

THE TAKEOVER PANEL

BRITISH & COMMONWEALTH HOLDINGS PLC ("B&C") /
MERCANTILE HOUSE HOLDINGS PLC ("MERCANTILE") /
QUADREX HOLDINGS, INC ("QUADREX") /
CROWNX INC ("CROWNX")

The full Panel met today to consider an appeal by Kleinwort Benson Limited, on behalf of Crownx, against a ruling of the Panel executive relating to the application of Rule 16 of the Code as regards the agreement entered into on 13 August 1987 between B&C and Quadrex for the sale to Quadrex, if B&C's offer is successful, of the wholesale broking division of Mercantile. This was in the context of the announcement yesterday of a counter proposal put by Crownx to the current board of Mercantile offering, subject to various conditions, to purchase the same business for the same price, £280mn, as to be paid by Quadrex together with an additional payment of 10p per share to each Mercantile shareholder who was an acceptor of the B&C offer for Mercantile.

The ruling of the executive was that:-

- (i) the extraordinary general meeting of shareholders of Mercantile, convened for 21 September, to consider a resolution pursuant to Rule 16 of the Code to approve the transaction between B&C and Quadrex is in the circumstances now inappropriate; and
- (ii) the Panel gives its consent to such transaction being completed without the passing of such a resolution.

The Panel upheld the executive's ruling and accordingly the transaction can proceed without the approval of shareholders of Mercantile.

The Panel considers it is appropriate to set out a summary of the case and reasons for its decision in some detail.

THE ISSUE

The Panel was concerned with the application of Rule 16 of the Code, which is set out in full at the end of this statement. The purpose of the Rule is to ensure the practical application of the important General Principle that all shareholders of the same class of an offeree company must be treated similarly by an offeror. It therefore prevents an offeror from entering into any arrangements with an offeree shareholder which would confer on him benefits not available to all other shareholders. Note 2 recognises, however, that there may be situations in which an offeror may want to dispose of some of the assets of an offeree company to an existing offeree shareholder and it provides a mechanism for ensuring fairness. This mechanism has two elements: first, that independent advisers to the offeree company must state that in their view the proposed transaction is fair and reasonable, and so has been entered into on an arms' length basis, and, second, that independent shareholders give their approval of the transaction to demonstrate that they agree that it has no favourable conditions attached.

THE EVENTS

The events leading up to today's hearing are as follows:

16 July 1987	B&C announced a recommended offer for Mercantile.
28 July-6 August	Quadrex became a potential offeror for the whole of Mercantile and put proposals to the board.

- 7 August B&C increased its offer and issued a revised offer document on 11 August.
- 17 August B&C announced an agreement with Quadrex to sell to it, for £280mn in cash, the wholesale broking business of Mercantile. The Panel executive ruled then that, since Quadrex held some 7% of Mercantile, this agreement was subject to the procedure set out in Note 2 to Rule 16, with both B&C and Quadrex being disenfranchised as interested parties.
- 3 September B&C declared its offer unconditional as to acceptances.
- 4 September The circular explaining the Quadrex agreement and convening the Rule 16 shareholders' meeting for 21 September was sent to Mercantile's shareholders.
- 16 September Crownx announced that it had approached the Mercantile board with a proposal to buy the wholesale broking business of Mercantile for the same cash price payable by Quadrex plus an extra 10p per share to all Mercantile shareholders accepting the B&C offer.

THE REASONS FOR THE PANEL'S DECISION

The agreement between B&C and Quadrex provides for the sale of certain Mercantile assets, the wholesale broking business, to Quadrex for £280mn if B&C's offer for Mercantile is successful. Quadrex was, at the time the agreement was entered into on 13 August, a 7% shareholder of Mercantile. It was clear that Rule 16 of the Code applies to this agreement.

The need to follow the specific procedure to ensure equality of treatment was recognised in August and the Code was followed. That is, S G Warburg & Co Ltd, the independent advisers to Mercantile, stated in the circular to Mercantile shareholders of 4 September that the terms of the transaction were fair and reasonable; a shareholders' meeting was convened for 21 September. Appropriate arrangements were made to ensure that, notwithstanding that shareholders may have accepted the B&C offer, they would be able to exercise their voting rights at the meeting should they wish to do so. This included Crownx, a 15% shareholder. Accordingly, at least until the announcement by Crownx on 16 September, it was possible for the normal procedure to be followed and the purpose of the resolution to be fulfilled.

That purpose is a narrow one: shareholders would in effect be voting at the relevant meeting as to whether they considered there to be some form of special deal for the shareholder, in this case Quadrex, purchasing the asset in question, and not on any other matter. In normal circumstances the procedure is easily workable and the vote follows acceptances of the offer.

In this case an extraneous factor intervened. This was the announcement by Crownx on 16 September and particularly its proposal to pay to Mercantile shareholders an additional 10p per share if its offer for the wholesale broking business was accepted.

The Panel considered carefully all the arguments put to it by all the parties. The Panel rejected the argument by Crownx that its proposal proved that the agreement between B&C and Quadrex involved a special deal for Quadrex such that the equality of treatment principle had been breached and that the only effect of the announcement of its proposal was to provide further information on which Mercantile shareholders could base a decision.

The Panel considered that the Crownx proposal had introduced a factor which was likely to mean that shareholders could not, in effect, be voting at the meeting on whether or not the Quadrex transaction involved favourable conditions to Quadrex as a shareholder of Mercantile; rather, because the Crownx proposal - including the potential payment of an extra 10p per share to Mercantile acceptors of the B&C offer - is dependent upon the resolution not being passed, shareholders would be influenced by issues irrelevant to the purpose for which the resolution was designed, that is to fulfil the requirements of Rule 16.

There was no evidence to suggest that the Quadrex transaction involved any special benefit to Quadrex such as could result in them effectively receiving a greater amount per Mercantile share than other shareholders of Mercantile. On the contrary, it was important that the Quadrex transaction had been independently assessed by Warburgs in this regard, that Warburgs had concluded that the transaction was fair and reasonable when it was entered into and that Warburgs had made a statement to this effect publicly in the circular of 4 September. Therefore, one of the important features of the requirements of Rule 16 in the circumstances of a sale of an asset to a shareholder had been satisfied. Since the Panel considered that it was now not possible for the second element of the Panel's normal requirements to be satisfied, that is a resolution of shareholders' approving the transaction, within the purposes of the Rule, the Panel decided that it should, in these unusual circumstances, waive that second requirement.

Accordingly the Panel, upholding the executive's ruling, gave its consent to the agreement between Quadrex and B&C being completed without a resolution approving the transaction being passed.

17 September 1987

RULE 16. SPECIAL DEALS WITH FAVOURABLE CONDITIONS

Except with the consent of the Panel, the offeror or persons acting in concert with it may not deal or enter into arrangements to deal in shares of the offeree company, either during an offer or when one is reasonably in contemplation, if there are favourable conditions attached which are not being extended to all shareholders.

NOTES ON RULE 16

1. Top-ups etc.

An arrangement to deal with favourable conditions attached includes any arrangement where there is a promise to make good to a vendor of shares any difference between the sale price and the price of any subsequent successful offer. An irrevocable commitment to accept an offer combined with an option to put the shares should the offer fail will also be regarded as such an arrangement.

2. Disposal of offeree company assets

In some cases, certain assets of the offeree company may be of no interest to the offeror. There is a possibility if a shareholder in the offeree company seeks to acquire the assets in question that the terms of the transaction will be such as to confer a special benefit on him: in any event, the arrangement is not capable of being extended to all shareholders. The Panel will normally consent to such a transaction, provided that the independent adviser to the offeree company publicly states that in his opinion the terms of the transaction are fair and reasonable and the transaction is approved at a general meeting of the offeree company's shareholders. At this meeting the vote must be taken on a poll and interested parties must be disenfranchised. Where a sale of assets takes place after the offer has become unconditional, the Panel will be concerned to see that there was no element of pre-arrangement in the transaction.

3. Finders fees

This Rule also covers cases where a shareholder in an offeree company is to be remunerated for the part that he has played in promoting the take-over. The Panel will normally consent to such remuneration provided that the shareholding is not substantial and it can be demonstrated that a person who had performed the same services but had not at the same time been a shareholder would have been entitled to receive no less remuneration.

H₄**RULE 16 CONTINUED***NOTES ON RULE 16 continued**4. Management retaining an interest*

Sometimes an offeror may wish to arrange for the management of the offeree company to remain financially involved in the business. The methods by which this may be achieved vary but the principle which the Panel is concerned to safeguard is that the risks as well as the rewards associated with an equity shareholding should apply to the management's retained interest. For example, the Panel would not normally find acceptable an option arrangement which guaranteed the original offer price as a minimum. The Panel may require as a condition of its consent that the matter be dealt with in the manner described in Note 2 above.