutory test that the Regulator had to satisfy we regard the key issues in this case as follows:

- (i) what was the relevant act or acts (assuming that it was open to the Panel to have regard to more than one)?
- (ii) was each of the Targets a party to the relevant act or acts (as set out in (i) above)?;
- (iii) was the main purpose, or one of the main purposes, of the act or acts to prevent the recovery of the whole or part of a debt under Article 75 of the 1995 Order which was or might become due?
- (iv) for what amount, if any, is it reasonable to impose liability on the Targets?

### **The relevant act**

19. The Regulator put forward a number of “acts” which occurred after 27 April 2004 and which, in its view, satisfied the test in Article 34 (5) (a) (i). These acts were in summary as follows:

- (i) seeking and receiving continuing advice from various professional advisors who had as their brief the reduction of sums to be paid to the Scheme in order to maximise the amount that Targets could realise from Desmonds;
- (ii) seeking and receiving continuous advice from leading Pensions Counsel relating to the provisions of the Pensions Act 2004 and the closure of the MVL loophole along with the “anti mischief” provisions (a reference to the moral hazard provisions);
- (iii) a number of acts designed to give the deliberate impression to the Trustees that Desmonds would continue to trade and support the Scheme in breach of Desmonds’ obligations pursuant to the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (the “Administration Regulations”);
- (iv) the Targets’ decision, as shareholders and directors of Desmonds, to place Desmonds into an MVL on 3 June 2004 as swiftly as possible.

20. The Panel considers that the relevant act is the placing Desmonds into an MVL. The Regulator referred to this as the Targets' decision to place Desmonds into an MVL on 3 June as swiftly as possible. Our view was that the act should be described as the entry of Desmonds into an MVL. Article 34 (5) (a) (i) states:

“[the main purpose or one of the main purposes of the act or failure was] to prevent the recovery of the whole or part of a debt which was, or might become, due from the employer in relation to the Scheme under Article 75 of the 1995 Order.” (emphasis added)

21. In this case it is not disputed that the Targets caused Desmonds to enter into an MVL. One of the questions for us was whether the act of placing Desmonds into an MVL prevented the recovery of “the whole or part of a debt which was or might become due”. We find that it did.

22. Although we deal with purpose in more detail below it is clear to us that the effect of placing Desmonds into an MVL was to exploit the extant legislation in order to ensure that the debt due to the Scheme was calculated on an MFR basis as opposed to a buyout basis.

23. There was evidence before us, which we accept, that the Targets knew that the MVL loophole might close in the future. Accordingly it was known that the debt which might become due was the buyout debt. That was the debt that the MVL prevented from arising. We therefore find that the act of placing Desmonds into an MVL on 3 June 2004 prevented the Scheme from recovering the buyout debt which might have become due rather than the MFR debt.

24. We acknowledge the Targets' submission that nothing they did prevented a debt becoming due because, as they put it, they brought the debt into existence. In one sense this is true. The MVL did trigger the Article 75 debt. However, this ignores the fact that by triggering the debt on the MFR basis the Targets, as a result of the MVL, prevented a debt from arising on the buyout basis which might have become due in the future.

25. Support for this construction, although it is not determinative, can be found in the reasoning of Mr Justice Richards in *Re T&N Limited [2004] EWHC 1680* which we were referred to in the course of submissions. In *T&N* the court had to consider the position of administrators who were seeking to serve notice of withdrawal on the trustees of a scheme on behalf of a number of participating employers in the *T&N* group. The administrators were keen to serve notices of withdrawal quickly because the trustees were in a position to wind up the scheme in question. If the trustees sought to wind up the scheme before the administrator served notice then the scheme's liabilities would be valued on the buyout basis whereas if the administrator acted first the MFR basis would apply.

26. At ¶15 of his judgment Mr Justice Richards said this:

*“In considering the interests of creditors, as against the position of the trustees, it is important to note that the associated companies have no liability to the trustees to fund a deficit on the buy-out basis. **Although circumstances could arise in the future which would lead to such a liability, no such liability exists now and the companies are lawfully permitted to withdraw from the scheme, so preventing the liability from arising**”* (emphasis added)

27. He went on to state that the administrators had drawn his attention to what is now Section 38 of The Pensions Act 2004 (Article 34's counterpart) which was then in draft and the concern that the administrators had in relation to being issued with a CN should they give notice of withdrawal to the trustees. Mr Justice Richards stated at ¶19 that:

*“So far as relevant, the Regulator would be entitled to issue a notice only if he is of the opinion that the person was a party to an act and the main purpose, or one of the main purposes, of the act was “otherwise than in good faith” **to prevent such a debt becoming due.**”* (emphasis added)

28. Mr Justice Richards then went on to state at ¶20 of his judgment that:

*“It is clear that the main purpose of the proposed notices of withdrawal to be given by the administration in this case **is to prevent a liability on a buy-out basis arising under section 75 of the Pensions Act 1995.**”* (emphasis added)



29. Therefore the court was of the view that conduct which had as its main purpose the prevention of a liability arising on the buyout basis in favour of the MFR basis was conduct capable of being caught by the then draft provisions of the Pensions Act 2004. Further that triggering a Section 75 debt on an MFR basis as opposed to a buyout basis “prevented” the debt on a buyout basis becoming due.

**Were the Targets party to the Act?**

30. As set out above we have found that only Mr Desmond and Mr Gordon are liable to make any contribution as a result of placing Desmonds into an MVL. It was not disputed, as set in the Targets’ response, that Mr Desmond and Mr Gordon “were in effective control of the Company leading up to the MVL and voted in favour of it.” Additionally both Mr Desmond and Mr Gordon were shareholders (Mr Desmond owned 29.8% and Mr Gordon owned 3.7%) and as shareholders they approved the MVL.

31. The remaining targets namely Ms Annick Desmond and Dr Stephanie Desmond were also parties to the act of placing Desmonds into an MVL. Although we do not consider either of them as having the same level of involvement as Mr Desmond and Mr Gordon, they were shareholders (Dr Desmond owned 2.1% of the shareholding and Ms Desmond owned 24.5%) and they approved the MVL. As such they were plainly a party to the act of placing Desmonds into an MVL. However, as we set out in more detail below we consider that their degree of involvement in the MVL was so minimal that it would not be reasonable to impose any liability on them in all the circumstances.

**The main purpose or one of the main purposes of the MVL**

32. It is clear from the wording of Article 34 (5) that an act which falls within Article 34 (5) (a) (i) can have more than one purpose. Therefore, what we must be satisfied about is whether one of the main purposes of placing Desmonds into an MVL was to prevent the recovery of the buyout debt which might have become due to the Scheme.

33. Before we turn to the factual background that surrounded the Targets' decision to place Desmonds into an MVL we first consider an authority to which we were referred which dealt with the meaning of "main purpose". In *Hashmi v IRC [2002] EWCA Civ 981* Lady Justice Arden stated:

*"I cite these examples to emphasise that for something to be a purpose it must be a real substantial purpose; it is not sufficient to quote something which is a by-product of the transaction under consideration, or to show that it was simply a result of it, as in the Royscot Spa case itself, or an element which made no contribution of importance to the debtor's purpose of carrying out the transaction under consideration. I agree with the point made by Lord Justice Laws in argument, that trivial purposes must be excluded."*

34. In this case the Targets submit that considerations about the Scheme played no part in the decision to place to Desmonds into an MVL. Rather the MVL was an inevitable consequence of the M&S decision. In other words once notice had been given that the long term relationship with M&S would come to an end, and no viable future for Desmonds could be found, the MVL was unavoidable.

35. At the outset we ought to say that the exercise of ascertaining whether the main purpose, or one of the main purposes, of the MVL was to avoid the buyout cost had to be undertaken on the basis of the documentation before us. The Targets declined to provide witness statements or attend the oral hearing to give evidence before the Panel notwithstanding the fact that the oral hearing was held later than it otherwise would have been to accommodate their attendance. As a result we make the following findings on the basis of the documents that were produced in the run up to the MVL.

36. On 3 February 2004 the future of Desmonds was thrown into flux when M&S announced that it wished to end its involvement with Desmonds. Immediately thereafter Mr Desmond formed an advisory committee (the "Committee") which held its first meeting on 8 February 2004. We understand that the principal aim of the Committee was to consider how Desmonds should react to M&S and whether Desmonds had a viable future.

37. To this end the Committee established a number of “workstreams” which were tasked with handling discrete aspects of Desmonds’ affairs. Although the Scheme was not discussed initially it soon became, as is clear from the minutes of the Committee, a workstream in its own right. Additionally a workstream was established to provide an “optimum strategy to maximise shareholder wealth”.

38. On 12 February 2004 there was a meeting between M&S and Desmonds to follow up on what had occurred on 3 February. The minutes of that meeting record the rationale for M&S’s decision as:

*“M&S wish to deal with factories and at an agreed point in time there will be no interface between Desmonds and M&S. In the new direct model M&S wish to deal directly with the manufacturing units.”*

39. M&S was therefore clear that its relationship with Desmonds would be coming to an end. As to timing the minutes go onto record that:

*“M&S would envisage a period of transition of up to 12 to 24 months or earlier if this suits the operational requirements of Desmonds, before final disengagement takes place.”*

40. In response to this Mr Gordon stated, as the minutes show, that:

*“DG indicated that clearly in this situation Desmonds would have to consider all it’s options and potential business opportunities and that Desmonds would consider doing business with other customers in the future.”*

41. The Committee met again on 16 February 2004 at the offices of Deloitte who were subsequently retained to advise Desmonds. The minutes of that meeting state that:

*“DG to discuss potential corporation tax issues arising with Deloitte. This may include treatments of closure costs and pension costs, and an examination of potential group restructuring issues.”*

42. Also, on 16 February, the law firm Hammonds was asked to prepare a “position paper” in relation to the Scheme. By the time of the next Committee meeting, on 23 February, Hammonds’ role had become more specific since it was asked to “provide guidance on possible timing of enactment of draft pensions legislation” by 27 February.
43. Hammonds and Deloitte were not the only advisers that Desmonds had retained. On 26 February 2004 Mr Gordon, on behalf of Desmonds, specifically retained KPMG Pensions to provide “written and verbal strategic advice”. However, it transpires that KPMG had already begun work.
44. On 25 February 2004 an internal email between two KPMG employees revealed the nature of the advice being given to Desmonds in so far as the Scheme was concerned. The material part of that email is as follows:

***“met with XXXX XXXX (a partner at Hammonds LLP) on Tuesday 24/2/4 at 4 p.m. to run through the background to this job:***

- *Hammonds are covering legal and tax issues*
- *M&S have pulled plug, dealing direct and need to exit in 2 weeks*
- *Strong balance sheet – net assets £40M, turnover £120M*

*Pension Scheme*

- *FRS17 31/12/3 – assets £14M, liabs £22M – estimate buyout deficit £14-£19M*
- *Maybe £2M MFR deficit?*
- *B&W & Kerr are trustee advisers*
- *trustees don’t have power to trigger windup (except via opra)*

*Goals*

- ***get as much money out the company as possible without the pension scheme grabbing windup costs***
- ***working on members voluntary liquidation + dividend payments circa £4M***

*Our job*

- *they have had counsel's opinion on ability to get MFR debt and avoid buyout (We should consider sharing this wider?)*
- *XXXX thinks trustees may try and use cont rule to get buy out cost*
- *XXXX said that there had been a recent ruling on Gilt Matching and that he'd send me the transcript*
- *Clearly very urgent and sensitive.*" (emphases added)

45. This KPMG e-mail was followed on 27 February by a preliminary report. That report recorded in its introduction that:

*"We, KPMG Pensions, are instructed by our client ("Project Tiramisu") to prepare a preliminary commentary on the proposed strategy and the outline financial implications (in pensions terms) based on the legal and actuarial advice provide (sic) to date relating to Tiramisu defined benefit pension scheme:*

*This advice may be summarised as follows:*

*Legal:                    Counsel's Opinion 20 February 2004*  
*Counsel's Further Opinion 27 February 2004*  
*Hammonds draft report sent 25 February 2004" (emphases added)*

46. The KPMG report then went onto state that:

*"We are advised that the basic principle is to limit the Company's legal obligation to provide additional funding into the pension scheme which becomes payable to the Scheme Trustees as a result of the restructuring of the Company, and a consequential winding-up of the Scheme.*

*The amount payable on the winding-up of a scheme (known as a Section 75 debt) is governed by pensions law. The law in this area has changed significantly in the last two years and is presently in the throes of further change. A Pensions Bill was issued on 12 February 2004, and new regulations were laid before Parliament on 23 February 2004 coming into force on 15 March 2004. **Timescales are therefore critical.***

*The key issue is whether events that the Company now take will dictate that the Section 75 debt is to be determined by reference to the more expensive annuity costs, or by reference to the less expensive minimum funding requirement (“MFR”) basis, or a mixture of the two.” (emphases added)*

47. The KPMG report then went on to outline why the MVL option was attractive:

*“If the MVL can be agreed at short notice (with 95% shareholder approval) then it may be possible to effect the MVL with immediate agreement which will then crystallise the Company’s financial obligation to the Scheme. If the MVL cannot be agreed at short notice then the Scheme Trustees may take action to increase the Section 75 debt before the MVL takes effect.”*

48. The contents of this report and that of the email which preceded it cannot be ignored. One of the objectives in our view was to minimise Desmonds’ exposure to the Scheme through the use of an MVL implemented at short notice. The advice given by KPMG was clear namely that Desmonds should take advantage of the MVL in order to ensure that the Article 75 debt was as low as possible and that Desmonds should do this at short notice to minimise the risk of the Trustees taking action. It also emphasised that the relevant legislation was changing and that timings were critical. We consider that the KPMG advice would have been carefully considered by Desmonds and regarded as a significant and important way in which it could keep the Article 75 debt as low as possible thereby maximising shareholder value.

49. What the KPMG material also demonstrates is that Desmonds had, by 27 February 2004, been to counsel twice about how the buyout cost could be avoided. Again this indicates to us that avoiding the buyout debt was a substantial feature of Desmonds' decision making process at this stage. The Committee meeting of 1 March shows that the KPMG advice, in relation to affecting the MVL at short notice was being followed because the minutes state that:

*“PH to revise draft workout programme on assumption that MVL occurs at **24 hours notice**. PH to liaise with XX on workout plan arising from approval of preferred option by shareholders.”* (emphasis added)

50. The next day, on 2 March 2004, Deloitte gave a presentation to the shareholders. Deloitte described its retainer in the following terms:

*“Deloitte has been retained by Desmonds to evaluate a number of business model options which would demonstrate, both in terms of quantum and timing, **how shareholder value could be maximised.**”*

51. The Deloitte presentation set out a number of business models which gave the Targets an estimate of what they might achieve on the insolvency of Desmonds. Some of those business models assumed that Desmonds would cease trading on 30 April 2004. Others assumed that business would continue after this date but end at a later stage. However, those business models that assumed a cessation of trade on 30 April estimated the Scheme's liabilities at £2 million and those that assumed trade after 30 April 2004 followed by an MVL or wind up at a later date, set out the Scheme's liabilities at £17 million. The discrepancy between the figures can only be explained by a reference to the MFR basis of calculating the Scheme's liabilities versus the buyout cost which might have become due if an MVL occurred at a later date or which would have become due on wind up at any time.

52. Given the difference between the two figures it is not surprising that the Targets authorised the directors to proceed on the basis of ceasing trade on 30 April 2004. On the face of the Deloitte presentation, which followed in the wake of the KPMG advice, the key difference between the business models was the pension cost. The

Targets chose the least expensive option because they wanted to maximise the return on their shares and they could only achieve the maximum return if they minimised Desmonds' exposure to the Scheme.

53. We appreciate that there were other significant considerations which featured in the decision making process. There was obviously a concern for a deal to be done with M&S on the best possible terms. We accept that part of the strategy for ensuring that the best deal was reached was to obtain as much commercial leverage over M&S as possible. What this meant in reality was putting pressure on M&S by potentially withholding Desmonds' support to M&S in setting up a direct relationship with the factories. As Mr Gordon set out in his letter to M&S dated 31 March 2004:

*“It has become quite apparent from our recent discussions to date that M&S is not in a position legitimately to acquire the necessary knowledge and intellectual property, or to source its requirements for Spring 2004 and Autumn 2004, without assistance from Desmonds and its joint venture and manufacturing base....Desmonds will not continue to transfer knowledge and intellectual property until M&S demonstrates a commitment to do the right thing by us.”*

54. However, the ultimate product of the M&S negotiations was a payment of £5 million to Desmonds on 28 May 2004. Although this is a significant sum it is comfortably overshadowed by the saving that Desmonds stood to make if it could pay the Scheme's liabilities on the MFR basis rather than the buyout basis. The saving to Desmonds, if this could be achieved was, according to an actuarial valuation dated 22 April 2004, approximately £14 million.

55. We find that one of the main purposes of the MVL was to avoid the buyout cost that might have otherwise been payable had the MVL not been used. The documents show that minimising Desmonds' exposure to the Scheme played a substantial part in the decision to place Desmonds into an MVL. It follows that we do not accept that the MVL was merely an inevitable consequence of M&S's decision to sever its links with Desmonds. On the contrary one of the main purposes of the MVL was to avoid the buyout cost.



56. Accordingly we find that one of the main purposes of the MVL was to avoid the buyout liability to the Scheme and to ensure that the Article 75 debt was calculated on an MFR basis. That had the effect, as set out in Deloitte report, of ensuring that the Targets maximised their shareholder value.

### **The Shortfall Sum**

57. Articles 34 and 35 came into effect on 6 April 2005. Article 35 provides the method by which the sum in CN, referred to as the “shortfall sum”, is calculated. The material parts of Article 35 provide that:

*“(1) The sum specified by the Regulator in a contribution notice under Article 34 may be either the whole or a specified part of the shortfall sum in relation to the scheme.*

***(2) Subject to paragraph (3), the shortfall sum in relation to a scheme is-***

*(a) in a case where, at the relevant time, a debt was due from the employer to the trustees or managers of the scheme under Article 75 of the 1995 Order (deficiencies in the scheme assets), the amount which the Regulator estimates to be the amount of the debt at that time, and*

***(b) in a case where, at the relevant time, no such debt was due, the amount which the Regulator estimates to be the amount of the debt under Article 75 of the 1995 Order which would become due if***

*(i) paragraph (2) of that Article applied, and*

*(ii) the time designated by the trustees or managers of the scheme for the purposes of that paragraph were the relevant time.” (emphasis added)*

58. The “relevant time” for the purposes of Article 35 is the date of the MVL. Further there was no dispute that because the Scheme was, at the date of the MVL, fully funded on the MFR basis the correct sub paragraph of Article 35 was (2) (b) because no debt was due to the Scheme. As set out above this was because the MVL allowed Desmonds to be treated as “insolvent” and therefore the MFR basis applied.

59. Paragraph (2) (b) is clear. It requires the Regulator, in situations where no debt is due, as was the case at 3 June 2004, to estimate the amount of the Article 75 debt which would have become due if:

- (i) paragraph (2) of Article 75 applied; and
- (ii) the time designated by the Trustees, for the purposes of Article 75, was the relevant time (i.e. the date of the MVL namely 3 June 2004).

60. Article 75, and its underlying regulations, was amended on 6 April 2005 by the 2005 Order. In short the amendments meant that the MVL loophole was closed because the buyout basis, rather than the MFR basis, would apply on the occurrence of an “insolvency event”. The amended version of Article 75 (2) also introduced the requirement of trustees designating a time, here the date of the MVL, for the purposes of Article 75 (2).

61. Article 75 (2), as amended by the 2005 Order, states:

*“(2) If-*

*(a) at any time which falls-*

- (i) when a scheme is being wound up, but*
- (ii) before any relevant event in relation to the employer which occurs while the scheme is being wound up,*  
*the value of the assets of the scheme is less than the amount at that time of the liabilities of the scheme, and*

*(b) the trustees or managers of the scheme **designate that time** for the purposes of this subsection (before the occurrence of an event within paragraph (a)(ii)), an amount equal to the difference shall be treated as a debt due from the employer to the trustees or managers of the scheme.*

*(6A) For the purposes of this section, a relevant event occurs in relation to the employer in relation to an occupational pension scheme if and when-*

- (a) an insolvency event occurs in relation to the employer,*
- (b) the trustees or managers of the scheme make an application under subsection (1) of section 129 of the 2004 Act or receive a notice from the Board of the Pension Protection Fund under subsection (5)(a) of that section, or*
- (c) a resolution is passed for a voluntary winding up of the employer in a case where a declaration of solvency has been made under Article 75 of the Insolvency (Northern Ireland) Order 1989 (members' voluntary winding up)."*

62. The effect of the above provisions is to assume that the Scheme is being wound up before any relevant event has occurred. For the purposes of Article 75 (6A) (c) a "relevant event" is an MVL. Therefore, the Scheme is treated as having been wound up prior to the MVL. If the Scheme had been wound up, prior to the MVL, then the buyout basis would have applied.

63. The Targets submitted that the effect of this approach is that Article 75, as amended by the 2005 Order, is being applied retrospectively and that we ought to apply the unamended version of Article 75 because this was the version in force as at the date of the MVL. The Targets submitted that the result of this approach would be that the shortfall sum would be nil because the Scheme's liabilities, should the unamended version of Article 75 apply, would be calculated on the MFR basis and, as at the date of the MVL, the Scheme was fully funded on that basis.

64. The Regulator disagreed with this approach. It submitted that what was being retrospectively applied was Article 34 which permits us to consider an act, i.e. the MVL, before Article 75 was amended. It followed that once Article 34 was engaged all that Article 35 did was to provide a calculation method. In this sense Article 35 was not a standalone provision and could not be considered independently from Article 34.

65. The Regulator also submitted that the amended version of Article 75 ought to be used because it was only in the amended version that there was a reference, as set out in Article 35 (2) (b) (ii), to the trustees designating a time for the purposes of Article 75. If the unamended version of Article 75 is applied, which does not contain a provision for the trustees designating a time for the purposes of Article 75, then Article 35 (2)

(b) (ii) is redundant. The Regulator submitted that this points to the fact that it is the amended version of Article 75 that ought to be used because, if the inverse was true, Article 35 (2) (b) (ii) would be ineffective and superfluous.

66. We prefer the Regulator's submissions on this point. It is important to note that Articles 34 and 35 and the amended version of Article 75 all came into force on the same day. As the Regulator submitted this points towards the various articles being construed as a whole. In particular it is only the amended version of Article 75 which contains the cross reference, in Article 35, to the trustees designating a time for the purposes of Article 75. This strongly suggests, given that these provisions came into force on the same day, that it is the amended version of Article 75 that ought to be used because otherwise the concept of the trustees designating a time, which must be a deliberate cross reference to Article 35, is redundant.

67. What also strikes us as important is the purpose of Article 35. Article 35 is, as the Regulator put it, a parasite of Article 34. It is Article 34 that permits us to consider, retrospectively, conduct which is potentially caught by its provisions. Once the threshold of Article 34 is met all Article 35 serves to do is to provide a calculation method as an extension of Article 34.

68. For these reasons we preferred the Regulator's submissions on the shortfall sum which in this case, as set out in the warning notice, was £10.9 million.

### **Reasonableness**

69. In the paragraphs above we have explained our reasoning why, in our view, the shortfall sum is £10.9 million. However, Article 34 requires us to be satisfied that it is reasonable to impose liability on the Targets for this sum by reference to a number of non-exhaustive factors as set out in Article 34 (7) which we set out below:

*(7) The Regulator, when deciding for the purposes of paragraph (3)(d) whether it is reasonable to impose liability on a particular person to pay the sum specified in the notice, must have regard to such matters as the Regulator considers relevant including, where relevant, the following matters-*

*(a) the degree of involvement of the person in the act or failure to act which falls within paragraph (5),*

*(b) the relationship which the person has or has had with the employer (including, where the employer is a company within the meaning of paragraph (11) of Article 4 of the Insolvency Order, whether the person has or has had control of the employer within the meaning of paragraph (10) of that Article),*

*(c) any connection or involvement which the person has or has had with the scheme,*

*(d) if the act or failure to act was a notifiable event for the purposes of Article 64 (duty to notify the Regulator of certain events), any failure by the person to comply with any obligation imposed on the person by paragraph (1) of that Article to give the Regulator notice of the event,*

*(e) all the purposes of the act or failure to act (including whether a purpose of the act or failure was to prevent or limit loss of employment),*

*(f) the financial circumstances of the person, and*

*(g) such other matters as may be prescribed.”*

70. First we should explain why we are of the view that it would not be reasonable to impose any liability on either Dr Stephanie Desmond or Ms Annick Desmond. Although they were strictly parties to the MVL, since they were shareholders, they were not in any meaningful way involved with the decision making process that led Desmonds into the MVL. Dr Desmond only became involved in the affairs of Desmonds because of fears over her father's health and there was no evidence to suggest that she took any active part in the decision making process that led to the MVL. The same is true of Ms Desmond. For these reasons we are of the view that it would not be reasonable for Dr Desmond or Ms Desmond to be liable to pay any sum.

71. The same cannot be said for either Mr Desmond or Mr Gordon. They were both, at all material times, directly involved with the affairs of Desmonds and were the architects of the MVL. However, we are of the view that it would not be reasonable for either Mr Desmond or Mr Gordon to pay the full amount of the shortfall sum for a number of reasons.

72. Much was made, by the Regulator and the Trustees, of the Targets failure to notify the Trustees, at a meeting on 6 May 2004, of the intention to place Desmonds into an MVL and M&S's decision. It was submitted that had the Trustees known the true position then they could have taken steps to extract more value from Desmonds for the benefit of the Scheme.

73. The Targets submitted that they were not under a duty to inform the Trustees. Further that they had, in any event, informed the Trustees' agent namely the Scheme's actuary Mr XXXX. The duty to disclose information is set out in regulation 6 of the Administration Regulations which provides that:

*“(1) it shall be the duty of any person-*

*(a) who is the employer in relation to an occupational pension scheme within 1 month of the occurrence, to disclose to the trustees or managers the occurrence of any event relating to the employer which there is reasonable cause to believe will be of material significance in the exercise by the trustees or managers or professional advisers of any of their functions.”*

74. We are of the view that M&S's decision, as articulated on 3 February and subsequently, was an event of material significance as was the decision of the Targets on 2 March authorising the directors to proceed with the MVL. As such Desmonds should have informed the Trustees within a month of the occurrence of either of these events.

75. The Targets submitted that they had discharged their obligations under the Administration Regulations because Mr Gordon had told Mr XXXX, the Scheme's actuary, about Desmonds' plans. We are firmly of the view that this is not the case because the Targets' submission supposes that Mr XXXX sat through the Trustees' meeting on 6 May, where the future of the Scheme was discussed, and said not a word about the MVL. We find this inherently unlikely. If Mr XXXX was alive to Desmonds' plans we find that he would not have been mute about this explosive topic throughout the meeting on 6 May. On the contrary he would brought it to the attention of the Trustees.

76. We also considered the various submissions as to whether Mr XXXX was a “manager” within the meaning of the Administration Regulations. However, given our findings above it is not necessary to come to a conclusion on this point.

77. Central to our decision on reasonableness of the amount of the CN is an assessment of the amount that may have been recovered by the Trustees had they been informed of the M&S decision or the decision to place Desmonds into an MVL. The Regulator and the Trustees submitted that there were a number of steps the Trustees could have taken had they known the true position.

78. One way, in which it was said the Trustees could have improved the position, was to try and use the Scheme’s rules to trigger a wind up which would have resulted in the buyout basis applying. Rule 16 states:

*“The Administrator shall cause the Scheme to be discontinued if:-*

*(a) All Employers under the Scheme shall either*

*(i) sell or dispose of their business or undertaking, go into liquidation, dissolve partnership or otherwise cease to function, and no arrangement shall be made for the continuation of the Scheme in the manner described in rule 15.0.”*

79. It was agreed that for the purposes of rule 16 “Administrator” meant the Trustees. However, we are of the view that rule 16 would not have applied because the conditions set out in (a) (i) were not met. Prior to the MVL Desmonds continued to trade and no sale, disposal or liquidation of Desmonds had occurred. Further, no decision had been made about the continuation of the Scheme. For these reasons it is difficult to see how rule 16 applied.

80. In the alternative, it was submitted that had the Trustees known of the situation then they could have approached the Occupational Pensions Regulatory Authority (“OPRA”) which could have used its powers to assist the Trustees. However, it was conceded by the Trustees that there was no evidence before us that this was likely to

happen. In any event we accept, as submitted by the Targets, that the most likely outcome would have been that OPRA would have, in the first instance, suggested that the Trustees try and use the Scheme's contribution rule.

81. We are of the view that one way in which the Trustees might have extracted more value from the Desmonds would have been to use the contribution rule which is set out in the Scheme's rules at 4.2. Essentially rule 4.2 provides that the Trustees can require Desmonds "to provide the benefits under the Scheme" which could include seeking the buyout cost.
82. If Mr Desmond and Mr Gordon had been less concerned with maximising their interests as shareholders and more willing to be open with the Trustees then it is possible that the Trustees may have used the contribution rule in their favour. However, it is also possible that Desmonds would have triggered the MVL before any such demand had been made or while negotiations were ongoing.
83. We cannot be sure ultimately what would have happened. However, on a subjective view we think that had the Trustees known the true position then it is likely that they would have attempted first to negotiate with Desmonds. Equally we think it a reasonable assumption that as a fair minded and reasonable employer Desmonds would have engaged with the Trustees in the negotiation but with the ability and resolve to use the MVL. We believe that it is likely that the outcome would have been a larger payment than the £4 million that Desmonds actually paid though falling significantly short of the buyout cost.
84. We considered the fact that in April 2007 the Regulator concluded its enquiries into the MVL and stated that it would not be reasonable to issue a CN against the Targets. The Regulator then, at the very extreme limit of the statutory deadline, decided to pursue the Targets after all. While the Targets did not argue that the Regulator's decision in April 2007 created a "legitimate expectation" the Panel takes the Regulator's late change of position into account when assessing what is a reasonable amount to specify in the CN.



85. Ultimately taking all of the above into account including what we think may have been the likely outcome of any negotiation we are of the view that imposing a liability of £1 million is reasonable in the circumstances. Given the distribution of the proceeds of the sale of Desmonds we are of the view that it would be reasonable to split the £1 million liability between Mr Desmond and Mr Gordon in the ratio of £900,000 and £100,000. We do not impose joint and several liability.

**Other matters**

86. This document constitutes a determination to exercise the power to issue a CN. Accordingly time, for the purposes of any appeal to the Tribunal, begins to run from the date of this determination notice. A CN will follow after a period of 28 days or an unsuccessful appeal to the Tribunal.
87. **Appendix 2** to this Determination Notice contains important information about the rights of appeal of the parties against this decision.

Signed: *John Scampion*

Chairman: John Scampion

Dated: 17 May 2010

## **Appendix 1**

### **Article 4 of the Pensions (Northern Ireland) Order 2005**

#### **Regulator's objectives**

- (1) The main objectives of the Regulator in exercising its functions are –
- (a) to protect the benefits under occupational pension schemes of, or in respect of, members of such schemes,
  - (b) to protect the benefits under personal pension schemes of, or in respect of, members of such schemes within paragraph (2),
  - (c) to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (see Part III), and
  - (d) to promote, and to improve understanding of, the good administration of work-based pension schemes.
- (2) For the purposes of paragraph (1)(b) the members of personal pension schemes within this paragraph are-
- (a) the members who are employees in respect of whom direct payment arrangements exist, and
  - (b) where the scheme is a stakeholder pension scheme, any other members.
- (3) In this Article -
- “stakeholder pension scheme” means a personal pension scheme, which is or has been registered under Article 4 of the 1999 Order (register of stakeholder schemes);
- “work-based pension scheme” means-
- (a) an occupational pension scheme,
  - (b) a personal pensions scheme where direct payment arrangements exist in respect of one or more members of the scheme who are employees, or
  - (c) a stakeholder pension scheme.

## **Article 95 of the Pensions (Northern Ireland) Order 2005**

### **Duty to have regard to the interests of members etc**

- (1) The Regulator must have regard to the matters mentioned in paragraph (2) –
  - (a) when determining whether to exercise a regulatory function –
    - (i) in a case where the requirements of the standard or special procedure apply, or
    - (i) on a review under Article 94, and
  - (b) when exercising the regulatory function in question.
- (2) Those matters are –
  - (a) the interests of the generality of the members of the scheme to which the exercise of the function relates, and
  - (b) the interests of such persons as appear to the Regulator to be directly affected by the exercise.

## **Appendix 2**

### **Referral to the Tax and Chancery Chamber of the Upper Tribunal (“the Tribunal”)**

You have the right to refer the matter to which this Determination Notice relates to the Tribunal. Under Article 97(1)(a) of the Pensions (Northern Ireland) Order 2005 (“the Order”) you have 28 days from the date this Determination Notice is given to refer the matter to the Tribunal or such other period as specified in the Tribunal rules or as the Tribunal may allow. A reference to the Tribunal is made by way of a written notice signed by you and filed with a copy of this Determination Notice. The Tribunal’s address is:

The Tax and Chancery Chamber of the Upper Tribunal  
15-19 Bedford Square  
London  
WC1B 3DN  
Tel: 020 7612 9649.

The detailed procedures for making a reference to the Tribunal are contained in Article 97 of the Act and the Tribunal Rules.

You should note that the Tribunal rules provide that at the same time as filing a reference notice with the Tribunal, you must send a copy of the reference notice to The Pensions Regulator. Any copy reference notice should be sent to:

Determinations Support  
The Pensions Regulator,  
Napier House  
Trafalgar Place  
Brighton  
BN1 4DW.

Tel: 01273 627698