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ROBERT MAXWELL: Lessons Learned

November 16, 2007

The comments in the attached article are based on a series lectures given in Europe earlier this year about our firm's fourteen year investigation concerning Robert Maxwell's fraud and related bankruptcy actions that commenced in the early 1990s. The fraud involved public and private companies, foundations and trusts in Europe, United States and Japan.
Brian Rowbotham

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Lessons learned

Brian D Rowbotham looks at the valuable lessons that can be taken from Maxwell's international fraud

Robert Maxwell will be remembered as the architect of the greatest fraud in British history. It all happened right under the noses of the regulators and with the support of the well-paid but seemingly unwitting bankers, lawyers and accountants from the top firms in London. Maxwell built a vast publishing empire in the 1980s before it collapsed under a mountain of debt and fraud, which was only discovered following his mysterious death by drowning off the Canary Islands in November 1991. Born Jan Ludik Hoch in Czechoslovakia in 1923, he fled to Britain to avoid Nazi persecution. He served with distinction in the British Army and later became a British citizen, changing his name to Ivan du Maurier, then to Leslie Jones, and finally to Robert Ian Maxwell. However, the British tabloids had the last word when they dubbed him 'The Bouncing Czech'.

This article is intended to alert readers, particularly trustees, to key telltale signs where a Maxwell-type fraud can occur. From 1992 to 2006, we at Rowbotham & Company LLP were engaged, along with teams of forensic accountants and legal advisors in the UK, US, France, Germany and Liechtenstein, to assist the joint administrators in London with the daunting task of tracking down and recovering over GBP1billion of embezzled funds. The 14-year engagement involved accounting and forensic processes, international tax, and cross border litigation concerning private and public companies, and lesser known entities including *stiftings*, *anstalts* and foundations.

Maxwell's fraud

In the late 1980s, Maxwell withdrew vast sums from his flagship enterprise, Maxwell Communications Corporation plc (MCC), a listed company, to fund his personal buying-spree of companies held by Headington Ltd. He also used his MCC shares as collateral for personal loans to further expand his private acquisitions. When MCC's share price faltered, the value of his collateral declined, causing pressure on his loans. In an elaborate scheme, he began to funnel pension funds through myriad foreign entities he secretly controlled through nominees to acquire shares of MCC in the open market. The 'enablers' of this share support scheme were lawyers and investment banking firms based in New York and London. Maxwell was able to embezzle over GBP400million from various pension funds, in part because the Investment Management Regulatory Organisation (IMRO) approved Bishopsgate Investment Trust (BIT) as a trust management company. BIT was controlled by Maxwell's sons, Kevin and Ian. In another bold move, Maxwell Group Newspapers plc (MGN) was taken public in April 1991, six months prior to his death. He controlled MGN's board and had large unsecured personal loans before and after floating 49 per cent of the company. Despite virtually no board governance and eye-popping loan irregularities, solicitors and accountants in the City opined that all was in order when the company went public.

Immediately after Maxwell's death, numerous loans went into default, forcing his private and public enterprises into bankruptcy. In the end, the embezzled funds were used to acquire investments, some good, but many bad, and to set up an illegal share support scheme. As bankruptcies go, the recovery efforts were successful. The pension funds were made whole as a result of litigation settlements, and by the British government (i.e. the taxpayers), which chipped in approximately GBP100million.

The big banks recovered most of their loans. The professional advisors and bankers hired by Maxwell, thanks to litigation, didn't fare too well. The professional firms engaged in the aftermath fared rather better.

Lessons and recommendations

The following are patterns of fraud and lessons we learned as we unravelled Maxwell's web during our 14-year investigation. The comments in italics reflect our own recommendations.

1. 'Know your Customer' checklists don't prevent Maxwell-type frauds. The more important rule is to 'Know Your Structure' (KYS). Maxwell formed hundreds of companies, many with almost identical names, to confuse bankers and auditors. They were frequently lost in the maze of transactions and ultimately relied on Maxwell himself for assurance about financial transactions.

   Whenever complex structures are employed, fiduciaries must maintain detailed diagrams with ownership and legal relationships clearly spelled out.

2. Maxwell moved money with the skill of a blackjack dealer. Foreign companies were used because ownership and transactions could be kept confidential. In one instance, Maxwell funnelled hundreds of millions of dollars through a foreign subsidiary without the knowledge of the parent company. There was no reporting or communication between the officers and directors of the subsidiary (Maxwell's personal advisors) to the directors of the holding company.

   Where foreign structures are used, the directors of lower tier companies must be reportable and accountable to the board at the top.
3. The financial community took too much comfort in the fact that Maxwell's listed companies and pension funds were audited and regulated. The Department of Trade and Industry (DTI) stated in their official report about the Maxwell fraud: 'We have noted views expressed about the comparative inexperience of the regulatory staff that conducted the inspections. Both the audit and the regulatory functions failed due to poorly trained staff.'

   Trustees need to do their own due diligence beyond that of regulatory agencies or professional firms. They also need to meet and engage in a direct dialogue with the auditors to insure competency and thoroughness.
4. Maxwell hired top advisors in London and New York. If anything, the Maxwell fraud proved that hiring 'big' helped to facilitate the fraud:
   - Fees to solicitors were significant and transactions were rubber stamped. MGN, for example, had large unsecured loans to Maxwell before going public. There was virtually no governance at the board level. One of London's most prominent solicitors, hired by Maxwell, opined that all was in order. In later testimony, this solicitor made the interesting statement: 'It was not the practice at the time to read the board minutes nor was it the practice of other City solicitors.' Had the solicitors reviewed board minutes and made their concerns known, MGN would not have gone public.
   - Maxwell hired the same audit firm and had the same partner oversee all the audits of his listed companies, his private companies and their pension plans. The DTI criticised the accounting firm and the partner, stating that it had a 'major responsibility for failing to report abuses to the (pension plan) trustees… the interests of Maxwell were preferred to those of the trustees and the beneficiaries.'
   - Top-tier investment firms seemed to have turned a blind eye to Maxwell's share support scheme using pension money. The DTI criticised one firm, stating: 'They must have come to appreciate in due course that arrangements were made to avoid disclosure, and that the market did not have a true picture.'

   Professional firms generally want to maximise fees by selling 'integrated financial services' to large clients. Sarbanes Oxley notwithstanding, governments cannot legislate ethical behaviour. The inevitable conflict of interest arises in direct relation to the scale of fees involved. Diversification with professionals provides a safety net just as it does with asset management.
5. Financial statement limitations: pension plan administrators were deceived in part because financial statement balances at year end did not often reflect the true activity. Maxwell would withdraw funds and replenish them at the end of the year, only to borrow them back out again after year end.

   Massive funds were moved in and out of companies with offsetting receivables and payables that were netted to avoid detection.

   Trustees and audit committees need to conduct their own reviews from time to time. Financial audits are not intended or geared to detect fraud, especially when several people are part of a conspiracy. A good tactic is to review the cash and financial activity the month before the close of the fiscal year.
6. Professionals are often confronted by strong personalities. Maxwell was abusive with anyone that questioned his authority. To get his way, he would bring the matter to a senior partner or board member and threaten to take his business elsewhere. The gross oversights in professionalism were made by the senior level executives and partners, not by the juniors.

   Organisations (trust companies, banks, accounting and law firms) must have sound processes and governance in place that ensure the integrity of their reviews and that the concerns of subordinates are properly investigated.
7. When fraud occurs on a massive scale, the legal processes take over. In the Maxwell investigations, the ownership of investments and companies was often in question because transactions were not properly documented. The lack of clear title resulted in years of litigation.

   Properly executed documents evidencing clear title must be retained in company or trust files. The simple step of ensuring that proper documentation exists can save substantial litigation in the event of a title dispute.

Conclusions

How could one person commit such a vast fraud? It was mostly due to Maxwell's bravado and absolute control. Another important ingredient was the failure of professionals to do their job. They put money ahead of ethics and the public trust.

Where trustees are in positions of substantial responsibility, they need to:

- Retain a healthy scepticism towards professionals and their inherent conflicts of interest;
- Diversify, rather than consolidate, financial advisors on large accounts;
- Establish good governance and exercise discipline with following established procedures; and
- Take appropriate action whenever one's instincts start sending signals.

Enron and WorldCom proved that financial fraud on a grand scale can be accomplished with only a few well-placed individuals. Bigger scams will come along soon enough, but few with the same drama and intrigue.

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References:

Quotations and references to the Department of Trade and Industry are taken from Investigations under Sections 432(2) and 442 of the *Companies Act 1985*, the Report on Mirror Group Newspapers plc, prepared by inspectors appointed by the Secretary of State for Trade and Industry.