THE TAKEOVER PANEL

WARD WHITE GROUP plc

THE ISSUE

The full Panel met on 1 August to consider an appeal by Ward White Group plc ("Ward White") against a ruling of the Executive that The Boots Company PLC ("Boots") could take into account:-

(i) in the denominator of the acceptance condition to its Ordinary Offer, any ordinary shares which would arise in respect of valid conversion notices of the currently convertible preference shares of Ward White lodged prior to the offer being declared unconditional; and

(ii) in the numerator of the acceptance condition, any acceptances or purchases of such ordinary shares.

THE RULING

The Panel upheld the appeal. Accordingly, assuming that no new shares are allotted during the offer period otherwise than pursuant to the conversion of convertible preference shares, up to and including midnight on 1 September 1989, (the last day for lodging conversion notices), Boots' Ordinary Offer can become unconditional as to acceptances once Boots has acquired ordinary shares comprising 50% of the issued ordinary share capital of Ward White; after that time it will have to have acquired existing ordinary shares together with new ordinary shares to be issued following conversion of convertible preference shares, comprising 50% of the ordinary share capital as it will be enlarged pursuant to the exercise of such conversion rights.

THE BACKGROUND

The share capital of Ward White includes the following categories:-

(a) 118,469,991 ordinary shares of 25p each ("the ordinary shares"); and

(b) 238,235,799 convertible redeemable preference shares of l0p each ("the convertible preference shares").

The convertible preference shares are convertible into ordinary shares on the basis of 25p nominal of ordinary share capital for every 29.1971p nominal of convertible preference share capital. Thus, full conversion of all the convertible preference shares currently in issue would give rise to the need for Ward White to issue a further 81,595,706 ordinary shares, which would comprise 40.78% of the enlarged share capital. On the basis of the current Ward White dividend, a holder of convertible preference shares who converts during the offer period would suffer a substantial income penalty because of the different income entitlements on the ordinary shares and the convertible preference shares.

Under Ward White's Articles of Association the right to convert the convertible preference shares is exercisable by holders on any "Conversion Date" (being 1 September in the years 1989 to 2005) by service of a conversion notice at any time during the period of 28 days ending on the Conversion Date in question. Any allotment of ordinary share capital has to be made by the board within 14 days following the relevant Conversion Date.

Boots announced its offers on 3 July 1989. It has offered 400p for each Ward White ordinary share and 137p for each convertible preference share, valuing Ward White at approximately £800 million. The offer document was posted to Ward White's shareholders on 4 July 1989. The last date on which the offers can be declared unconditional as to aceptances is 2 September 1989.

The relevant part of the acceptance condition of Boots' Ordinary Offer reads as follows:-

> "...this condition will not be satisfied unless Boots shall have acquired or agreed to acquire, whether pursuant to the Ordinary Offer or otherwise, Ward White ordinary shares carrying more than (i) 50% of the voting rights normally exercisable at general meetings of Ward White and attributable to the Ward White equity share capital alone and (ii) 50% of the voting rights so exercisable and attributable to the Ward White equity share capital and non-equity share capital combined (including for this purpose to the extent, if any, required by the Panel on Take-Overs and Mergers (the "Panel"), any voting rights attaching to any Ward White shares which may be unconditionally allotted or issued before the Ordinary Offer becomes or is declared unconditional as to acceptances, whether pursuant to the exercise of outstanding conversion or subscription rights or otherwise);".

There is also the following additional interpretation of the treatment under the acceptance condition of the convertible preference shares:-

> "...Ward White shares which may be unconditionally allotted or issued shall include any Ward White ordinary shares which would arise on conversion of Ward White convertible preference shares pursuant to a valid Conversion Notice completed and delivered in accordance with the Articles of Association of Ward White (and not as thereby permitted having been withdrawn) of which Boots is or becomes aware before the Ordinary Offer becomes or is declared unconditional as to acceptances; and Ward White ordinary shares which Boots shall have acquired or agreed to acquire shall include any such Ward White ordinary shares which would arise on any such conversion in respect of Ward White convertible preference shares which Boots shall have acquired or agreed to acquire pursuant to the Offers or otherwise;".

Boots therefore wished to include, as part of the denominator of the fraction of the Ward White ordinary share capital which it needs to obtain in order to become unconditional as to acceptances, all ordinary shares attributable to those convertible preference shares in respect of which valid conversion notices have been served on Ward White prior to the offer being declared unconditional. In addition, Boots would wish to add to the numerator of the same fraction those ordinary shares deemed to have arisen in respect of converted convertible preference shares insofar as Boots had acquired or agreed to acquire such convertible preference shares.

Prior to announcing its offers the advisers to Boots discussed with the Executive the question of how to treat the Ward White convertible preference shares for the purposes of the acceptance condition of the Boots Ordinary Offer. The condition set out above reflects the outcome of these discussions. However, the Executive was not at that time able to discuss these matters with Ward White because Ward White was not aware that Boots intended to make an offer. The Executive therefore gave Boots an ex parte ruling which was subject to appeal by Ward White. Following the announcement of the offers the Executive had a number of discussions with the parties on this point and subsequently confirmed its original ruling.

Ward White appealed against that ruling.

THE CODE

Rule 10 of the Code provides as follows:-

> "It must be a condition of any offer for voting equity share capital which, if accepted in full, would result in the offeror holding shares carrying over 50% of the voting rights of the offeree company that the offer will not become or be declared unconditional as to acceptances unless the offeror has acquired or agreed to acquire (either pursuant to the offer or otherwise) shares carrying over 50% of the voting rights attributable to:-

(a) the equity share capital alone; and

(b) the equity share capital and the non-equity share capital combined".

The relevant part of Note 2 on Rule 10 provides as follows:-

> "New Shares
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> For the purpose of the acceptance condition, the offeror must take account of all shares carrying voting rights which are unconditionally allotted or issued before the offer becomes or is declared unconditional as to acceptances, whether pursuant to the exercise of conversion or subscription rights or otherwise".

The difficulty arises over whether or not ordinary shares which would arise on conversion fall within Note 2 on Rule 10.

The present wording of Note 2 on Rule 10 was introduced to the Code in January 1988. Before then an offeror was required to take account of existing voting shares and "potential equity", namely any voting shares which would be issued on the exercise of any conversion or subscription rights capable of being exercised during the offer period.

The reference to "potential equity" led to difficulties of interpretation which culminated in a Panel hearing in 1986. In that case the offeror objected to an interpretation of the then Note 2, which would have required it to obtain 50% of a class which had been artificially enlarged by the theoretical possibility of conversions taking place and out of which it could not in practice obtain any acceptances. The Panel upheld the offeror and subsequently amended Note 2 on Rule 10 in order to avoid the situation where shares are included in the denominator which are, in practice not going to be issued and are therefore incapable of being assented to the offer during the offer period. Now, therefore, instead of the concept of "potential equity" there is a reference to "voting rights which are unconditionally allotted or issued before the offer becomes or is declared unconditional as to acceptances".

THE VIEWS OF THE PARTIES

The Executive submitted that Ward White's interpretation of Note 2 on Rule 10 could mean that Boots' Ordinary Offer could go unconditional as to acceptances prior to midnight on 1 September if Boots achieved 50% only of the existing issued ordinary share capital. If conversion notices were received by Ward White during the conversion period, this would inevitably mean that, following the closing of the conversion period, more ordinary shares would be bound to come into existence, thereby diluting Boots' level of acceptances. The purpose behind the Executive's ruling was, therefore, to reduce the effect of such dilution by allowing Boots' Ordinary Offer to go unconditional as to acceptances at any point during the conversion period, but provided only that Boots had, at that time, 50% of the total amount of ordinary share capital which was in existence or was bound to come into existence as a result of valid conversion notices delivered up to that time. The Executive was influenced in this decision by the fact, firstly, that a holder of convertible preference shares could do nothing more, once he had submitted a valid conversion notice, to ensure that he received ordinary shares and, secondly, that the company had no discretion not to issue the ordinary shares. Boots agreed with the views of the Executive.

Ward White, on the other hand, emphasised that, if the Executive's ruling were to be followed, Boots' Ordinary Offer could go unconditional as to acceptances at a point when Boots only had approximately 37% of the ordinary shares in issue and 37% of the convertible preference shares. Following the offer going unconditional in this way, further conversions could result in the ordinary share capital being diluted; another offeror could emerge and could also get sufficient shares to go unconditional on the same basis as Boots, which in such circumstances would never acquire legal control of Ward White.

In circumstances in which an offeror had gone unconditional without having achieved legal control, the board of Ward White would be put in a difficult position.

Ward White's other main concern was that the Executive's ruling would put different categories of the preference shareholders in an unequal position. Those who wanted to support Boots could convert and accept the Ordinary Offer. Those who wished positively to oppose the offer (by increasing the denominator of the acceptance condition and not accepting either offer) would have to convert. In so doing they would lose their right to the higher income entitlement arising from their preference shares.

Ward White therefore proposed that Boots' Ordinary Offer should be able to become unconditional as to acceptances prior to midnight on 1 September (i.e. the closure of the conversion period) on the basis of 50% only of the existing issued ordinary share capital; and after that time on the basis of 50% of the actual enlarged issued ordinary share capital. Special arrangements could be put in place to ensure that Boots could include in the numerator of the Ordinary Offer on 2 September any acceptances received from holders of the convertible preference shares who had served valid conversion notices.

THE PANEL'S REASONS

The Panel most carefully considered the facts set out above and also the arguments of the parties as recorded here. The Panel decided that the contentions of Ward White should be upheld.

The Panel's reasons for reaching these conclusions are as follows:-

(a) The issues raised by this appeal are complex and the Panel's decision is reached on the basis of the facts of this particular case. In particular, the timing of the conversion period and the 60 day period of Boots' offers are nearly coincident and this adds to the difficulties of this decision.

(b) The decision is essentially an interpretation, in the light of the facts, of Rule 10 of the Code as amended by the new Note 2. This is best summarised on page 5 of this statement where it says:-

> "The present wording of Note 2 on Rule 10 was introduced to the Code in January 1988. Before then an offeror was required to take account of existing voting shares and "potential equity" namely any voting shares which would be issued on the exercise of any conversion or subscription rights capable of being exercised during the offer period...
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> Now, therefore, instead of the concept of "potential equity" there is a reference to "voting rights which are unconditionally allotted or issued before the offer becomes or is declared unconditional as to acceptances"."

(c) We were provided by S G Warburg with a carefully constructed "Illustration of the effect of the Boots acceptance condition" (attached hereto). This shows how, on the amount of shares there used as an illustration, the offer could be declared unconditional by Boots at a time when they temporarily controlled 50% of the "equity", although on full conversion they would have only 37.2%. Accordingly, it was argued by Warburgs that a subsequent offer, possibly by a third party, could reverse the controlling position after the bid had been declared unconditional. This would clearly be an unsatisfactory situation.

(d) We believe that substantial importance must be attached to the change introduced into Rule 10 by Note 2 but that, in the present case, this means that shares arising on conversion cannot be taken into account for the purposes of the acceptance condition until all such conversions could be counted. This can only be done after the end of the conversion period, namely on 2 September 1989. Accordingly, as stated at the opening of this Statement, assuming that no new shares are allotted during the offer period otherwise than pursuant to the conversion of convertible preference shares, up to and including midnight on 1 September 1989, Boots' Ordinary Offer can become unconditional as to acceptances once Boots has acquired ordinary shares comprising 50% of the issued ordinary share capital of Ward White; after that time it will have to have acquired existing ordinary shares together with new ordinary shares to be issued following conversion of convertible preference shares, comprising 50% of the ordinary share capital as it will be enlarged pursuant to the exercise of such conversion rights. The Panel will operate the discretion given to it in the Boots' acceptance condition (see page 3) to give effect to this ruling.

3 August 1989

31st July, 1989

BOOTS/WARD WHITE

Illustration of the effect of the Boots acceptance condition

Class of shares	Shares held by Boots Including acceptances (%)	million	Denominator as per ruling million	Fully diluted share capital million
Ordinary shares	37.2	44.1	118.5	118.5
Convertible preference shares	37.2	30.4	30.4	81.6
		74.5	148.9	200.1

Boots' holding as:

- proportion as per ruling $\frac{74.5}{148.9}$ = +50%

- proportion on fully diluted basis $\frac{74.5}{200.1}$ = 37.2%