THE TAKEOVER PANEL

Mooloya Investments Limited ("Mooloya") /
Customagic Manufacturing Company Limited
("Customagic")

The Panel met on Thursday, 6th July to consider a reference from the Panel executive whether undertakings by Mooloya, shortly before an offer by it for the share capital of Customagic, to make certain payments for the benefit of Mr. Maurice Prax and his family interests constituted breaches of Rule 36 of the Take-over Code.

Mooloya is a listed investment trust, with issued share capital of 630,000 ordinary shares of £1 each and 20,000 4.9 per cent cumulative preference shares of £1 each.

Customagic is a listed company, located in Manchester and engaged largely in the manufacture and sale of loose stretch covers for Chairs and car seats. The fully paid share capital consists of 5,250,000 ordinary shares of 10 p. each.

Customagic was set up more than twenty years ago to exploit a licence to manufacture stretch covers by a process that had been developed in the U.S.A. The business was then managed by Mr. Sidney Terry, Mr. Bernard Terry and another. Mr. Maurice Prax was instrumental in forming a trading connection between Customagic and Great Universal Stores and when he retired from GUS in 1970 he agreed to act as a consultant for Customagic at an annual fee of £1,000, later £2,000, and often attended board meetings. In recent years, however, Mr. Prax developed misgivings about the management of Customagic which he communicated to the Chairman, Sir Cecil Burney, who was also a director of Mooloya (but resigned from that board on 21st June, 1978 because of conflicts created by the bid). Mr.Prax also discussed this matter with Mr.B.Hersh who has an interest in 25% of Mooloya's share capital and is a partner in the stockbroking firm of Schaverien & Co., which at the end of 1977 had arranged the placing of a 12% stake in Customagic. Schaverien & Co. are brokers to Mooloya and a consultant to the firm, Mr.I.A.Phillips, is a director of Mooloya. Mr.Hersh was then instrumental in introducing new management into Customagic in January 1978. When, in the spring of this year, Mr. Prax,

Mr.Hersh and the Terrys considered that this new management was not being effective, Mr.Hersh, after exploring other possible courses, suggested to Mr.Prax a bid by Mooloya, on the basis that the price did not exceed 20 p. per Customagic share. Mooloya held 135,000 Customagic shares (2.8%) but was not prepared to make a bid unless shares already owned or committed to it constituted nearly 50% of Customagic's issued share capital. Mr.Prax, able to speak for at least 462,000 shares (8.8%), appears to have told Mr. Hersh that he was in a position to influence the Terrys (1,445,430 Shares, i.e., 27.5%) and the question of a procurement fee was mentioned. Mr.M.S.Gampell, the Chairman of Mooloya, examined the proposition of a bid for Customagic with Charterhouse Japhet Limited ("Charterhouse") on 20th April: but he has said that he did not know about a procurement fee to be paid to Mr. Prax until a series of meetings held at Mr. Gampell's house on Sunday 30th April.

At these meetings on 30th April, which were continued on the following day, there were present at various times Mr.Gampell; Mrs.Sewell of Alexander Rubens, solicitors to Mooloya; Mr.Hersh; Mr.Bernard Terry and his solicitor, Mr.Alexander of Alexander, Tatham & Co.; Mr.Sidney Terry and his solicitor, Mr.Jay of Jay Benning & Solomon; and Mr. Prax with his legal advisers, Mr.Silverman of Taylor & Humbert and Mr.Anthony Scrivener QC. Mr.Collins, a member of the staff of Charterhouse was present in the evening of 30th April. Before the Terrys arrived, there was some hard bargaining between Mooloya and Mr. Prax, assisted by Mr.Scrivener, about the amount and conditions of the procurement fee to be paid to him. There were then long negotiations with the Terrys on price, with Mr. Prax playing a prominent part. Mr.Bernard Terry has told us frankly that in agreeing to accept 20 p. on the following day, he was influenced by a promise to renew a service agreement which was on the point of expiry, following the reorganisation earlier in the year which had ousted him from any active share in the management.

The meetings resulted in a number of documents which we had before us:-

(a) A hand-written agreement, initialled by the parties and dated 30th April, between Mooloya and a Jersey resident company, Gras d'Eau Consultants Company Ltd., by which Mooloya agreed to pay a fee of £38,625 for the procurement by Gras d'Eau of the transfer to Mooloya of shares in Customagic held by "certain companies incorporated and resident in the Channel Island of Jersey and shareholders resident in the C.I.". Gras d'Eau is owned by a

trust, whose beneficiaries include members of the family of Mr. Maurice Prax. The agreement did not identify the shares but it is not disputed that the reference was to most of the 658,040 shares (12.5%) described in (b) below. The services provided by Gras d'Eau were to be provided entirely outside the United Kingdom. A later memorandum, dated 13th June, said to evidence the agreement of 30th April, purports to say that the agreement referred to the procurement of the transfer to Mooloya of 1,445,430 shares in Customagic held by the Terry family and some other shareholders. These shareholders were not resident in the Channel Islands.

(b) A preliminary memorandum of an agreement, dated 30th April, initialled by Mr.Gampell and Mr.Prax, followed by an agreement dated 15th June, by which Mooloya conditionally acquired 658,040 Customagic shares mostly owned in the Channel Islands. The vending shareholders included Hall Moss Finance Company Ltd. (265,000 shares), a company owned by a trust for members of Mr. Prax' family, and Beckley Investments (Jersey) Limited (197,000 shares), a company owned by Mr.Prax, of which he was a director. Mr.Prax told us that at the meetings on 30th April he was in a position to pledge all the Channel Island shares to Mooloya.

(c) Correspondence dated 8th and 13th June, between Mooloya and Mr.Prax, under which, if the bid was successful, Mr. Prax would have a consultancy agreement with Mooloya for a period of 5 years at an annual fee of £7,500. Under this agreement Mr.Prax would not be required to perform services outside Jersey, and in the event of Mr.Prax' death during the currency of the agreement (he is now 74 years of age) the fee would be paid to his estate for the remainder of the unexpired term.

(d) Heads of an agreement, dated 1st May, by which (subject to certain conditions, including Panel confirmation that the service and consultancy agreements with the Terrys did not breach the Code) Mooloya conditionally acquired 1,445,430 shares in Customagic held by the Terrys and others.

(e) An agreement, dated 1st May, between Mooloya and Mr.Bernard Terry by which Mr.Terry agreed, subject to the bid going unconditional, to serve Customagic as a director in charge of the mail order division for six years, on broadly the same terms as in the service agreement due to expire. A consultancy contract was agreed for Mr.Sidney Terry but later cancelled by mutual agreement.

(f) A manuscript note, dated 30th April, to the effect that the various agreements benefiting Mr.Prax were to take effect when Mooloya came to terms with the Terry shareholders.

There is some conflict of evidence whether the agreements concerning Mr. Prax were to be submitted to the Panel. Mr.Prax' legal advisers said that their understanding of the meeting with Mooloya on 30th April was that all the documents relating to those agreements would be shown to the Panel by Mooloya. They added that Mr.Gampell expressly stated that this would be done. Mr.Gampell denied ever having committed himself to do so but stated that he had merely said that they could, if necessary, be cleared. In the event he had taken the view that Rule 36 was not concerned with a normal commercial transaction and that, in consequence, no need for clearance arose.

Mr.Bernard Terry's solicitor had wished to be assured that his client's service agreement did not breach the Take-over Code and a stipulation for clearance by the Panel was inserted in the agreement. Accordingly Mr.Gampell, Mr. Bernard Terry and his solicitor, and two representatives of Charterhouse went to the Panel executive on 2nd May. At this meeting Mr.Gampell represented that, if the proposed bid succeeded, Mooloya would need the professional skills of the Terrys in managing Customagic and that the service agreement with Mr.Bernard Terry and the proposed consultancy agreement with Mr.Sidney Terry were commercially justified. The Panel executive accepted this argument and in accord with practice about commercially justified contracts accepted that the agreements were not in breach of Rule 36. No mention was made to the Panel executive of any of the agreements reached between Mooloya and Mr.Prax.

On 1st May, the Chairman of Mooloya informed the Chairman of Customagic that Mooloya proposed to make an offer at 20 p. for the ordinary shares of Customagic. On 3rd May dealing in the shares of Customagic was temporarily suspended. On 15th May,

Mooloya announced the intended offer and that it had entered into conditional agreements with certain shareholders of Customagic to acquire 2,328,470 shares in Customagic (44.4 %.) at a price of 20 p. per share. To these had to be added 135,000 (2.8%) Customagic shares already held by Mooloya. The board of Customagic (other than Mr.Bernard Terry and his son Mr.Andrew Terry) advised rejection of the offer.

On 17th June Charterhouse posted an offer on behalf of Mooloya to acquire the issued share capital of Customagic, other than the 135,000 already held, on the basis of partly convertible unsecured loan stock of Mooloya, with a cash underwritten alternative of 20 p. The first closing date of the offer was 10th July.

The offer document issued on 17th June made some reference to agreements other than the service agreements with the Terrys of which the Panel executive had been informed. The executive then asked for further details and, at their request, a further circular giving more information was issued on 28th June.

In the course of further enquiries, the Panel executive were informed, as recently as 3rd July, of special underwriting arrangements for the Mooloya loan stock offered to Prator Properties Limited of Jersey, a Company owned by Mr.Prax. Under these arrangements Mooloya agreed on 30th April that Prator Properties should participate in the underwriting of a nominal amount of loan stock equal to £200,000 less one-half of the nominal amount receivable by Prator Properties and other Customagic shareholders who had conditionally agreed to sell their shares under the arrangements referred to in (b) above. Mooloya also agreed that Prator should be indemnified as to any loss Prator might incur in respect of up to £100,000 nominal of the stock. The offer of this underwriting was stated to be open for acceptance by Prator any time from 30th April, 1978 until three days prior to the posting of the formal offer document. These agreements were never implemented but they existed with Prator Properties at least until the middle of June when the original arrangements were transferred to another company owned by Mr.Prax. Charterhouse, aware of the Prator Properties arrangements, did make enquiries why reference to them was not included under

material contracts in the offer document. Charterhouse were informed that the arrangement with Prator had been dropped and would not be implemented. They were not informed that the arrangements had been transferred to another company owned by Mr.Prax. In the event none of these underwriting arrangements were implemented. Had they been so they would have been in clear breach of Rule 36.

This case has caused the Panel considerable concern on a number of grounds.

Rule 36 provides that, save with the consent of the Panel, an offeror may not enter into arrangements to make purchases of shares of the offeree company, if such arrangements have attached thereto favourable conditions which are not being extended to all shareholders. This is an application of General Principle 8, which provides that all shareholders of the same class of an offeree company should be treated similarly by the offeror. In form, the procurement agreement was for Mr.Prax to secure for Mooloya, 658,040 shares mostly held in the Channel Islands of which Mr.Prax had already effective control of at least 462,000. Mr.Gampell informed us, however, that the intention was to pay the fee primarily for Mr.Prax' services in inducing the Terrys to dispose of their shares at 20 p. The memorandum of 13th June therefore rectified this shortcoming.

In our view this presentation ignores the fact that Mr.Prax owned or controlled a substantial number of shares. The sequence of events suggests that he was unwilling to co-operate in furthering the bid unless he received a substantial procurement fee. It is impossible in these circumstances to distinguish between the substantial extra amount that he received as a shareholder and the reward of his services in inducing others to accept a smaller amount than he received. As regards those services, Mr.Prax was a consultant of Customagic and attended board meetings. He was presumably paid to help to look after the best interests of the Company and Mr.Prax has stated that he did indeed believe the bid by Mooloya was in the Company's best interests. It was a source of some disquiet to Panel members that in the pursuit of such a satisfactory solution to Customagic's problems as he saw them, Mr.Prax should have attached so much importance to his own special arrangements.

The Panel concluded that the fee of £38,625 could not be distinguished from the amount paid for Mr.Prax' shares and should be regarded as an additional consideration to the 20 p. per share offered to other shareholders. As such it constituted a breach of General Principle 8 and Rule 36.

We did not find it easy to reach a conclusion about the consultancy fee to be paid to Mr.Prax. Mr.Prax' present consultancy agreement secures an annual fee of £2,000 and nothing is said about limiting the services to performance in Jersey. That Mr.Prax is now to be paid £7,500 p.a., that the services are to be performed in Jersey (if that is the effect of the agreement in practice) and that the provision for payment is for five years, whether or not Mr.Prax survives that period, must throw some doubt on the nature of the agreement. Mr.Prax produced evidence to show that he could work effectively on material sent to him from Manchester, and we can see that his advice would be of use to Mooloya if the bid succeeds and Mooloya has to manage Customagic. Although we found it difficult to divorce the consultancy agreement from the other arrangements between Mooloya and Mr.Prax, on balance we decided that it was not in itself offensive under Rule 36.

As indicated in a short statement issued on 6th July, we directed that the offer should proceed on its existing terms but that the fee of £38,625 should not be paid and that Mooloya, subject to the offer becoming unconditional, should pay an extra consideration amounting to 1 p. cash per Customagic share to all shareholders of Customagic who accepted the offer.

The Panel considers that prime responsibility for the breach of General Principle 8 and Rule 36 must lie with Mooloya. Mr.Gampell is a practising solicitor with extensive experience in the field of take-overs and in the work of the Panel. Whether or not he gave an express undertaking to clear the fee arrangement with the Panel, he was certainly on notice that Mr.Prax' advisers were concerned about the application of the Code. The Panel found it extraordinary that Mr.Gampell only two days later discussed with the Panel executive the Terry arrangements and obtained clearance under Rule 36 yet found it possible to avoid mentioning the far more sensitive Prax arrangements. Even after it became evident that the Panel was pursuing an investigation into possible breaches of Rule 36 following publication of the offer document, no complete disclosure to the Panel of all the various arrangements with Mr.Prax was forthcoming from the Mooloya side. The Panel has concluded that the conduct of

Mooloya and in particular of Mr.Gampell merits serious criticism.

The issues which arise under Rule 36 when additional payments are made to persons who are also shareholders in the offeree are sometimes difficult to determine. The proper test is whether such a payment is commercially justified and would have been made even if no shares were owned. The Panel considers there is a heavy onus on the parties to such an arrangement to satisfy themselves that there is no infringement of Rule 36 and the best way to achieve this is to discuss the intended arrangements with the Panel executive. The Panel executive is available for advice at all times and companies and their advisers have been urged from the inception of the Panel to make full use of this service. The Code is not a legal document and it is no answer to a failure to consult the Panel executive that a legal opinion has been obtained on the interpretation of a Rule. The authority designated to interpret the Code is the Panel and it is the Panel executive that should be consulted in any case of doubt. An offeree shareholder who is to receive a special payment cannot absolve himself from the responsibility for establishing that there is no infringement of Rule 36.

The Panel has also considered the role and conduct of Charterhouse. Mr.P.P.Ralph, the Charterhouse Director in charge, has considerable experience in the field of take-overs and in the course of the Panel hearing he informed the Panel of the concern he felt whilst the offer document was being prepared that the arrangements might be in breach of Rule 36. Enquiries initiated by him were made at a meeting attended by, among others, Mr. Gampell and Mr. Hersh. The explanations he received were recorded within Charterhouse and led Mr.Ralph to conclude that the arrangements were commercially justified and therefore not in breach of Rule 36. Nevertheless, in view of the nature of the arrangements and of the fact that Charterhouse took part in the discussion with the Panel executive about the more defensible arrangements with the Terrys, the Panel considers it a serious error of judgment by Charterhouse not to have consulted the Panel executive about the arrangements with Mr.Prax.

19th July 1978.