THE TAKEOVER PANEL

UNITED DRAPERIES OFFER FOR SWEARS & WELLS LIMITED

There was an Appeal to the full City Panel by Authority Investments Ltd., on behalf of themselves and other holders of over 29% of the issued 'C' non-voting shares in Swears & Wells Ltd., against a decision of the Panel Executive that the terms of the offer by United Drapery Stores Ltd. did not constitute a breach of the Rules of the City Code and, in particular, involved no infringement of Rules 10 and 15.

Rule 10 provides that Directors who effectively control a company and contemplate transferring that control should not do so ". . . . . unless the buyer undertakes to extend . . . . . a comparable offer to the holders of the remaining equity share capital" whether carrying votes or not. The relevant part of Rule 15 provides that "when revaluations of assets are given in connection with an offer the Board should be supported by the opinion of independent professional experts and the basis of valuation should be given".

Swears & Wells is a company, the capital of which is divided into three classes. The 'A' and 'B' shares carry voting rights. The 'C' shares are non-voting. No question arises, save incidentally, as to the 'A' shares which could only be held by employees and which were not the subject of a market quotation. The majority of the 'B' shares were held by Directors of Swears & Wells and their families, and the main question for decision was whether the offer for the 'C' shares was "comparable" to that made for the 'B' shares whose holders were contemplating transferring control.

The offer made for the 'B' shares was a cash one of 21s. 6d. being 4s. 9d., or 25%, above the middle market price on the day before the offer was announced, and 9s. 7d., or about 80%, above the average price ruling on the first day of dealing in each of the six months immediately preceding the offer.

In the case of the 'C' shares the cash offer was in the sum of 14s. which was 5s. 9d., or 70%, above the middle market price on the day before the offer and 6s. 2d., or slightly under 79%, above the six months average. Looking at the matter in a different way, the weekly average premium enjoyed by the 'B' shares during the previous six months period over the 'C' shares was 56. 2%. The premium represented by the offer was 54%.

The Panel were also furnished with graphs showing the relationship between the market prices of the 'B' and 'C' shares from as far back as 1960. During that time the premium had fluctuated considerably and was sometimes smaller and sometimes larger than that constituted by the offer.

Authority Investments Ltd. contended before the Panel that the words "comparable offer" in Rule 10 meant "a fair" offer and that what was "fair" could not be ascertained by reference to the market since the market price reflecting the difference is not a true measure of what is a "comparable" price on a take-over. The reason, it was said, was that the market price is "an estimate of what the offerors in a bid can offer without laying themselves open to legal claims". It was said that the legal protection for non-voting shareholders under English law was quite inadequate in a case like the present and that it was the purpose and duty of the Panel to supplement the law and to ensure "fair play". The Appellants did not go so far as to contend that there should be no differential between the price of voting and non-voting shares but said that "City opinion" considered a "typical" differential to lie between 15 and 20%.

The Panel are quite unable to accept these contentions. It is not their view that market prices of shares generally or these shares in particular are, during a period when no offer is contemplated or rumoured, an estimate of what (or in effect how little) an offeror could risk paying for non-voting shares without becoming exposed to legal action.

The Appellants were able to produce no real evidence of "opinion in the City", although they cited two or three cases where the premium enjoyed by the voting shares was in fact between 14 and 18%. The Director-General, however, referred to a larger number of cases in which the premia had varied to a much greater extent. Appellants were unable to suggest any criteria by reference to which the Panel could itself fix the correct premium. It must be a "fair" premium, the Appellants argued; otherwise the word comparable would mean unfair. This seems to be a matter of semantics. No doubt the premium should be fair. But fair in relation to what? The very existence of non-voting shares, carrying a price discount, is regarded by some as unfair. Such shares are permitted by law and the Panel cannot by a side wind attempt to mitigate the value difference resulting from their existence. The Panel has consistently refused to value or pass judgment upon the merits of particular offers. Not only has it not the machinery so to do but any such attempt would involve an unjustifiable interference with the freedom of shareholders to decide for themselves whether a particular offer is acceptable or not.

The Panel has no doubt that in the present context it has no power whatever to fix its own differential or premium in a particular case. In deciding whether a particular offer is comparable it has regard, not to some unpublished code of unspecified ethics, but to a comparison of the substance or rights which were bought, the manner in which they were to be paid for - e.g. in cash or paper - and the value which has been placed upon them in sales in the market over a period. If that which is bought is identical then the price should be

identical but an offer, for example, for deferred shares need not be at the same price as is paid for ordinary (non-deferred) shares. This is what is meant by comparable. In the present case the offers were for substances or rights which were not identical. Shares possessing voting rights are normally (although not invariably) worth more than non-voting shares. How much more varies greatly and depends on a number of factors, including the relative sizes of the two classes of capital, and whether the voting shares are concentrated in a few hands or spread equally over a large body of shareholders. Like must be compared with like: where the question is a premium between different classes of shares a perfectly valid, and as the Panel consider, fair comparison is between the premium established by the offer and that existing during some prior period in the free market. Certainly it would be grossly unfair to holders of voting shares if, having bought at an average pre-bid market premium of X, they were compelled to accept an offer representing a premium of X - Y simply in order that those who had purchased non-voting shares at a discount of X should receive an offer reducing that discount by Y!

The Panel therefore consider that the appropriate and, in a case like the present, indeed the only criterion available by which they can judge comparability is market experience. In the circumstances of the present case they see no reason to go back a long time. In this case it was considered that the period of six months before the announcement of the bid indicated a fair market assessment of the value of the voting rights in this company. By that test, the price offered for the 'C' shares is in line with and therefore comparable to, although slightly more favourable than the market assessment. The Panel so hold.

In an earlier case in 1968 the Panel considered a like point and reached a similar conclusion. The Panel is not finally bound by previous decisions and reached its present conclusion independently. It is fortified in this conclusion by the earlier decision.

The two other matters raised in this Appeal can be shortly dealt with. It is pointed out that, in their letter to the shareholders of Swears & Wells, the Board stated that "in the latest annual report (they had estimated) that there was a surplus over book values of land and buildings and taking this into account the theoretical break up value is in excess of the current value of the U. D. S. offer". The Appellants contended that under Rule 15 this was a revaluation of assets which should have been supported by an independent valuation. The Panel, whilst appreciating the force of the argument under Rule 15, consider that this is not so in the present case. There had in fact been no "revaluation of assets . . . . . in connection with an offer" within the meaning of Rule 15. The Board referred to an earlier estimate they had given in order to comply with the requirements of

the Companies Acts simply to dismiss it as they, being the controlling shareholders, had not considered a sale on a termination of trading and realisation of assets as satisfactory or appropriate. This was a transfer of control on the express condition, agreed by the offerors (who are not a property dealing company but owners of retail stores) and imposed by the offerees, that the business would be continued as a going concern. This being the decision of the controlling shareholders the Panel does not consider there was an obligation to the 'C' shareholders to have an independent valuation of assets.

The further point was made that the 'C' shareholders ought to have been independently advised since there was a conflict of interest between them and the 'B' shareholders and a single merchant bank could not divide itself into two factions putting forward different advice. If this point were correct it would seem that the 'A' shareholders, and possibly even the Board, should also have had independent advice although it is by no means clear by whom they would have been appointed. But the point seems to the Panel to be misconceived. Merchant banks do indeed very frequently discharge with complete impartiality and objectivity responsibilities in which there is an apparent conflict of interest and this is characteristic of English arrangements in many other fields. In the present case, however, there was no conflict of interest at all. Kleinwort, Benson Limited were called in to advise not the Board, not the controlling shareholders, nor the shareholders of any particular class, but the Company and its general body of shareholders as a whole. It was their duty, looking at the whole position to advise generally what would be an appropriate price for the different classes of share. We have no reason to doubt that they discharged this duty properly: indeed, at one stage, the whole negotiations were called off, since although the offer for the 'B' shares was considered appropriate, that for the 'A' shares was regarded as inadequate. It would have been the duty of the Directors, whether they agreed with it or not, to convey to the shareholders any advice against acceptance had they received it. It might indeed have been suggested that there was some conflict of interest between the Directors (as 'B' shareholders) and the 'C' shareholders. However, the duty of Directors is not to themselves but in the nature of trustees to the general body of shareholders. The Panel are satisfied it was so understood.

17th February 1970.