THE TAKEOVER PANEL

J. CORAL LIMITED

This case turns upon its own facts but the question of principle which it raises is whether the City Panel has any right to assess the comparative values of two or more competing offers for the shares of the same company. It has not. It is neither within the province nor the competence of the Panel to adjudicate upon the merits of one offer as against another. This is essentially a matter for the directors and shareholders concerned and their financial advisers. All that, under the existing City Code, the Panel can seek to do is to enjoin upon all concerned the necessity of considering in such a context the interests of the shareholders as a whole and not only those of a section, even a majority, and still less of the directors themselves.

The present case, which is an appeal from a decision at the Panel's executive level, arises from competing attempts to effect a merger with J. Coral Limited, a company engaged in the business of bookmaking and the conduct of betting shops in which approximately 53% of the equity is held by members of the Board or their relatives. During March of this year the Directors of Coral and of The Mark Lane Group Limited, engaged in discussions with a view to the merger of their activities and towards the end of that month put forward a Scheme of Arrangement which would have involved a merger of the two companies upon the basis that a new holding company would be formed in which Mark Lane shareholders would exchange their existing shares on a one for one basis whilst Coral shareholders would obtain 10 shares in the new company for every 19 ordinary shares in Coral. On the then value of Mark Lane shares at 82p, this put a value of 58. 2p on Coral shares, somewhat above their then market value around 45p and would have given Mark Lane 51% and Coral 49% of the equity in the new company. This proportion was broadly in line with the latest published results of the two companies. The proposed Scheme of Arrangement which had, of course, the support of both Boards would, in the opinion of some newspaper commentators at the time, have made good sense both geographically, financially and in the combination of technical and management knowledge which the merger would bring.

However, Ladbroke Group Limited, a company of more diversified activities than Mark Lane or Coral but also owning more betting shops than the two of them, lost little time in indicating its own interest in the acquisition of Coral. On the 8th April Ladbroke announced that they already held around 11% of the Coral equity and would make an offer subject to the Coral Board's agreement. The Coral Board did not agree but on the 17th May Ladbroke publicly announced a formal offer for Coral in the form of two ordinary Ladbroke shares plus 35p in cash for every 7 ordinary shares of Coral. On the basis of the middle market quotations from the

Official List, this valued the Coral ordinary shares at 73¾p against the closing price of 72½p that day. On the same basis of the then existing market prices, the proposed Mark Lane/Coral merger put a value of about 65½p on the Coral shares. At the same time Ladbroke announced a forecast that their profits for the year to 29th June 1971 would be £2. 4 mn., £0. 2 mn., more than the figure announced 3 weeks earlier and £1. 3 mn. more than the previous year. Coral's Board, which had, of course, already concurred in the proposed Scheme of Arrangement, forthwith rejected this offer by Ladbroke. Ladbroke however went on to buy further shares in the market and on the 26th May, two days before the statutory meeting to approve the Scheme of Arrangement, improved their own offer by increasing the cash element per Coral ordinary share by approximately 6p. At the time of the statutory meeting to approve the merger held on 28th May, Ladbroke held 16% of the Coral ordinary shares and had obtained proxies which enabled them to secure the rejection of the merger proposals, which needed a 75% vote to ensure their acceptance. Mark Lane and Coral were, however, not unprepared for this contingency. By the 25th May it appeared to them possible, if not probable that their proposals would not secure the necessary 75% majority and they agreed that, in that event, Mark Lane would immediately put forward an outright take-over bid for Coral which the Coral Board would recommend. On the 27th May, Charterhouse Japhet Limited, on behalf of Mark Lane, sent Coral a letter (copy attached) stating that Mark Lane would make an offer but were only prepared so to do if shareholders representing more than 50% of the Coral equity undertook that day to accept it. The offer to be so made was on the same terms as those already proposed for the merger arrangements. At the then ruling prices, this valued the Coral shares at 69½p as compared with Ladbroke's increased offer then worth 80p per share. Mark Lane had however announced an increased forecast of pre-tax profits for the final three months to 30th June giving a 12 months forecast of £1. 2 mn. as against £0. 6 mn. for the corresponding period ending 30th June 1970. The Coral Directors and family shareholders in fact gave the undertakings which Mark Lane had required in writing on the 28th, but before the statutory meeting.

At the statutory meeting a representative of Hill Samuel & Co. Limited, the merchant bank advisers to Coral, in answer to a question suggesting that Mark Lane might come forward with a better offer, stated "categorically" that this was not so. He did not, however, disclose the already existing contingency arrangement, which did not in fact involve better terms. The Acting Chairman declined to commit himself to accepting the highest bid which might be made but said that in the event of the Scheme of Arrangement not being adopted, Coral would consult with their advisers. He did not say that an arrangement already existed in relation to this contingency. After some discussion, the Scheme of Arrangement failed to secure the necessary 75% majority. Thereupon Mark Lane and Coral announced that

Mark Lane would make their offer (on the same terms as those involved in the merger) and that over 50% of the Coral shareholders had already irrevocably undertaken to accept it. Subsequently Ladbroke complained to the Panel executive that the action of the Coral Board in, as they alleged, thus precipitately rejecting the Ladbroke offer and accepting the lower bid from Mark Lane involved an abuse of the powers of majority shareholders and thus infringed the provisions of the City Code. The Panel executive heard the submissions of both sides. In the course of these hearings in which each side is of necessity heard separately and on a confidential basis, the Panel executive were informed of the arrangement put forward in the letter of 27th May. They were told that the Coral Directors and their relations regarded the Mark Lane offer as being, at least in the long term, better than that put forward by Ladbroke and that Hill Samuel strongly supported this view.

The Panel executive, having heard the evidence and argument of both sides, concluded that the Coral Board had acted within their proper province and in good faith and that accordingly the requirements of the City Code had not been infringed. Against this general background, the matter has come before the full Panel on appeal from the executive and the Panel has heard, in the presence of all concerned, evidence and argument from the parties and their advisers and arguments from the Director General.

The matter is not expressly governed by any single Rule of the City Code but the following provisions may be relevant:

General Principle 3

> Shareholders shall have in their possession sufficient evidence, facts and opinions upon which an adequate judgment and decision can be reached, and shall have sufficient time to make an assessment and decision. No relevant information shall be withheld from them.

General Principle 7

> Rights of control must be exercised in good faith and the oppression of a minority is wholly unacceptable.

General Principle 11

> Directors of an offeror or an offeree company shall always, in advising their shareholders, act only in their capacity as Directors and not have regard to their personal or family shareholdings or their personal relationship with the companies. It is the shareholders' interests taken as a whole which should be considered, together with those of employees and creditors.

Rule 9

> Directors must always have in mind that they should act in the interests of the shareholders taken as a whole. Shareholders in companies which are effectively controlled by their Directors have to accept that in

> respect of any offer the attitude of their Board is decisive. Exceptionally, there may be good reasons for such a Board preferring a lower offer or rejecting an offer. Nevertheless, where a Board recommends acceptance of the lower of two offers, or, being a controlling Board, accepts such lower offer or rejects an offer, thus in effect frequently forcing the minority shareholders to act similarly, it must very carefully examine its motive for so doing and be prepared to justify its good faith in the interests of the shareholders as a whole.

At first sight it may not seem entirely easy to reconcile General Principle 11 and Rule 9 and certainly difficulty may arise in applying these provisions to the facts of particular cases. It is therefore appropriate for the Panel to state here the general way in which the provisions of the City Code in this context are to be applied. Whilst it is clear that the paramount duty of Directors is to consider the interests of the general body of shareholders and in the advice they give or decisions they take, not to prefer their own interests or those of any special group or section, it is also the case that the control of companies lies with a majority of the shareholders rather than with a minority. The Panel will always be vigilant so far as it lies within its power to ensure that Boards of Directors which, through their own members or through associated family shareholdings (as in the present case) control a majority of shares, do not exercise their powers as a Board in order to oppress a minority or to force through some proposal which, properly considered, could not be regarded as for the benefit of the body of shareholders as a whole. But, whilst Directors in their actions as such must disregard what they may consider their personal interests, it does not invariably and inevitably follow that in voting their own shares, which are no less their individual property because they are Directors of the Company as well as shareholders, they must defer what they conceive as their own interest as shareholders to that of a minority. The general position of Directors is indeed not dissimilar whether they control a majority or only a minority of the voting shares. Directors controlling a minority of shares, which is the case with which General Principle 11 is usually concerned, must of course not use their powers as Directors in a way which promotes their own interests but is inimical to that of the majority. The possession of control over a majority of shares does not, however, diminish the powers of a Director as such although it should make him the more careful that his actions are manifestly seen to be in accordance with his responsibilities. This said, it is, however, not inconceivable that whilst the duty of Directors might require them to advise minority shareholders that some particular course would appear to be in their interest, where the Directors come as individual shareholders to exercise their own personal proprietary rights in their shares they might, for their own part, act differently. Where a Board, with or without associated or family

shareholders, control a majority of the voting shares, the remaining shareholders must be deemed to be aware of the fact and, subject to the paramount requirement of good faith, must recognise that should any difference of view arise it must in the end be resolved by a decision of the majority. Any contrary view would, of course, give an overriding power to the minority and would also seem either to disenfranchise the Directors' and associated shares or to mean that majority shareholders could not sit on the Boards of the Companies concerned, results which could hardly be thought on any view to be reasonable. Rule 9 is in fact quite explicit in providing that this should not be the case. Majorities must not abuse their position, but minorities cannot dominate.

Applying these principles to the present case, the only complaint against the Coral Board which it was sought to press - and indeed it was pressed strongly - was that the Coral Directors had acted in bad faith. It is the case that they recommended for acceptance and had accepted in advance for themselves an offer by Mark Lane which, at all events in arithmetical terms by a comparison of market prices at a particular date, appeared lower than the offer made by Ladbroke. Market prices of the relevant shares on a particular day are a most important guide even in the uncertain fluctuations of a take-over situation but they may not always fully reflect factors like past earnings, future growth, assets and management. Rule 9 in such a case requires the Directors to justify their good faith in the interest of shareholders as a whole. The members of the Panel were unanimous in concluding that this the Coral Board had done. A good deal of evidence and argument before the Panel was addressed to the comparative merits of the Ladbroke and the Mark Lane offers. Whilst the Panel cannot substitute themselves for the Board nor by the exercise of wisdom after the event conclude that a Board was wrong in the assessment it made of the value of one offer as against another, the fact that professional advice was sought, given and acted upon, is, of course, of the utmost importance in regard to an allegation of bad faith. Hill Samuel at all material times acted as advisers to Coral. They consistently advised the Coral Board that the merger with Mark Lane was the better of the courses open. Before the Panel the two representatives of Hill Samuel repeated the advice which they had given to the Coral Board and produced strong evidence and argument in support of it. The Panel deliberately refrains from saying whether these were well founded or conclusive. A contrary view was expressed by Slater, Walker Limited, merchant bank advisers to Ladbroke. It is not for the Panel to arbitrate or to express any preference for either view, but to decide whether, in face of the clear advice they had received from their professional advisers, the Coral Board was actuated by bad faith in accepting it. In this connection it is relevant that Mr. Nicholas Coral and Mr. Cyril Stein, the chairman of Ladbroke, had, at an earlier stage had an inconclusive discussion at which the differences in approach and principle had been evident.

It was suggested that, having received from Ladbroke letters which stated explicitly that if they were not answered within two days it would be assumed that the Ladbroke offer was rejected, the Coral Board should nonetheless have replied. The Panel sees no evidence of bad faith in Coral's failure so to do: whether it would have been wise to send a reasoned refusal of the Ladbroke offer rather than issue a bald statement to the press is a matter of public relations on which the Panel does not propose to comment. It was contended that before rejecting the Ladbroke offer Coral should have sought clarification of it, although in what respect their offer lacked clarity those who had put the offer forward did not say. It was said that having received an offer from Ladbroke which they regarded as inadequate, Coral should have gone back and asked Ladbroke to what extent they would increase it. By parity of reasoning, it was argued that faced by two competing proposals Coral should have gone out and canvassed for offers from other concerns said to have expressed an interest. The Panel would not accede to any general proposition that Directors who are not seeking a take-over and who consider that they have a satisfactory arrangement for merger with a particular company are, because of the receipt of an unsolicited offer from elsewhere, under a duty to hawk their business round the market place in the possibility that higher bids might be obtained. The market was open: it was for Ladbroke or other interested parties to put forward such offers as they wished.

The real gravamen of the complaint against Coral was, however, that "in collusion" with Mark Lane they had concocted a scheme intended to defeat any possible take-over offer, however advantageous. The Panel sees no evidence of this. It is of course true that the original proposal for a merger and the sub sequent general offer by Mark Lane had been arrived at in consultation between the Boards of both Mark Lane and Coral. To use the epithet "collusive" to describe these negotiations carries the facts no further. Such negotiations are in fact perfectly proper and indeed Rule 1 of the Code expressly requires that in the first instance an offer should be put to the Board of the offeree company. It is however true that, realising that 25% of the shareholders present and voting at the statutory meeting (albeit a minority) might, following the purchase of further shares by Ladbroke and their solicitation of proxies, defeat the proposed Scheme of Arrangement, Mark Lane and Coral had reached an agreement for a take-over which would defeat the Ladbroke or any other bid, because a majority of Coral shareholders were already committed to accepting it. This arrangement was not, in the Panel's view, in itself evidence of bad faith. It may be perfectly proper for an offeror company to say in advance that they will only put forward an offer if they can be assured, in advance, of its acceptance: this often happens, because public companies do not wish to involve themselves in a competitive auction. Nor does such an arrangement become improper because it is prepared as a contingency against the failure of another method being employed with the object of securing a like result. Such an

arrangement would, however, be improper if the motives underlying it were of bad faith. The Panel sees no evidence of this. The Panel does, indeed, regret that the existence of the letter of 27th May and its acceptance was not disclosed at the statutory meeting on the 28th: all shareholders are entitled to the fullest information about the affairs of their company at the earliest opportunity. But whilst it is not entirely surprising that a charge of disingenuousness should be based on this circumstance, it is difficult to see how the position of shareholders could have been in any way altered if the letter had been disclosed at the meeting. In any event the question is not whether the Coral Directors were in bad faith at the meeting on 28th May but acted in bad faith before that meeting when they undertook in writing to accept the contingent offer from Mark Lane.

In a welter of conflicting arguments and inconclusive facts it is often helpful to look at the evidence of the laymen who are the principals involved. The Panel was impressed by the way in which both Mr. Cyril Stein and Mr. Nicholas Coral gave their evidence. Mr. Stein, clearly a man of ability and integrity, said, in reply to questions, that the view expressed in the Daily Telegraph when the Mark Lane merger proposal was first announced was a perfectly fair one for the Coral Directors (or those of Ladbroke or of any other rival bidder) also to take. That view was that:

> "The new line up which will have Mr. Joseph Coral as its President and Mr. Mark Lane as its Chairman makes good sense geographically, financially and in the technical knowledge of bookmaking that each group will bring. But above all, the two groups like each other, an important factor in this highly personal and professionalised business."

Mr. Stein later qualified his answer by saying that the business was not highly personal but it was highly professional. He also candidly agreed that the Coral family shareholders were perfectly entitled not to accept his offer. But if they had not accepted it the offer would of course have failed.

Mark Lane assured the Panel that the contingent arrangement was made because they were not willing to be a stalking horse in a competitive bid situation in the small world of bookmakers. This the Panel accepts.

Mr. Coral struck us as being equally honest and frank and in summary said that present prices and even past earnings apart (although it was strongly contended that Mark Lane earnings had shown a better growth record than Ladbroke) the future growth of earnings of Mark Lane and Coral in combination was the most important consideration. He also made the point that, as part of Ladbroke, Coral would be the junior partner in a company which was diversifying into fields such as casinos and hotels in which it had yet to demonstrate growth potential. It was as to these points that the Coral Board had exercised a judgement. In their judgment the

Mark Lane/Coral combination had a greater potential growth rate than the hypothetical combination of Ladbroke/Coral. That would be in the interest of all shareholders, not only the Coral family, and that was why he and his associates had acted as they did. Mr. Coral may well be right in his judgment. The Panel need only say that it is satisfied he honestly believes he is.

18th June 1971.