The Pensions Regulator	**Special Procedure** **REASONS of the DETERMINATIONS PANEL of THE PENSIONS REGULATOR in relation to the Final Notice issued on 9 November 2012** **Pursuant to section 99(4) of the Pensions Act 2004 (the "Act")** **Pennines RBS;** **Mendip RBS; and** **Malvern RBS** **("the Schemes")**	**The Pensions Regulator case ref:** **C9074071**

Introduction

1. The Determinations Panel (the "Panel"), on behalf of the Pensions Regulator (the "Regulator"), met on 8-9 November 2012 to carry out a compulsory review under section 99 of the Act of the determinations it had made on 28 March 2012 in respect of the Schemes.

2. Those determinations were made under the special procedure, as defined in section 98(2) of the Act. The Panel had received a Request from the Regulator dated 28 March 2012, and evidence in support of it.

3. The determinations of the Panel were to make orders under section 7 of the Pensions Act 1995 appointing Dalriada Trustees Limited ("DTL") as a trustee of the Schemes with DTL's powers and duties to be exercisable to the exclusion of other trustees, and to make orders under section 9 of the Pensions Act 1995 that all property and assets of the Schemes be vested in, assigned to and transferred to DTL.

4. Pursuant to those determinations, orders were made in respect of the Schemes on 28 March 2012 that provided as follows:

(1) *"Dalriada Trustees Limited of Chamber of Commerce House, 22 Great Victoria Street, Belfast, BT2 7BA is hereby appointed as trustee of the Scheme with immediate effect from 28 March 2012.*

(2) *This order is made because the Pensions Regulator is satisfied that it is reasonable to do so, pursuant to the relevant provisions of the Pensions Act 1995 as set out below, in order:*

i. *to secure that the trustees as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the Scheme pursuant to Section 7(3)(a);*
ii. *to secure the proper use or application of the assets of the Scheme pursuant to Section 7(3)(c);*
iii. *otherwise to protect the interests of the generality of the members of the Scheme pursuant to Section 7(3)(d).*

(3) *The powers and duties exercisable by Dalriada Trustees Limited shall be to the exclusion of all other trustees of the Scheme pursuant to Section 8(4)(b) of the Pensions Act 1995.*

(4) *Pursuant to Section 8(1)(b) of the Pensions Act 1995, the fees and expenses of Dalriada Trustees Limited shall be paid out of the resources of the Scheme.*

(5) *Pursuant to Section 8(2) of the Pensions Act 1995, it is ordered that an amount equal to the amount paid out of the resources of the Scheme by virtue of Section 8(1)(b) is to be treated for all purposes as a debt due from the employer to the trustees of the Scheme.*

(6) *Pursuant to Section 9 of the Pensions Act 1995, it is ordered that all property and assets of the Scheme, heritable, moveable, real and personal, of every description and wherever situated be vested in, assigned to and transferred to Dalriada Trustees Limited as trustee of the Scheme.*

(7) *This order may be terminated, or the appointed trustee replaced, at the expiration of 28 days' notice from the Pensions Regulator to the appointed trustee, pursuant to Section 7(5)(c) of the Pensions Act 1995."*

5. Pursuant to section 99(1) and (2), where the special procedure applies the Regulator, acting by the Panel, must review the determination to exercise the regulatory function. Accordingly such a review took place in this case on 8 and 9 November 2012, including an oral hearing on 8 November 2012. The delay in holding this hearing was due to the request by the Hedge Companies not to hold the hearing until the conclusion of a summary judgment application in concurrent related High Court proceedings as explained below, and the subsequent difficulty of listing an oral hearing that had been requested by the Hedge Companies.

6. Having completed the review the Panel determined to confirm the determinations made on 28 March 2012 and the orders given as a result of those determinations.

7. On 9 November 2012 a Final Notice to this effect was sent to the persons who appeared to the Panel to be directly affected by its determination on the review, in accordance with section 99(4). That Final Notice stated that the reasons of the Panel would be published separately. These are the Panel's reasons.

Parties and Representation

8. The Panel received written and oral submissions from a number of parties, not all of whom the Panel considered to be directly affected by the determinations that had been made.

9. The Regulator's Request dated 28 March 2012 specified the following parties as being directly affected by the regulatory action outlined in that Request, and the Panel agreed that these were "directly affected parties":

    i. John Laurence Woodward and Jennifer Doris Ilett (together the "Trustees")
    ii. DTL, and
    iii. Clarendon Hill Investments Limited – (the "Provider" in respect of the Schemes, a position akin to the sponsoring employer).

10. In the factual circumstances of this case, as described below, the Panel determined that Pitmans Trustees Limited ("PTL") and the Schemes' administrator, T12 Administration Limited ("T12"), were also directly affected parties.

11. Of these parties the Panel received written submissions from or on behalf of Mr Woodward, Ms Ilett, DTL, PTL, and T12.

12. The Panel also received written submissions on behalf of the Regulator.

13. The Panel also received written communications from a number of members of the Scheme. The Panel had considerable regard to the importance of hearing from members in this matter. As will become clear, one key issue in this review was whether DTL's actions as independent trustee of the Scheme have been in the best interests of members. The Panel therefore communicated to the parties in advance of the hearing that it considered it important that members of the Schemes should feel able to make their views known to the Panel, and should not feel restricted from doing so by a lack of legal representation. We considered it was appropriate, in the particular circumstances of this Scheme, to take this action in order to further our compliance with the duty placed upon us by section 100. This is a duty to have regard, when carrying out a review under section 99, to the interests of the generality of members of the scheme to which the exercise of the regulatory function that has been exercised relates.

14. Finally the Panel received written submissions on behalf of three companies that were used as investment vehicles for assets of the Schemes. They are Hedge Capital Investments Limited, Hedge Capital Investments Group plc and Hedge Capital Limited ("the Hedge Companies" and HCIL, HCIG and HCL respectively). The Panel determined that these companies were not directly affected parties. While

they were indirectly affected by the appointment of DTL as a trustee of the Schemes, they were not directly affected by that appointment. In the Panel's view the Hedge Companies would be affected by the appointment by reason of the intervention of an intermediate agency, namely the Trustees, since the previous use of the Schemes' assets might alter and the Hedge Companies were third parties that the Trustees dealt with for investment reasons, rather than being directly involved in the operation of the Schemes and thus directly affected by the appointment of DTL. In this regard the Panel adopts the reasoning of the House of Lords in *R v Rent Officer Service ex parte Muldoon & Kelly* [1996] 1 WLR 1103 in finding the Hedge Companies not to be directly affected persons within the meaning of section 98(2)(a) of the Pensions Act 2004.

15. The Panel did however allow the Hedge Companies to make written and oral submissions. We did so for three interlinked reasons, specific to the facts of this case:

    (a) We noted that no party other than the Hedge Companies was active in putting forward a positive case that DTL's appointment should not be confirmed. The Regulator argued for DTL's appointment to be confirmed; DTL expressed itself neutral on this issue; Ms Ilett was also neutral (although her representations endorsed the suggestion that an independent trustee should be appointed), and Mr Woodward expressed a view by email that the appointment of an independent trustee other than DTL would be appropriate, but his reasons were simply to share the views and concerns of the Hedge Companies and he played no active role in the proceedings. We should note that Mr Woodward resigned as a Trustee on 20 March 2012. Allowing representations from the Hedge Companies assisted the Panel by causing the points in issue to be tested in argument. We noted that the Hedge Companies had been given permission to make written submissions to the High Court judge hearing a Beddoe application concerning the Schemes that covers similar issues to those we are concerned with.
    (b) The Hedge Companies and those individuals standing behind them were in large part the architects of the activities in the Schemes that were relied upon by the Regulator to justify the appointment of DTL as independent trustee. The Hedge Companies had considerable knowledge of the uses to which the assets of the Schemes had been put and were proposed to be put, the communications made to members when joining the Schemes, and the tax regime within which the Schemes operate.
    (c) The Hedge Companies were able to assist the Panel in identifying the wishes of certain members of the Schemes. As noted above, the Panel considered the issue of members' interests to be important in this case. Allowing the Hedge Companies to make representations to the Panel increased the Panel's access to the views of the membership and allowed us to receive clear submissions on the question of where members' best interests lay in this matter.

16. As regards oral representation at the hearing:

    (a) The Regulator was represented by Mr Paul Newman QC;
    (b) DTL was represented by Mr Fenner Moeran of counsel;
    (c) The Hedge Companies were represented by Mr John Stephens of counsel; and
    (d) Ms Ilett was represented by Heffords Solicitors. No oral submissions were in fact made on her behalf, although an opportunity was afforded for these at Ms Ilett's request.

Issues

17. All parties accepted before the Panel that the determinations made on 28 March 2012 had been correct. The Hedge Companies did not seek to have DTL's appointment revoked from its inception, but rather to have DTL replaced for the future based on its actions since appointment.

18. The only issue in dispute between the parties was whether DTL should be confirmed as independent trustee of the Schemes, with exclusive executive powers, or whether another independent trustee should now be appointed in place of DTL. The Hedge Companies had initially suggested that PTL be the replacement independent trustee, but at the hearing their position was that they were content to leave the identity of the replacement to the Panel.

19. Despite the common ground between the parties that the original determinations should not be altered, for the reasons given below the Panel considered that it should satisfy itself that the original determinations were appropriate on the evidence now available to it, before turning to the issue in dispute between the parties. We therefore propose to consider first the question of whether to confirm the determinations made on 28 March 2012 to appoint an independent trustee to the Schemes with exclusive powers, and to vest the Schemes' property in them, before turning to whether DTL should be confirmed in that role for the future.

Review

20. Section 99 describes the Regulator's powers on a compulsory review such as this:

    "(3) The Regulator's powers on a review under this section include power to–
    (a) confirm, vary or revoke the determination,
    (b) confirm, vary or revoke any order, notice or direction made, issued or given as a result of the determination,
    (c) substitute a different determination, order, notice or direction,
    (d) deal with the matters arising on the review as if they had arisen on the original determination, and

(e) make savings and transitional provision."

21. On a compulsory review under section 99 we are reviewing the original determinations to exercise the regulatory function in question, in light of the representations received in relation to those determinations since they were made (s.98(2)(d)). However we also have power to deal with new matters arising on the review as if they had arisen on the original determination (s.99(3)(d)).

22. On a compulsory review the Panel thus approaches the case before it on the basis of a "rehearing" of the question whether to exercise the regulatory function and of the appropriate order, notice or direction to make (if any). The Panel will take into account all the evidence and representations that are now available to it, any new matters arising, and the material that was before it at the original hearing. This is in accordance with paragraph 15 of the Panel's Procedure, and with the position as described by the Panel in its decision in the case of the *Brownberrie Pension Scheme and Others* dated 10 August 2011 at paragraph 2.1.

23. The above analysis is of some importance in this case, since the Hedge Companies state that the Panel "is not being asked to review its original decision" (paragraph 24 of their Representations). As noted above, the issue between the parties is whether an order should now be made appointing a new independent trustee of the Schemes in place of DTL. We heard no submissions on whether this would have to be done by variation of the original order or substitution of that order by a new one, or some other procedural route. We are content however that section 99 gives the Regulator power on a review such as this to replace one independent trustee with another if it considers it appropriate.

Background to original determination

24. The factual background to the Schemes was set out by the Chancellor in a judgment given on 15 June 2012 in proceedings brought by DTL against the Trustees and the Hedge Companies as follows:

"1 By trust deeds dated respectively 23rd August and 9th September 2011 made between Clarendon Hill Investments Ltd and the first and second defendants, Mr Woodward and Ms Ilett, the Pennines and the Mendip Retirement Benefit Schemes were established as occupational pension schemes for the sole purpose of providing pensions and lump sum benefits for their members. In each case Mr Woodward and Ms Ilett were the trustees, T12 Administration was the scheme administrator and the Scheme was registered with HMRC under s.153 Finance Act 2004. The effect of such registration was to confer substantial tax advantages on the schemes and their members as well as to impose limitations on what benefits might be conferred on such members and when.

2 The establishment of the Pennines and Mendip schemes was part of a plan for 'pensions liberation' devised and implemented by and for Mr Woodward and Mr John Davies through the third, fourth and fifth defendants. Mr Woodward is the sole

shareholder and controlling director of both Clarendon Hill Investments Ltd and the fifth Defendant Hedge Capital Ltd ("HCL"). Mr Davies is the majority shareholder and controlling director of the fourth defendant Hedge Capital Investment Group plc ("HCIG"). He is also a director of its wholly owned subsidiary the third defendant, Hedge Capital Investments Ltd ("HCIL"). The material elements of the plan were:

- *(1) Members of other occupational or personal pension schemes were to be encouraged to transfer the cash equivalent of their benefits under those schemes to Mr Woodward and Ms Ilett as the trustees of the Pennines or Mendip schemes under s.95 Pension Schemes Act 1993.*
- *(2) The money so received by Mr Woodward and Ms Ilett was to be applied by them in subscribing for preference shares in HCIG yielding 3% per annum payable out of distributable profits and an additional dividend up to half such annual profits at the directors' discretion.*
- *(3) The subscription money received by HCIG was to be lent on to HCIL repayable on demand with interest at 3% above Barclays Bank base rate and secured by a debenture dated 20th October 2011 on all the assets present and future of HCIL.*
- *(4) The proceeds of such loans from HCIG were to be applied by HCIL in (a) making loans to HCL repayable on three months notice with interest at 4% above Barclays Bank base rate as provided by an agreement made between them dated 20th October 2011 and secured by a debenture made the same day on all the property of HCL and (b) investing the balance in, as described by Mr John Davies, "alternative (or unregulated) products" or "appropriate investment opportunities".*
- *(5) The money lent to HCL by HCIL was to be applied in making advances to members of the Pennines or Mendip pension schemes. The amount of such advances was calculated by reference to the lump sum to which the member would be entitled on retirement and carried interest at the rate of 5% payable monthly. The advances were unsecured and repayable at the expiration of a term of between 14 and 27 years.*

Thus, the overall effect of this plan was that the sums transferred into the Pennines or Mendip pension scheme funded the loan to the member if he wanted one and the investments held by HCIL.

3 In implementation of the plan, between October 2011 and 28th March 2012 476 individuals transferred approximately £19m from other occupational pension schemes to the trustees of the Pennines and Mendip pension schemes. Such sum (less expenses and a small retention in cash) was applied by them in subscribing for 18,086,000 preference shares in HCIG. Approximately £6.5m was applied by HCL in making loans to members of one or other scheme. £2.750m was invested by HCIL and is now represented by 58 plots of land in Brazil to be used for the growing and harvesting of teak trees, 1,000 acres of agricultural land in Florida, shares in Street of Dreams Ltd for investment in a musical production and shares in Ko-Su Ltd which has developed a mobile learning platform. The balance has been used to pay commission or expenses or is now standing to the credit of the bank accounts of HCIG, HCIL or HCL."

We note the Chancellor's use of the phrase "pensions liberation" for the events of this case in paragraph 2 of his judgment. The applicability of this term in this case was a matter of dispute before us. The parties used the term in both a generic sense and in the sense set out in sections 18-20 of

the Act. The Panel made no finding on whether the Schemes were being used for "pensions liberation" in either sense.

It is also relevant that in November 2011 Pitmans LLP were instructed by Clarendon Hill, the provider of the Scheme, to give legal advice on the Schemes' structures. Advice was in turn sought from counsel, who highlighted Mr Woodward's conflict of interest (in acting as trustee and the director of Clarendon Hill) and the risks regarding the proposed investments being contrary to the Occupational Pension Schemes (Investments) Regulations 2005 and the loans being unauthorised payments under the Finance Act 2004. This advice does not appear to have been acted upon.

25. There were also steps to appoint PTL as independent trustee of the Pennines and Mendip Schemes (the Malvern Scheme had no assets or members). PTL issued a client care letter in respect of the Pennines and Mendip Schemes in November 2011 and produced some scheme documentation at the end of that month. Steps were taken to appoint it as trustee of the Pennines Scheme on 20 March 2012, although it is unclear that PTL was formally appointed by 28 March 2012 when DTL was appointed. It is also unclear what degree of involvement the Hedge Companies had in progressing this appointment; they are shown on certain documents as responsible for or involved in the appointment of PTL, and may therefore share some blame for the delay in effecting it. PTL informed the Panel on 20 April 2012 that it did not intend to make any representations on this review.

26. The basis for the determinations of 28 March 2012 are given in the Determination Notice signed on 3 April 2012. In summary, the Panel was satisfied that it was reasonable to appoint an independent trustee to the Schemes, by reference to the matters set out in section 7 of the Pensions Act 1995, in order:

    i. to secure that the trustees as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the Schemes pursuant to Section 7(3)(a);
    ii. to secure the proper use or application of the assets of the Schemes pursuant to Section 7(3)(c); or
    iii. otherwise to protect the interests of the generality of the members of the Schemes pursuant to Section 7(3)(d).

27. The Panel placed particular emphasis on the following, as it set out at paragraph 7 of its Determination Notice signed on 3 April 2012:

    1. "Clarendon Hill as provider was held out by the Trustees to be an employer setting up an occupational pension scheme with membership restricted to the present, former and future employees of it as provider. This appeared not to be the case given that deposits had been made by members who were not associated with the company and the scheme administrator, T12, had expressly

stated that there was no such restriction. The Panel was satisfied on the evidence presented that this was not a bona fide occupational pension scheme in which funds are held under a trust to provide pension benefits on retirement. The Panel considered on the evidence provided that it was more likely that the Schemes were represented to depositors as a vehicle for the release of pension capital in a manner to circumvent legally enforceable limitations on its use.

2. *There was a clear conflict of interest in the Trustee John Woodward holding the position of sole director and shareholder of HCL, the company that ultimately received the capital invested by the members, which in the Pennine and Mendip Schemes amounted to a sum in excess of £7 million. The loan making objectives of HCL – both those expressly stated of short term property bridging advances and the loans made in practice of advances to individual members - were not consistent with and in conflict with the duties of a trustee in securing the proper long term growth and security of the pension funds entrusted to Mr Woodward as Trustee.*

3. *The evidence in bank statements for the Pennines Scheme exhibited by the Regulator demonstrated that funds received from members were quickly and systematically being paid out to HCL. The evidence in bank statements for HCL included a substantial payment out described as 'cash from pensions'. The bank statements appeared to provide prima facie evidence that the main purpose of the arrangements was the release of cash from pensions in the form of loans and not the proper trusteeship of pension assets.*

4. *There was an obvious breach of appropriate investment principles and consequently a breach of the fiduciary duties owed by trustees. Loans to individual members whose particular circumstances were apparently unexamined by either the Provider - Clarendon Hill - or by the Trustees were inherently risky and not in the longer term interest of making best use of scheme funds. Moreover, placing of substantial funds in this way by making a series of loans to members constituted a clear failure to diversify the investment in breach of the Occupational Pension Investment Rules 2005.*

5. *There was lack of clarity about the use and whereabouts of that part of the total funds invested in the Pennine and Mendip Schemes and transferred to HCL and which had not been advanced by way of loan to individual members. The Panel could not be satisfied that the monies either were secure or had not been invested in a further inappropriate purpose."*

28. For these reasons the Panel concluded on 28 March 2012 that all three grounds for the determination under section 7 of the 1995 Act were made out in respect of each of the three Schemes. Whilst the evidence in respect of the Malvern Scheme was not as direct as that in relation to the

Pennine and Mendip Schemes, the Panel was satisfied, given the involvement of one of the trustees, Mr Woodward, as sole director of Clarendon Hill the provider of the Malvern Scheme, that there were reasonable grounds for concern in that the arrangements for that scheme were similarly likely to put scheme assets at immediate risk.

29. In light of all the evidence submitted to the Panel for this review (including material not available to us in March 2012) the Panel was more than satisfied that the determination to appoint an independent trustee to the Schemes had been correct. The Panel placed particular reliance on:

    (a) The clear conflict of interest that the Trustees had allowed to exist regarding the roles of Mr Woodward, as described at paragraph 27(2) above.

    (b) The inappropriate way in which the Schemes assets had been invested. In that regard it was clear to us, as it had not been in March 2012, that the monies transferred into the Pennines and Mendip schemes by their members (the Malvern scheme never became active) were almost all used by the Trustees to subscribe for preference shares in HCIG, and that those shares could not be redeemed at the Trustees' request but only at the discretion of the directors of HCIG (Article 46 of HCIG's Articles of Association). They thus represented an investment in a single asset class of a single company, over which the Trustees had no real control. They gave a right to a 3% dividend if HCIG made distributable profits, and a further dividend of up to 50% of those profits if the directors of HCIG so decided (including Mr J Davies, a 65% ordinary shareholder, whose interests would have been best served by HCIG paying no further dividends on preference shares but declaring dividends on ordinary shares). It thus appears that the preference shares were set up in a way that those proposing the Schemes could profit if HCIG's investments did well (as could the Schemes, but depending on the exercise of the HCIG board's discretion), whilst avoiding losses if HCIG's investments did badly. The Schemes would suffer losses if those investments did badly. They would in those circumstances be unlikely to receive a dividend of 3%, or at all and might not receive their original investment back in full.

    (c) The unsuitability of the underlying investments, which the Panel considered against the background of the structure set out above. £2.7m of the £19m transferred out of the Schemes was in turn invested in assets that on any analysis were unconventional and we consider bore an inappropriate risk for pension fund investments, including land in Brazil for the growing and harvesting of teak trees and shares in a company, Street of Dreams Limited, proposing to produce a musical based on Coronation Street. Further, £6.5m of the £18m invested in HCIG was loaned back to members by way of loans to be repaid from the 25% lump sum of their pensions that could be taken at retirement. We considered there was a real risk that these

loans might not be repaid, if the Scheme's other assets had not performed sufficiently well to produce a lump sum payment that equalled the original amount of the loans. The resulting defaults would further reduce the Schemes' assets and reduce the amounts available to other members on retirement, in turn increasing the chance that they too would not be able to repay the amounts they had originally borrowed. The Hedge Companies were unable to say how they proposed to deal with this risk. We were told that there was no method in place for addressing the risk caused by HCL borrowing funds at a variable rate of 3% above Barclays base rate and lending those funds out at a fixed rate of 5%. We were also told that at the time of the appointment of DTL the Hedge Companies were still working to address matters such as the risk inherent in the above structure. We consider this wholly inadequate, given that some six months had elapsed since the establishment of the Schemes and over £18m had already been invested by the Trustees in HCIG. Finally we consider the Hedge Companies were wrong to suggest that each member had their own "account" in the Schemes, if this was intended to imply their funds were safer as a result. In fact the investments made by HCIG were made without keeping one member's fund separate from another, and each bore a pooled risk of investment underperformance. In summary the Panel's view on the unsuitability of investments was that:

i. Scheme funds had been invested in shares in HCIG structured in a way unlikely to deliver the promised returns to members;
ii. HCIG's underlying investments bore inappropriate risk, and
iii. Those investments were insufficiently diversified.

(d) The inappropriate way the Schemes were marketed to customers. This was conducted by a Mr Howard Davies, a general manager of HCL, who describes in a witness statement of 16 May 2012 how he told prospective members of the "guaranteed growth of 3% of the pension". This was seriously misleading, as the Hedge Companies now accept, in that the Schemes' investments provided no guarantee of growth. We accept that the Trustees were not the authors of this communication, but they nevertheless allowed the Scheme to be represented in that manner.

30. Having considered all the evidence now available we concluded that the determinations made on 28 March 2012 had been correct, and we decided to confirm those determinations.

31. It is unfortunate that the Warning Notice did not refer to the involvement of PTL with the Schemes in the period leading up to 28 March 2012. That involvement was relevant, to the issues of whether to utilise the special procedure, whether to appoint an independent trustee, and to the question of the identity of that trustee. The steps taken to appoint PTL as independent trustee of the Schemes support the Panel's view in March

2012 that an independent trustee should be appointed, but would have been a factor counting against the use of the special procedure at that time. The use of the special procedure might still have been appropriate, but this would have been a relevant factor in that consideration.

Events since 28 March 2012

32. It is necessary to set out the key events since DTL's appointment as they form the basis of the Hedge Companies' argument that DTL has failed to act in the best interests of members, has fallen out irretrievably with members and the Hedge Companies, and has commenced proceedings calculated to result in serious damage to members.

33. On 2 April 2012 DTL obtained freezing orders against the Hedge Companies and the Trustees, limited to £12m (later increased to £18m). These were obtained at a hearing without notice and continued on 18 April 2012.

34. On or about 3 April 2012 DTL issued a claim against the Trustees and Hedge Companies in the High Court. It alleged several breaches of duty on the part of the Trustees by investing Scheme monies in breach of the Occupational Pension Schemes (Investments) Regulations 2005, which require Scheme assets to be predominantly investments admitted to trading on regulated markets, to be properly diversified, and to be calculated to ensure the security, quality, liquidity and profitability of the relevant portfolio as a whole. The Particulars of Claim also alleged that the transfers of Scheme monies to the Hedge Companies were outside the scope of the powers of the Trustees, a fraud on those powers, and "unauthorised member payments" (as defined by the Finance Act 2004). The relief claimed at the conclusion of the Particulars of Claim, dated 24 April 2012, comprises an account of the transfers of Scheme monies, orders for delivery up of the money transferred and payment of sums found due and owing thereon and / or equitable restitution in lieu, and rescission of any investments in HCIL and HCIG with an order that all of the Hedge Companies restore the sums transferred out of the Schemes to them, or restore the proceeds thereof, to the Schemes.

35. On 17 April 2012 Mr Woodward and Mr Davies swore affidavits pursuant to the freezing order describing the funds transferred out of the Schemes and the use to which those funds had been put.

36. On 14 May 2012 the Hedge Companies applied for summary judgment dismissing DTL's claims on the basis they had no real prospect of success. That application was heard on 29-30 May 2012 and dismissed by the Chancellor of the High Court in his judgment of 15 June 2012.

37. On 14 August 2012 DTL issued an application for what is commonly termed "Beddoe" relief, seeking permission for it to continue the High Court proceedings and an indemnity against all costs of those proceedings out of the assets of the Schemes. That application came on

for hearing on 5 November 2012 but we were told was adjourned to 12 November 2012.

38. We were informed that the parties to the High Court proceedings had taken steps to compromise that action, but that those steps had been unsuccessful. For understandable reasons we had before us no details of those steps, but the failure to compromise formed a basis for the Hedge Companies' submission that the relationship between them and DTL had broken down such that they could not prosper while DTL remained in place. Since the financial wellbeing of the Schemes' assets depended, it was said, on the Hedge Companies prospering, a breakdown in this relationship damaged members' interests.

39. It is also relevant to note certain matters that did not occur during the period 28 March to 8 November 2012.

40. DTL did not approach the Regulator and ask it to utilise the powers available to it under sections 18-20 of the Act. These are headed "pension liberation" and allow the Regulator to apply to court for an order securing any money "liberated" from a pension scheme within the meaning of that phrase in s.18(2). As the Chancellor noted in the passage of his judgment quoted above, it has been alleged that "pensions liberation" has occurred in this case. We were told by DTL that it did not allege "pension liberation" within the meaning of section 18-20 of the Act, but in a wider sense. DTL considered the use of these sections but did not ask the Regulator to utilise them. The Regulator told us, in argument, that had such a request been made it would have been considered, but that the Regulator's view in March 2012 was that a) the provisions of ss.18-20 of the Act were not appropriate or sufficiently compendious to deal with all of the Regulator's concerns about the Schemes, which went wider than pensions liberation and the loans made to members, and b) the resources of the Regulator were better directed to ensuring the appointment of an independent trustee than to litigation under ss.18-20 of the Act. Thus the decision was taken to seek the appointment of an independent trustee.

41. It is also relevant that members do not appear to have received from DTL as full and clear a statement of their situation as they perhaps could have done. Only in the week before the hearing of this review did DTL make clear to members that the High Court proceedings did not seek an order that would force members who had taken loans from HCL to repay them immediately. We also note that there does not appear to have been any clear statement by DTL to members of the risk inherent in the investment of their pension monies by virtue of the terms of HCIG's preference shares, the various interest rates in play and the unconventional assets in which the Schemes' monies had been invested. We considered it would have been preferable if fuller information had been given to members sooner, but we formed the view that this was a matter of judgment for independent trustees. While it appeared, on the evidence before us, that fuller information could have been given, this did not form a basis for

concluding that DTL should be replaced as independent trustee of the Schemes.

Argument

42. The Hedge Companies argued that DTL should be replaced on the grounds that the relationship between DTL and the Schemes' members, and the Hedge Companies, had broken down. They pointed to the failure to compromise the litigation to date, and stated that a new trustee would be able to attempt to negotiate a settlement without the relationship history that DTL had in this matter. They accepted that a new trustee would have to carry out its own assessment of whether to continue the litigation, with the benefit of the Beddoe Judge's ruling, but said that nonetheless a new trustee would stand a greater chance of achieving a settlement with the Hedge Companies.

43. Further they argued that DTL's continuation of the proceedings would damage members' interests. In support of this latter point they stated that DTL's success in the proceedings would result in significant costs from the process of unwinding investments that would ensue, and highly damaging tax consequences for members who were unable to repay their loans immediately. They then relied on communications from various members in response to an email from Mr Woodward dated 31 October 2012 that sought members' views on DTL continuing with the High Court litigation at the expense of the Schemes, and seeking repayment of the loans made to most members (loans were made to some 370 of the 476 members). All members whose responses we were shown (we were told around 40 had expressed views) wished the litigation to cease and said that it was not in their best interests for repayment of the loans to be sought. A number reported that they were happy for the original investment plans to continue and were opposed to DTL's actions in taking and continuing the proceedings. They were particularly opposed to the use of the Schemes' assets to fund DTL's legal fees in the litigation. One member reported that what frustrated him most was the lack of information. Another said that the litigation sounded as though DTL were suing on behalf of the Regulator, which should be at the Regulator's cost if so. Others emphasised that it should be their decision what happened to their pension fund.

44. The Hedge Companies noted a number of legal authorities to the effect that where a trustee is impeding the execution of the trust for the benefit of the beneficiaries the court may remove him. They argued that that principle applied to support the removal of DTL.

45. A further strand to this argument was that DTL was allegedly continuing with the proceedings as an "enforcer" of the Regulator. It has been noted that the Regulator has powers under ss.18-20 of the Act to take steps against pension liberation within the meaning of those sections. The Hedge Companies argued that it was the Regulator that had the duty, and power, to take action in true cases of pension liberation (which they

denied had occurred in this case). It was not appropriate for any trustee to use Scheme monies to fund litigation contrary to members' interests in order to disrupt what the Regulator considered to be pension liberation.

46. Finally the Hedge Companies stated that DTL was in a position of conflict in remaining in office as it had taken the proceedings this far without a Beddoe order confirming that its costs would be indemnified from Scheme assets. DTL was therefore said to be "fighting for its life" in the Beddoe application, since if it lost it would have to discontinue the proceedings and be left liable to pay legal fees that exceed the net worth shown on its latest balance sheet. DTL was said to be unable to present the sort of impartial approach required of a trustee in Beddoe proceedings.

47. At the hearing Mr Stephens developed his argument to rely more heavily on his contention that the relationship between the Hedge Companies and DTL had become untenable, such that it was appropriate to replace DTL. He described a "difference in philosophy" between the Regulator and DTL on the one hand and the Hedge Companies on the other as regards the best interests of members. This difference was in the weight to be put on the members' views that they did not wish the litigation to continue. He described the Regulator and DTL taking a view that they knew better than the members where the best interests of members lay, and that in progressing the proceedings they appeared to consider they were acting to save members from themselves.

Decision

48. The issue before us is whether to replace DTL with another independent trustee of the Schemes for the future. It is important to recall that the basis for the Panel to appoint an independent trustee under s.7 of the Pensions Act 1995 is as follows:

"(3) The Authority may also by order appoint a trustee of a trust scheme where they are satisfied that it is reasonable to do so in order—
(a) to secure that the trustees as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the scheme,
(b) to secure that the number of trustees is sufficient for the proper administration of the scheme,
(c) to secure the proper use or application of the assets of the scheme , or
(d) otherwise to protect the interests of the generality of the members of the scheme."

49. We have therefore considered whether we are satisfied that the appointment of a replacement for DTL would be "reasonable" in order to achieve the aims set out in s.7(3)(a) to (d) of the Pensions Act 1995.

50. In answering that question it is important to note that all parties recognised that the Panel should not trespass on the territory of the Beddoe judge in deciding whether the proceedings should continue. We were told that the Hedge Companies were able to put written submissions before that judge, so that their arguments will be before that court, and it is clear from the papers that attempts have been made to secure a

representative beneficiary as a party to those Beddoe proceedings who will be able to make submissions on where the best interests of members lie. Accordingly we do not propose to consider whether the litigation should continue: the decision of the Beddoe judge on this point will apply equally to DTL or any replacement trustee in any event. Our focus is on whether the actions and inactions of DTL to date make it reasonable, in all the circumstances, for them to be replaced as trustee.

51. The parties were also agreed that we should not make findings on the issue of whether the structure used by the Schemes to cause loans to be made to members would result in adverse tax consequences for them. DTL's Particulars of Claim allege that the transfers of money from the Schemes to HCIL had the effect of making an unauthorised member payment within the meaning of the Finance Act 2004. The Hedge Companies dispute this, and it is an issue in the High Court proceedings. Before us Mr Stephens considered it sufficient to say that it was by no means clear there would be adverse tax consequences as a result of the payments made. We note that this depends on HMRC taking the view that the loans to members were genuine loans, but we make no finding on the tax consequences of the payments made out of the Schemes and the loans to members.

52. We turn first to the issue of members' interests. As noted, the communications we have seen from members were almost all in response to an email from Mr Woodward of 31 October 2012. We found this email misleading in a number of respects, and thus found that the members' views we received were based on inaccurate information. This was highly regrettable. Mr Woodward's email stated, for example, that the Hedge Group had taken professional advice to assist in the set-up and management of the Schemes. The evidence shows that the legal advice received in fact recommended significant changes be made, for example to diversify investments in order to comply with the 2005 Regulations, but that no changes were made and no actuarial advice on investment strategy appears to have been obtained. The email makes no mention of this.

53. We also did not consider that any proper explanation had ever been given to members of the risks to their pensions that were inherent in the structure and investments chosen by the former trustees and the Hedge Companies. We have already noted the misleading information given to prospective members regarding the "guaranteed growth of 3% of the pension" (paragraph 29(d) above). In these circumstances we found the expressions of members' wishes that we received to be expressed on the basis of misleading and incomplete information and unfortunately of little assistance on the issue before us. They did not show that replacing DTL was reasonable to protect members' interests, as the litigation that the members complained of might well be continued by a replacement trustee and the question of continuing the litigation is one before the Beddoe Judge. In any event, it is clear that the wishes of members (even if based on accurate information) may well not coincide with the best interests of

those members as members of a pension scheme. It is the latter to which the Panel must have regard.

54. We have noted that the Hedge Companies relied on legal authorities holding that where a trustee is impeding the execution of the trust for the benefit of the beneficiaries the court may remove him. These were decisions regarding trustees of family trusts, not pension schemes, and we considered this an important distinction given the very different legal and regulatory context within which pension schemes operate, which will affect (among other matters) investment decisions and uses of trust assets.

55. Indeed on the evidence we have seen, members' interests were very poorly served indeed by the investment structure adopted by the Trustees and Hedge Companies, by the unfavourable terms of the preference shares and HCIG's reliance on members being able to repay their loans, and by the choice of unconventional investments made by HCIG.

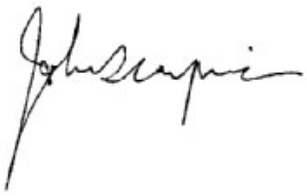
56. We were also unpersuaded that any breakdown in relationship between DTL, members and the Hedge Companies that had occurred was ground for DTL's removal. The failure to settle the High Court litigation is a fact, but we are unable to say that any party behaved inappropriately in this regard as we have not seen the relevant communications. In any event the main basis for any breakdown appears to be the continuation of the litigation, which may well be the policy of any replacement trustee. This is a question for the Beddoe judge, and in respect of it the Chancellor has already ruled that DTL's claims have real prospects of success. We did not conclude that DTL has acted inappropriately in continuing the litigation given that judgment. We also note that the Hedge Companies are likely to have restricted the scope for any settlement by their early application for summary judgment on 14 May 2012. Finally on this point we consider there is an important difference between an allegation that DTL's relationship with the members has broken down, and that DTL's relationship with the Hedge Companies has done so. The former allegation is an important matter, but the points made in the paragraph above are relevant to it. As regards the latter allegation, the relationship between a trustee and the investment vehicles for scheme assets should be a professional, arm's-length relationship intended to secure members' best interests. We have seen no evidence that DTL has prevented such a relationship operating in this case.

57. We were concerned by the possibility that action by the Regulator under ss.18-20 of the Act would have been a more appropriate route to address any pension liberation concerns in this case, without DTL embarking on its own High Court litigation funded by Scheme assets. We have noted above that DTL did not approach the Regulator after its appointment to explore the possibility of such action being taken. We were told by DTL and the Regulator that the facts of this case might not satisfy the tests of ss.18-20, and by DTL that some consideration of these provisions had been undertaken after appointment. We are alive to the risk of hindsight

in matters such as this, and to the apparent need to issue proceedings as a matter of urgency, but do consider that it would have been in members' interests for the possibility of action under ss.18-20 of the Act to be considered by DTL with the Regulator and ruled out before proceeding too far with DTL's own claims. We do not however consider this a factor of great weight in favour of replacing DTL for the future.

58. Finally we noted the allegation that DTL was unable to present the sort of impartial approach required of a trustee in Beddoe proceedings due to its conflict of interest in proceeding thus far without a Beddoe order. This appeared to us a matter for the Beddoe judge, and we note that the Hedge Companies may make this point in those proceedings. We have seen no evidence that DTL is unable to act impartially in fulfilling its trustee functions, as we would expect a professional trustee to do.

59. For all of these reasons we do not consider we should replace DTL with another independent trustee. We do not criticise the purposeful approach of DTL in obtaining a Freezing Order and seeking to secure the Schemes' assets, noting that the subsequent legal action has been prolonged and made much more expensive, in considerable part, by the response of the Hedge Companies to it. We found no evidence on which to conclude that any other independent trustee we might appoint would have taken any different course in relation to the litigation or formed a significantly different relationship with members or the Hedge Companies. As noted above, the criticisms made in relation to DTL's communications to members and failure to raise with the Regulator the possibility of action under ss.18-20 do not constitute fundamental shortcomings which should affect our decision.

Signed: 

Chairman: **John Scampion**

Dated: 29 November 2012