The Panel on Take-overs and Mergers

Report on the Year ended 31st March 1971

MEMBERSHIP OF THE PANEL

Lord Shawcross (Chairman)	Nominated by the Governor of the Bank of England
Sir Alexander Johnston (Deputy Chairman)	Nominated by the Governor of the Bank of England
K. C. P. Barrington	Chairman, Issuing Houses Association
G. H. Fletcher	Chairman, Association of Unit Trust Managers
Sir Archibald Forbes	Chairman, Committee of London Clearing Bankers
G. F. B. Grant	Chairman, Association of Investment Trust Companies
Maurice Haddon-Grant	Vice Chairman, The National Association of Pension Funds
The Viscount Harcourt	Chairman, Accepting Houses Committee
P. T. Menzies	Nominated by the Confederation of British Industry
Basil Robarts	Chairman, British Insurance Association
Sir Martin Wilkinson	Chairman of the Council of The Stock Exchange, London

---

Lord Pearce	Chairman of the Appeal Committee of the Panel

THE PANEL EXECUTIVE

I. J. Fraser	Director General
W. S. Wareham	Deputy Director General
A. R. Beevor	Secretary
P. R. Frazer	Assistant Secretary
P. B. Mitford-Slade	Assistant Secretary

FOREWORD

This third Annual Report of the Panel on Take-overs and Mergers briefly records the still considerable work of the Panel at both the executive and the full Panel level during a year of somewhat reduced activity in the take-over and merger field. The possibility of further major take-overs or mergers is obviously diminished by each one which is in fact effected, but it is notable that during the past year there has continued to be a tendency for the number of these transactions to be less and for the size of the companies involved to be generally smaller. Various factors, including the obvious one mentioned here, have no doubt contributed to this tendency. It may be, however, that one of these has been the very existence of the Panel itself which may sometimes discourage the initiation of transactions which would be unlikely to survive careful scrutiny. None the less, at the executive level, the Panel has been called upon to examine, to advise upon and occasionally to intervene in cases arising at an average rate of about eight a week, and the practice of early consultation with the Panel has continued to be useful to all concerned.

The Panel has been rather less "in the news" during the past year: a welcome circumstance, not, as I think, solely attributable to the fact that few major problems have had to be dealt with, but also resulting from a general acceptance of the Panel's activity as part of the normal machinery of the City. Certainly the co-operation of the City community, sometimes in cases with significant financial implications, has continued to be very high. In the same sense it may be observed that the cynicism, which sometimes arose on the question whether a voluntary system such as the Panel operates would work, is now less often heard and a number of foreign countries, including Japan, Sweden and France have sent representatives of Government or of Stock Exchanges to study just how the system does operate. Indeed, the Basle Stock Exchange has proposed that arrangements broadly similar to our own should be adopted officially for all Swiss Stock Exchanges and in Germany a voluntary code of conduct has been introduced to deal with "insider" transactions.

During recent years the proportion of "paper" as against cash offers has increased. In 1964 cash formed more than half the total consideration in take-over bids; by 1970 the cash proportion had fallen to 23 per cent. The Finance Act 1965 made paper more attractive to the offeree shareholder through the introduction of capital gains tax and also made the issue of debentures and loan stock more attractive to the offeror company.

The evaluation of the paper offered in some of these cases can be a matter of some difficulty, particularly if the offeror is a shell company or a small company which has operated in a field wholly different from that contemplated for the merged company. The Panel does not concern itself with the question whether an offer is adequate or not; that is for the shareholders of the offeree company to decide. But it is sometimes difficult in cases of this kind for anyone to put a value on the paper that is

being offered and yet a proper valuation can be important particularly if an offeror has been buying offeree shares for cash in the market. In such a case he may be called upon to establish that the paper which he is offering is not less in value than the cash he has paid on the market. A case in which this problem arose is dealt with more fully in the body of this Report.

It is right that I should, on behalf of the full Panel, pay tribute to the expert and devoted work of the Director General and our small executive staff, on the uniformly high quality of which the Panel's work is wholly based. I also wish to thank the Council of The Stock Exchange for the excellent and convenient accommodation which they have made available and for their constant co-operation in our activities.

Chairman

May 1971

REPORT ON THE YEAR ENDED 31st MARCH 1971

General

In the year ended 31st March 1971 the Panel, in addition to its regular quarterly meetings at which general business and policy matters were discussed, held a number of extraordinary meetings. These latter were concerned with particular cases in which detailed consideration by the Panel was required. Some of them are referred to elsewhere in this Report.

The Appeal Committee met once under the Chairmanship of Lord Pearce. The meeting followed a disciplinary case involving Rule 29 of the City Code (reporting of dealings during an offer) and Rule 33 (frustration of an offer) brought by the Director General against two parties; the Panel having heard the evidence and resolved public censure, both exercised their right of appeal to the Appeal Committee, which sustained the appeal in one case. Since it was not possible to refer publicly to the other case without mentioning the successful appellant the Panel converted the other penalty to a private reprimand and accordingly no statement was issued.

Sir Alexander Johnston was appointed to the Panel as Deputy Chairman, in place of Sir Humphrey Mynors, Bart.

Statistics

The Panel executive was concerned with take-over or merger proposals made in respect of 292 companies (last year 355), of which 242 (302) were companies whose securities were quoted on a Stock Exchange. In 36 (31) cases there were one or more rival bids and in all there were 331 (392) proposals. The great majority (296–last year 363) of the proposals made reached the stage where formal documents were circulated to shareholders. Of the 296 merger documents, 219 (277) were circulated by Exempted Dealers, 9 (21) by Licensed Dealers, 36 (37) by others exempted under the Prevention of Fraud (Investments) Act, 1958 and 30 (27) on the basis of specific authority from the Board of Trade.

Two offers were circulated during 1970 on behalf of a bidder company for the share capital of Harrott & Co. Ltd., which besides contravening the City Code in several respects also contravened the Prevention of Fraud (Investments) Act, 1958; the Panel executive issued a public statement on the City Code aspects and drew the attention of the Board of Trade to the offers; proceedings were instituted against the bidder and a director leading to a conviction and a fine.

The merger proposals and their outcome are analysed as follows:–

Proposals involving change of control	1970/71	1969/70
Take-over bids recommended or unopposed from outset	160	(195)
Take-over bids opposed and later recommended ..	7	(17)
Take-over bids finally opposed (including 8 initially recommended)	47	(41)
Take-over bids withdrawn before issue of documents (including bids overtaken by higher bids)	35	(25)
Mergers by Scheme of Arrangement	17	(27)
Offers and Schemes of Arrangement involving minorities, preference issues, etc.	65	(87)
	331	(392)

	1970/71	1969/70
Successful proposals involving control	186	(239)
Unsuccessful take-over bids involving control	44	(37)
Unsuccessful Scheme of Arrangement involving control ..	1	–
Proposals withdrawn before issue of documents	35	(29)
Minorities, preference issues, etc.	65	(87)
	331	(392)

Only 5 (3) agreed bids failed and only 8 (3) in the category "finally opposed" succeeded. The data given above refer to transactions where there was at least a public announcement of a firm intention to bid. They include cases where one or both merger parties were non-resident companies provided there was a substantial body of offeree company shareholders in the United Kingdom. The executive was consulted on a further 108 cases where the names were disclosed but no published proposals materialised. A further 60 (61) cases still open at the 31st March are not included in the above figures.

Consultation

Once again a very high proportion of the take-over bids and mergers were the subject of consultation between the companies concerned or their financial advisers and the Panel executive. This consultation continued to take place at an early stage. Although rulings given at the executive level are of course subject to appeal and may have to be amended in the light of changed circumstances, the practice of informal consultation has proved a most useful one and has ensured that those concerned conducted their transactions in a manner consistent with the requirements of the Code.

Profit Forecasts

As reported last year, the Panel executive is keeping records of profit forecasts made by companies in connection with take-over bids and mergers for the purpose of comparing them, where possible, with the actual results. These records have been kept since 1st May 1969, the date on which the revised edition of The City Code on Take-overs and Mergers (the "Blue Book") came into effect; the figures given below cover forecasts for periods ending on or before 30th September 1970. Comparison becomes possible when the related results are either published generally or otherwise made available to the Panel in response to a special request (for instance in cases where the forecasting company has become a wholly-owned subsidiary of another company as a result of a successful take-over bid). The executive has so far been able to consider 226 cases (out of the 245 forecasts for periods ending on or before 30th September 1970). 16 of the 226 have been discarded on the grounds that there were no results available which were comparable to the forecasts; these were all cases of companies which were successfully taken over and whose accounting dates or group structure were so changed as to make useful comparison impossible or very difficult. Of the remaining 210 forecasts 170 were achieved within a margin of 10 per cent. (with minor variations for special reasons). Over-forecasting was treated just as much as an error as under-forecasting on the grounds that, unlike a forecast in a prospectus, a forecast in a take-over context may operate against the interests of the general body of shareholders when it is too conservative. Of the 40 classified as "failures", 31 were forecasts by offeree companies (out of 107 offeree forecasts) and 9 forecasts by offeror companies (out of 103 offeror forecasts). However in only one of the offeree cases (for which investigations into the reasons have not yet been completed) did the forecast form part of a successful defence

and 4 of the 9 offeror failures were cases of under- rather than over-forecasting. The Panel executive is investigating the reasons for the 40 failures in all except 5 cases where, because of special factors connected with the particular case, this has not proved possible. It has completed these investigations in 19 cases, in only three of which were satisfactory explanations not given. In the remainder the executive, which retains Price Waterhouse & Co. to advise it on these and other accounting matters, concluded that the shortfall, or as the case may be the excess, was due to reasons of an unforeseeable nature reflecting no discredit on those who had been responsible for making or reporting on the forecasts.

During its inquiries, both as to the extent to which forecasts have been achieved and as to the reasons for the failures, the Panel executive has received the maximum co-operation from the companies concerned and, in particular, from their financial advisers and accountants. The Panel recognises the extra burden that these inquiries cause and is most grateful for this co-operation in what it is confident is a worth-while exercise in improving public confidence in forecasting.

Forecasts of profit by company managements, when responsibly made and subject to the proper disciplines laid down in the City Code, normally constitute the best available view of company prospects. In the Panel's opinion responsible profit forecasts are a vital element in shareholders' assessment of the worth of equity investments. Since it is not given to directors to foretell the future there can be no criticism of them if a responsibly made forecast is not achieved in the event. The fact that it is not subsequently achieved does not lessen its merit as being the best available view of the prospects at the time it is made. The outcome of the present study reinforces the opinion that the present policy on forecasts is the right one. The executive does, however, intend to continue the survey for the time being so as to verify whether present standards are being maintained.

In order to improve still further the usefulness of the profit forecast in bid documents, the Panel will shortly publish a Practice Note which is being prepared after consultation with the Institute of Chartered Accountants in England and Wales and makes recommendations on the statement of assumptions underlying profit forecasts.

Practice Notes and Publication of Rulings

During the year the Panel published Practice Notes Nos. 4 and 5 dealing with Rule 15 (Profit Forecasts and Asset Valuations) and Rule 29 (Disclosure of Dealings). Copies of these Practice Notes may be obtained from the Panel offices or from the Issuing Houses Association.

In pursuance of its policy of publishing significant rulings from time to time the Panel made a public statement of its finding in the Adepton/Williams Hudson case, which is further discussed below. There is also given in an Appendix, as in last year's report, a synopsis of executive rulings given during the year which may be of general interest.

Revision of the Code

The Issuing Houses Association, which is responsible for organising the drafting of the Code, drafted amendments to Rules 8 and 16 which were approved by the City Working Party. These amendments which make new disclosure requirements for persons "acting in concert" with an offeror, were designed to combat the technique known as "warehousing" whereby an intending offeror arranges for friendly parties to accumulate shares in a company which might become the object of a bid without any of them incurring the statutory obligation to declare his holding. These amendments have been in effect since the middle of last year.

In its finding in the Adepton/Williams Hudson case the Panel suggested that the constituent bodies might wish to consider amendments to the City Code to cater for the situation which arose during the Adepton bid. The Issuing Houses Association is studying the matter. This will no doubt also provide an opportunity to consider whether the time is ripe for a more general up-dating of the City Code as indicated in last year's report.

Investigations into Dealings

The Panel executive has been concerned with results of inquiries by The Stock Exchange into market transactions in the shares of companies involved in take-over bids on eight occasions. These inquiries may be of two kinds. In the first it may be necessary to establish or at least obtain an indication of the identity of a buyer of shares where aggressive buying is taking place and it appears that the buying is such that disclosure ought to have been made. The second category of inquiry arises when there is a suspicion that individuals or companies acting on inside information have been dealing in shares of an offeree company (or in some cases an offeror company) in advance of an announcement.

Three of the eight inquiries referred to above were of the first kind and five of the second. A procedure has now been agreed with The Stock Exchange whereby the information resulting from the first kind of inquiry is passed to the Panel executive within a matter of hours. Of necessity, however, inquiries of the second kind take a great deal longer and, in the absence of statutory powers, may sometimes be inconclusive. Nevertheless as a result of close co-operation between The Stock Exchange and the Panel much is being done to throw light on transactions which if not properly illuminated can seriously undermine the confidence of the general investor in the fairness of the securities market.

As it has already demonstrated the Panel will not hesitate to act resolutely and publicly where it finds that inside information has been improperly acted upon. On the other hand it must be understood that it is not always possible to publish the fact that an inquiry has been called for, or that an inquiry has been finished, particularly where the results of the inquiry have been inconclusive as may sometimes be the case.

Pergamon Press Limited

The full Panel considered the implications of the report of Price Waterhouse & Co. on Pergamon Press Limited for the future conduct of take-over bids. Two particular aspects were considered. It was felt that much could be done to improve the confidence of the general shareholder in the audited accounts of public companies. In this connection the Chairman at a meeting with the Presidents of the Accountancy Institutes held in October last expressed the warm support of the Panel for the initiative now being taken by them for the establishment of new accounting standards. The Panel is represented on the Institutes' Accounting Standards Steering Committee by an observer member and has accordingly had the opportunity to note the energy and despatch with which this work is being undertaken.

Concern was also felt at the extent to which it is possible for a director of a public company to have a material direct or indirect personal interest in the assets and trading of the public company without full public disclosure. A small committee was set up to study this matter and report its conclusions. Since, however, the subject is of more general interest than purely in the context of take-over bids the Panel has so far limited its activity to an exchange of views with The Stock Exchange which is also actively concerning itself with this matter.

Cash purchases during the currency of a paper bid

There were several occasions during the year when an offeror who had announced a paper bid, which was or was likely to be opposed, sought to decide the contest by heavy purchases of offeree shares for cash in the market or outside it making later any upward revision to the terms of his paper offer which might be required. To the offeror his actions appeared unobjectionable on the grounds that Rules 29 and 31 permit any offeror to deal in offeree shares for cash subject only to (i) daily reporting of the amounts and price and (ii) upward revision of the offer if purchases are effected at above the offer value. At times, however, the technique appeared to the defending party to be in breach of General Principle 8 which requires all shareholders of the same class to be treated similarly by an offeror company. The breach appeared all the more grave when the offeror succeeded in buying control of the offeree company in the market while shareholders were still digesting the offer document with the result that frequently the more experienced or better advised investors were found to have realised their investment for cash while the remainder had to be content with the offer of less marketable paper.

The Panel executive, when asked, ruled in all cases that offerors for paper were permitted to purchase unlimited offeree shares for cash provided (i) the purchases were spread over a reasonable period of time and were not selective (or if selective were not selectively in favour of holdings critical to the outcome of the offer), and (ii) the reporting and revision requirements were met.

The executive ruling was challenged before the full Panel in the context of the Adepton/Williams Hudson matter. The full Panel, admitting that transactions of this type had caused anxiety, found nevertheless that, whilst the General Principles prevail and govern the interpretation of all the Rules, they cannot override any express Rule of the Code where this is clearly applicable to the case in question. In cases where there is an express Rule the General Principles can, except in matters of interpretation, only be resorted to if the Rule itself cannot be applied to a particular case. Thus–as the City Code is now written–there could be no objection to a bidder for paper buying a substantial amount of offeree company shares for cash in the market over a period of days starting with the moment of announcement of the bid. However if the offeror buys at prices above the value of his offer, the paper consideration must be adjusted upwards according to the procedures of Rule 31, as was acknowledged in this case. Rule 31 prescribes the manner of ascertaining the amount of the adjustment in normal circumstances. But if the circumstances are so abnormal that it is not reasonable and safe to use the procedures of Rule 31 in order to obtain for the remaining shareholders the rights to which the Code as a whole entitles them, then recourse must be had to the General Principle which requires similarity of treatment–in such a case the availability of a cash alternative to the paper offer to all shareholders. The circumstances were abnormal in the Adepton/Williams Hudson case as the offeror was seeking to acquire a company very much larger than itself, the past profit record of Adepton gave little or no guide to its future profitability and the amount of the notional asset and income cover for the new securities to be issued was subject to exceptionally wide variations depending on the proportion of the offeree's capital acquired.

Office and Staff

The Panel transferred its offices to a suite on the 20th Floor of The Stock Exchange tower during September, where it is now a tenant of The Stock Exchange. There were no changes to the Panel executive during the year.

APPENDIX

RULINGS OF GENERAL INTEREST

There follows a synopsis of rulings given by the Panel executive during the past year selected on the grounds that they may be of some general interest. A number of rulings have already been treated as the subject of Practice Notes. The rulings mentioned below are given without reference to the cases to which they apply and are grouped according to the Rules from which they are derived.

Rule 8 Any conditions to which an offer, or the posting of it, is subject (other than the normal conditions relating to acceptances, quotation and increase of capital) should be stated in the formal announcement of the offer.

Rule 12 The Panel should be consulted before an announced bid is publicly withdrawn.

Rule 14 An offeror company should state its intentions in regard to the future of the offeree, even where the consideration is solely cash.

Rule 19 (a) Copies of paid advertisements (with a list of the newspapers in which they are published) and of any material released to the press by parties to a take-over or merger should be lodged with the Panel at the time of publication.

(b) Reverse take-overs involving the change of control of a quoted company through the acquisition of a larger private company are subject to the Code and the relevant documents should be lodged with the Panel.

Rule 20 (a) If options, subscription warrants or conversion rights are exercisable during a bid situation, they must be taken into account in calculating the percentage of offeree shares required to be obtained.

(b) Where there are non-equity classes of capital carrying voting rights these need not be the subject of an offer but (whether or not this is the case) no offer for the equity should be declared unconditional unless, in addition to acquiring 50 per cent. of the votes attributable to the equity share capital, the offeror has acquired over 50 per cent. of the total voting rights of the company.

(c) Where a company has more than one class of equity capital, then a comparable offer should be made for each class; the Panel should be consulted in advance if more than one class carries votes. An offer for non-voting capital should not be made conditional on any particular level of acceptances in respect of that class.

Rule 21 Where there are two or more offerors competing for the same offeree, the Panel will give consideration to waiving the 60 day rule to prevent bidders from being forced to retire if such a waiver appears clearly in the interests of the shareholders concerned.

Copies of this Report may be obtained from the Panel on Take-overs and Mergers, P.O. Box No. 226, The Stock Exchange Building, London, **E.C.2.**