

Final
IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO: PFA/GA/200/04/KM

In the complaint between:

BRIAN COLIN BURKE

Complainant

and

MITCHELL COTTS PENSION FUND

First Respondent

MITCHELL COTTS (PTY) LTD

Second Respondent

**DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT 24
OF 1956 (“the Act”)**

Introduction

[1] This complaint concerns an allegation of maladministration of a fund by the board of trustees, the principal officer, and the employer, acting in concert, as a consequence of which the complainant and other pensioner members of the fund may sustain prejudice. In short, the complaint concerns allegations of a pension raid or “cherry-picking” situation. “Cherry picking” in the pension fund context was described in the famous *Pepcor case* (*Financial Services Board and Another v De Wet (in his capacity as liquidator) and Others* [2002] 4 BPLR 3259 (C) as

“a particular type of manipulation ... in relation to pension funds where surpluses existed. Senior executives who were in a position to control the affairs of the company and its

pension fund would cause the majority of the fund's membership to be transferred to another fund, leaving themselves and a large surplus in the original fund. The original fund would then go into voluntary liquidation and its assets would (in accordance with its rules) be distributed to the remaining members, namely the senior executives.”

[2] Cherry-picking, however, is not limited to instances of termination of funds. If the new surplus legislation (enacted by the Pension Funds Second Amendment Act, no 39 of 2001) has largely put paid to such lucrative long term dividends for pension raiders, it doesn't take much imagination to see that there is still scope for rapacious and pro-active plundering of surpluses in funds where the employer or its senior office bearers have control over them. The good governance of a fund relies on an arms-length relationship between the employer and the board of trustees, where the latter controls and oversees, in a transparent manner, the running of the fund for the benefit of all the members.

The complainant's case

[3] The complainant is a pensioner member of the respondent fund, a defined benefit scheme, having taken early retirement some twenty years ago. As a previous financial director of one of the companies in the group of former participating employers, he has taken a lively interest in the subsequent financial machinations of the fund, and has formulated a comprehensive series of complaints dealing with

the alleged abuse of the fund as a vehicle for corporate asset stripping by what he describes as the new family-controlled employer and trustees.

[4] As background to the complaint, he alleges that between approximately 1985 and 1990, Mitchell Cotts Plc sold off all the assets of the original participating employer (second respondent in this complaint), remitted all the proceeds to the U.K., and withdrew its activities from South Africa. A family controlled private company, described as an “investment company”, purchased the second respondent as a virtual shell, thereby giving the new shareholders and directors of the employer full management control of the fund. It is important to note in this regard that at that time there was no provision in the Act for member-elected trustees. The fund was left with a membership consisting almost entirely of pensioners and had a substantial surplus. Although the employer continued trading, it was on a greatly reduced scale. Indeed, the active membership lists for this period bear out this contention, as there do not appear to have been more than five or six active members at any given time.

[5] The complainant further alleges that during 1991, the employer granted executive status to all of its (six) active members. The effect of this was that the members were no longer liable for any contributions to the fund, as the executives enjoyed non-contributory status. Furthermore, the employer was on a contribution holiday, which effectively means that the total contributions (employer and employee) in respect of these new members were debited against the surplus in the fund.

[6] Finally, as regards the office bearers of the fund, the complainant reports the following:

“The Principal Officer, Mr R E Bailey, had sole control of the First Respondent for approximately ten years, refer annexures A,C,D,E, during which time the First Respondent was not required to submit any Financial Statements to the authorities or to have them audited. With the amendment to the Pensions Fund Act it became necessary to elect trustees. Mr R E Bailey resigned and his son Mr A E Bailey was elected Trustee Representative of the Employee Members and became the Principal Officer. His daughter Ms R M Keene-Young, was nominated as one of the Employee representatives, of whom there are three, and was elected chairman of the Board. As the Pensioners are only permitted to have two representatives, this means that in effect the Board may be controlled by the other four trustees which consists of the Bailey family and their nominees.”

[7] This description of “dynastic succession” in the control of a registered pension fund (which is a financial institution as defined in the Financial Institutions (Protection of Funds) Act 28 of 2001) is already somewhat disturbing. It is reminiscent of the infamous Robert Maxwell pension scandal of the 1980’s in Britain which only emerged late in 1991. Bearing in mind the membership profile of the fund, it is clear that the interests of the controlling minority are disproportionately represented. The membership statistics for the relevant period indicate that in 1997 (which is the earliest record with which I have been furnished) there were 234 pensioner members and 3 active members. In 2004 there were 143 pensioners and 5 active members. However, the specific allegations made by the complainant tend

to suggest a pattern of exploitation which is very concerning. In summary, the complaints he levels are the following:

- the lack of transparency by the principal officer and trustees in their running of the fund;
- the secrecy in which certain alarmingly high “legal” costs are shrouded (R200 304 for 2003 and R305 365 for 2004);
- the disproportionate remuneration of the principal officer, who is apparently in full-time employment with the employer (R496 020 for 2002 and R200 601 for 2003);
- the decline over the past decade and a half of the annual increases for pensioners when the fund was apparently in a position to afford greater increases;
- the general erosion of the surplus which should be for the benefit of all members, not just the “new” members who have not contributed to the fund;
- the concern that the employer, which refuses to divulge any details of its business or financial affairs, may not be in a state to guarantee the payment of benefits as they become due, should the fund become sufficiently destabilised through the above activities.

The respondents' case

[8] The employer, which was given an opportunity to comment on the complaint, stated in a half page response that

“The basis of the Complaint against the Company is refuted for the reasons more fully set out in the reply submitted by the Mitchell Cotts Pension Fund and where appropriate the contents thereof should be taken as representing the Company’s view. Moreover, we are advised that the Adjudicator’s Office does not have jurisdiction over the trading affairs and ownership of this private company.

Notwithstanding, the implication in Mr Burke’s submission that the Company is dormant is spurious and factually incorrect. The Company is neither required nor willing to discuss its business affairs with Mr Burke who left its service nineteen years ago.”

[9] The response by the fund only supplements the employer’s case to the extent that it contends that the fund and employer are distinct legal entities. It therefore submits that the information relating to the business of the employer, the number of employees and its source of revenue are not within the knowledge of the fund. This is a somewhat elliptic statement, given the overlap in management and control of the two entities, which is the main subject of this complaint. However, the fund administrator, Alexander Forbes Group (Pty) Ltd, following requests from this office, has been fully co-operative in furnishing the further information and documentation sought.

Determination and reasons therefor

[10] This fund has a history of secrecy in its governance. In 2001 a determination was made in this tribunal in a complaint against this same fund, lodged by a Mr Knight, who was then a member-elected trustee representing the pensioners. He had requested the principal officer to provide him with a list of active members, including each member's name, address, date of becoming a member and his or her pensionable emoluments. He also sought information about the pensioner members, including their full names, addresses, dates of becoming pensioners, and the current value of their pensions. The principal officer in concert with the board of trustees refused to disclose the information. In the determination (reported as *Knight v Mitchell Cotts Pension Fund* [2002] 8 BPLR 3765 (PFA)) a ruling was issued that the fund provide the complainant with the details requested.

[11] Further investigation by this office in the present complaint has brought to light certain issues of concern, which I enumerate hereunder.

Control by employer and its executives

[12] Neither in the employer's nor the fund's response has any light been shed on the question of the family relationships or the director/shareholder status in the employer of the active members, trustees and principal officer. This refusal to furnish information highly relevant to the complaint tends to lend credence to the

complainant's allegations that the trustees have a conflict of interest between their own financial prospects and that of the members in general, the vast majority of whom are pensioners. This, together with the marked lack of transparency in governance, tends to support the accusation that the fiduciary duty owed by the trustees to the members as a whole has been severely compromised.

Legal costs and non-disclosure

[13] Legal costs for the years 2003 and 2004 have been set out above (R200 304 and R305 365 respectively). The fund has responded in respect of this issue as follows:

“A portion of the legal expenses were for legal counsel in another Pension Funds Adjudicator matter, that of Knight v Mitchell Cotts Pension Fund [referred to above]. There are also additional legal issues being discussed by the Trustees at the present moment, in respect of which the Trustees have obtained expert legal advice.

The Trustees are of the opinion that it would not be prudent to divulge details of that situation at the current moment. However, it must be noted that the decision to seek legal advice has been approved by the board of Trustees, who are committed to acting in the best interests of the Fund. Furthermore, once the current legal issues have been resolved the members will, of course, be informed.”

[14] This is not satisfactory. The members are entitled to information about the issues on which the fund (apparently in their interests) is taking legal advice, especially on the scale that the costs indicate.

Remuneration of principal officer

- [15] The annual remuneration of the principal officer for the previous three years ending February 2002, 2003 and 2004 was R496 020, R200 601, and R226 489 respectively. This does appear to be an inordinately high sum, given that the principal officer is apparently a full time employee of the employer. In addition, professional administrators are also engaged by the fund, as well as investment administrators, legal advisers and auditors, leading one to question what services the principal officer actually renders. It must be borne in mind that the fund has only a handful of active members, and a hundred or so pensioners.

General administrative costs of the fund and financial soundness

- [16] The following table sets out the annual costs of administration next to the benefit payments:

YEAR	FAIR VALUE OF ASSESTS	FUND RETURN	BENEFITS PAID	ADMINISTRATION EXPENSES
2002	R55 855 036	R9 418 595	R3 453 899	R 905 865
2003	R51 630 427	R3 528 492	R3 997 422	R 898 762
2004	R48 917 871	R2 470 570	R4 614 520	R1 080 420

A number of features are apparent from this. Firstly there is a very unhealthy ratio of benefits paid out to costs incurred in administration. Expressed as a percentage of the benefits paid, the administration expenses for the three years are 26,2%, 22,5% and 23,4% respectively. In addition the ratio of annual fund earnings to fund expenses is also poor. (The reason for the unusually high return in 2002 was the inclusion of an amount of R9 118 500 in respect of Old Mutual demutualization shares.) The fund expenses form the following percentages of fund returns for the years 2002 - 2003: 10,4%, 25,5% and 43,7% respectively. The overall tendency is a decline in asset value. Moreover, these financial statements nowhere depict the liabilities of the fund in terms of future benefits payable discounted to present day, in other words the actuarial reserve values held in respect of the members. This means that it is hard to glean an overall picture of the soundness of the fund. There is therefore no way of knowing what the impact of the contribution holiday (for both the employer and non-contributory members) has been on the finances of the fund. While it has obviously increased the liabilities of the fund without increasing its assets, the extent to which it has done so is not ascertainable.

Pensioner increases

[18] Below is a comparative table showing the Consumer Price Index annual inflation rates from 1988 to 2002 and the increases in pensions for the corresponding years:

YEAR	CPI INCREASE	PENSION INCREASE	DIFFERENCE
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Final

11

1988:	12,9%	10,0%	-2,9%	
1989:	14,5%	15,0%	0,5%	
1990:	14,3%	15,0%	0,7%	
1991:	15,6%	14,5%	-1,1%	
1992:	13,7%	14,0%	0,3%	
1993:	9,9%	9,0%	-0,9%	
1994:	8,8%	7,0%	-1,8%	
1995:	8,7%	7,0%	-1,7%	
1996:	7,3%	5,0%	-2,3%	
1997:	8,6%	6,5%	-2,1%	
1998:	6,9%	8,5%	1,6%	
1999:	5,2%	0,0%	-5,2%	
2000:	5,4%	5,0%	-0,4%	
2001:	5,7%	5,4%	-0,3%	
2002:	9,2%	6,0%	-3,2%	(-18,8%)
2003:	5,8%	10,1%	4,3%	
2004:	1,4%	6,0%	4,6%	(-9.9%)

[19] An analysis of the above figures shows several trends. Firstly, the fund contends that the post retirement increases over the past nineteen years average 100% of CPI. However, if that average is indeed correct, it only goes to prove that the pensioners were originally in receipt of far more generous increases, since the recent trend has quite clearly been to give increases substantially less than CPI. Like statistics, averages can be manipulated to show different things depending on the outcome desired. The trend in the above table speaks for itself. The pensioners have only three times in the last twelve years received an increase which is not

below the CPI (and six times in the last seventeen years although the difference in the first five years is too insignificant to even mention). The total discrepancy between pension increases, on the one hand, and CPI, on the other, for the years shown above (commencing from approximately the period that the complainant alleges control of the company changed) is 9,9% less than CPI. If the last two years are disregarded, where there has been an obvious attempt to catch up, the discrepancy was 18,8% less than CPI. That is without compounding the percentage increase over the years. For a fund that was apparently in a very healthy surplus situation, this is a surprising turn-about.

[20] This office requested information about the factors considered in awarding the increase, and specifically the financial situation of the fund. Apart from three minutes of trustee meetings provided in respect of the last three years (in which there is no information about the financial circumstances of the fund), no light has been shed on this issue. It is still unclear what factors the trustees relied on, other than the recommendation of the actuary, in arriving at these increases.

Trustee expenses

[21] From the three financial statements supplied the following expenses were incurred by the trustees:

For the year ending 29 February 2004 – R14 023

For the year ending 28 February 2003 – R 1 791

For the year ending 28 February 2002 – R30 000

No breakdown or explanation is given of how these amounts were calculated, or what they were in respect of. Once again, the appropriateness of such expenditure or remuneration (it is unclear which) must be questioned in relation to the size of the fund and the profile of its membership, consisting almost exclusively of pensioners. A good example of this is to be found in the unsigned minute of the trustee meeting of 3 March 2004. At paragraph 14 the trustees noted the 2004 time-table setting out future dates for Trustee Education as well as the costs of these courses. Considering they were to be held at venues such as the Hilton Hotel in Durban, Grand West in Cape Town, and the Elangeni in Durban, one safely assumes these courses were not cheap. The discussion of these courses occurred directly after it was agreed to increase the pension rate by a mere 2% (2,6% below CPI), Mr Knight (for the pensioners) unsuccessfully arguing for a 5% increase. In fairness the pension increase was later raised to 6%, and there is no information either way as to whether the trustees attended any of the courses, and if so at what cost. However, the minute reveals a disturbing prioritisation of financial resources in the fund.

Summary of concerns

- [22] It can be seen from the above that there are several areas for concern in the governance of this fund, all of which are exacerbated by the secrecy and lack of transparency with which it conducts its affairs. This can only aggravate the perception that the employer and its coterie of executives are exploiting the fund for their own personal gain, with little or no regard for the fiduciary duty owed by the trustees, and the duty of good faith owed by the employer.
- [23] The complainant has made a sufficient case for serious questions to be posed regarding the management and administration of the fund. If there is merit in his contentions, it follows that, as a member, he may be prejudiced by reduced funding in the fund, leading to uncertainty of future benefit payments, potentially reduced pension increases, and a potential reduction in a possible share in surplus funds in accordance with a statutory distribution. I am therefore satisfied that, if proven, the allegations of maladministration amount to a complaint for purposes of the definition contained within the Act.
- [24] Unfortunately I am not in a position to grant any of the substantive relief that the complainant seeks, largely because the information necessary to make out a case thereon is with the fund trustees who refuse to disclose it. In the circumstances, I can only order the appointment of an independent auditor and the disclosure of this information (as sought by the complainant) so that these allegations of maladministration can be effectively probed. It is no good to suppress them

because some time down the line this tribunal will be faced with a similar complaint against this fund. If the independent audit should confirm any of these allegations, then the complainant (or any other person with a direct and substantial interest) will be free to lodge a fresh complaint for substantive relief.

[25] I also think it prudent in the circumstances to order the halting of any surplus apportionment exercise that the trustees may be contemplating pending the conclusion of the independent audit. It is for that reason that I shall forward a copy of this determination to the Registrar of Pension Funds with a specific request that any surplus apportionment scheme submitted by this fund be closely scrutinised, with particular regard to the areas of concern highlighted in this determination. I shall furthermore recommend that approval of any such scheme be suspended pending the outcome of the independent audit and the production of the further information that I shall order below.

[26] My order is therefore as follows:

[26.1] The first respondent is directed to appoint, in consultation with the complainant, by **Friday, 22 April 2005** an independent firm of auditors to investigate and report on the following matters, with supporting documentations:

- [26.1.1] The financial status of the fund for the years ending 29 February 2000 to 28 February 2005, inclusive, with specific reference to the fair value of its assets, the actuarially calculated value of its aggregate liabilities in respect of the total membership, such liabilities to be broken down into pensioners and active members, fund return, benefit payments made, the annual cost of the employer contribution holiday, the cost of executive employee member contributions, expressed in rand terms as well as a percentage of employee pensionable emoluments;
- [26.1.2] The total remuneration and disbursements to the principal officer for the years ending 29 February 2000 to 28 February 2005, inclusive, including any remuneration or recompense in terms of an arrangement other than monthly remuneration, and a proper investigation into the nature of this extra work, if any;
- [26.1.3] The total remuneration and/or disbursements in respect of trustees (individually and as a board) for the years ending 29 February 2000 to 28 February 2005, inclusive, with a detailed breakdown of the costs incurred and remunerated or expended;

- [26.1.4] The total legal costs incurred for the years ending 29 February 2000 to 28 February 2005, inclusive, with a detailed description of the date, the person from whom advice or professional assistance was sought, the entity to whom payment was made, and the reason for incurring the costs;
- [26.1.5] The total administrative costs for the years ending 29 February 2000 to 28 February 2005, inclusive, with a detailed breakdown as to the amounts incurred, the entity to whom payment was made, and nature of the administrative costs incurred;
- [26.1.6] The total costs of reinsurance for risk benefits (death and disability cover) for active members for the years ending 29 February 2000 to 28 February 2005, inclusive, indicating also whether these amounts are included in the contributions, or are funded additionally by the fund;
- [26.2] The first and second respondents are directed to make all relevant records and information available to the appointed auditors, and to lend all necessary co-operation for the performance of such task;

[26.3] The first respondent is directed to ensure that the appointed auditors complete their investigation, and submit a written report of their finding with regard to the terms of the above mandate to the first respondent, the complainant and to this office by **Friday 1 July 2005**;

[26.4] The costs attendant upon the appointment of the auditors will be borne by the first respondent;

[26.5] In the event of the first respondent and the complainant failing to agree on the appointment of an independent auditor within two weeks of date hereof, either party may approach this tribunal, and I shall appoint an auditor to perform the functions set out in para [26.1] above at the first respondent's expense;

[26.6] The first respondent is further directed to furnish the complainant with the following information on sworn affidavit:

[26.6.1] The nature of any family relationship between the principal officer, on the one hand, and any of the trustees, on the other, or between any of these parties and the other members of the fund, including relationship by marriage;

[26.6.2] The names of the employees of the second respondent who have executive status in the fund;

[26.6.3] The status of each employee in terms of part-time or full-time employment.

[26.7] The first respondent is directed to furnish the complainant on sworn affidavit with the reasons for its decisions to increase pensions in the amounts it did for the years ending 29 February 2000 to 28 February 2005, inclusive;

[26.8] The first respondent is directed to furnish the complainant with its reasons for seeking legal advice in respect of which legal costs were incurred in 2003 and 2004, and further to furnish the complainant with a copy of any written legal opinion or other correspondence received from its consultant(s) in connection with the advice or assistance sought;

[26.9] The first respondent is to comply with the directions given in paragraphs [26.6] to [26.9], inclusive, by **Friday 22 April 2005**.

DATED at Cape Town this 22nd day of March 2005

Vuyani Ngalwana
Pension Funds Adjudicator

Registered address of the fund

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Sandown
Johannesburg

Section 30M filing: High Court
Complainants unrepresented
Respondents unrepresented