

# THE TAKEOVER PANEL

**KRAFT FOODS INC. (“KRAFT”)**

**OFFER FOR**

**CADBURY PLC (“CADBURY”)**

## **Introduction**

This is a statement of public criticism by the Panel Executive (the “Executive”) of Kraft as a result of Kraft not meeting the standards required under Rule 19.1 of the Takeover Code (the “Code”) in connection with certain statements about Cadbury’s Somerdale facility.

## **Background**

On 7 September 2009, Kraft announced that it was considering making an offer for Cadbury. The summary of this announcement concluded with a quotation from the Chairman and CEO of Kraft setting out a brief explanation of Kraft’s rationale for the transaction. This quotation included a statement about Cadbury’s Somerdale facility which, in October 2007, Cadbury had announced would be subject to a phased closure from 2009 to 2010, with production being transferred principally to Cadbury’s new facilities in Poland (including a new purpose-built facility). The statement was as follows:

*“Our [i.e. Kraft’s] current plans contemplate that the UK would be a net beneficiary in terms of jobs. For example, we believe we would be in a position to continue to operate the Somerdale facility, which is currently planned to be closed, and to invest in Bournville, thereby preserving UK manufacturing jobs.”*

Kraft made a similar statement in a letter of approach dated 7 September to the Cadbury board, which was appended in full to Kraft's announcement of the same date. Kraft repeated this statement in substantially the same form on 9 November (in its firm offer announcement), on 4 December (in its offer document) and on 19 January 2010 (incorporated by reference, in its revised offer document, which was the first occasion on which the Cadbury board recommended Kraft's offer, as revised on that date). On each occasion that it made this statement, the only information known to Kraft regarding the progress of Cadbury's phased closure of Somerdale and the transfer of production from Somerdale to its new facilities in Poland was that which was available in the public domain, save that, on the night of 18/19 January, a limited discussion took place between representatives of Kraft and Cadbury in relation to certain high level due diligence matters, during the course of which Cadbury's closure of Somerdale was touched upon. At that meeting, Cadbury informed Kraft that it considered it would be difficult to continue to operate the Somerdale facility.

Kraft's offer for Cadbury was declared unconditional on 2 February. On 9 February, Kraft announced that, following extensive talks with senior management at Cadbury, it had reluctantly accepted that Cadbury's plans to close the Somerdale facility were so far advanced that it was unrealistic to reverse them. In this announcement, Kraft stated that it had now become clear that the investment required to reverse the closure programme would be so significant that alternative plans would not be viable. Kraft had now discovered, among other things, that Cadbury had already invested more than £100 million in building new facilities in Poland to which the majority of the production lines would be transferred by the middle of 2010.

### **Relevant provision of the Code – Rule 19.1**

Rule 19.1 provides that:

**“Each document or advertisement published, or statement made, during the course of an offer must be prepared with the highest standards of care and accuracy and the information given must be adequately and fairly presented.”**

Note 1 on Rule 19.1 explains that the Panel regards financial advisers as being responsible for guiding their clients with regard to any information published during an offer.

The Panel attaches great importance to Rule 19.1. Compliance with the Rule is fundamental to ensuring the orderly conduct of takeovers and, in relation to statements made by an offeror about its strategic plans for the offeree company and their likely repercussions on employment and the locations of the offeree company's places of business, that the board of the offeree company can fulfil its obligation under General Principle 2 and Rule 25.1(b) to set out its views on these subjects on a properly informed basis. Similarly, the company's employee representatives can only effectively exercise their right under Rule 30.2(b) to give their opinion on the effects of the offer on employment if these standards are met.

#### **Application of Rule 19.1 in this case**

Kraft has explained to the Executive that it needed additional manufacturing capacity for its chocolate products, particularly for the growing Continental European market. Kraft believed that the transfer of production from Somerdale to Cadbury's new facilities in Poland would not take place until the latter part of 2010 and that its offer (if successful) was likely to complete in early 2010. Kraft considered that it would then be able to use Cadbury's new Polish facilities to meet its need for additional capacity in Continental Europe and to continue to use the Somerdale facility to manufacture Cadbury products for the UK. However, given that Kraft did not know the detail of Cadbury's phased closure of Somerdale and the transfer of production from Somerdale to its new facilities, Kraft was not willing, nor was it in a position, to give any firm commitment in this regard, nor were its plans developed beyond a superficial level. As a result, Kraft chose to make the statement as one of belief.

Once Kraft had gained access to Cadbury's management, at the end of January, it became aware that Cadbury's phased closure of Somerdale and the transfer of production from Somerdale to its new facilities was significantly more advanced than

Kraft had previously believed. As a result, as announced on 9 February, Kraft decided to close the facility in accordance with Cadbury's original plans.

The Executive considers that, where a party to an offer makes a statement of belief of the kind made by Kraft, Rule 19.1 requires not only that the party concerned honestly and genuinely holds that belief (a subjective test) but also that it has a reasonable basis for so holding that belief (an objective test).

In this case, in view of the statements' prominence and the significance attached to them by Kraft and Cadbury's employees, and given that they repeatedly raised the prospect of Kraft reversing a high profile and contentious decision taken by Cadbury some two years previously, the Executive considers that particular care was required in relation to the statements regarding the Somerdale facility.

## **Conclusions**

### *Kraft*

The Executive has concluded that the statements made by Kraft regarding the Somerdale facility were not prepared to the standards required by Rule 19.1.

The Executive accepts that Kraft held an honest and genuine belief that it could keep Somerdale operational. Further, in Kraft's view, the publicly available information regarding the timing of the Somerdale closure, together with its own expert operational knowledge in relation to factory closure programmes in the industry, provided it with a reasonable basis for holding that belief.

However, the Executive considers that Kraft should not have made the statements in the form in which it did in circumstances where it did not know the details of Cadbury's phased closure of Somerdale and its investment in plant and machinery to make products for the UK in its new facilities in Poland. Without this information, Kraft's belief, no matter how well-intentioned, that it could continue to operate the

Somerdale facility on a commercial basis was, in the opinion of the Executive, not a belief which Kraft had a reasonable basis for holding.

Kraft had an opportunity to take mitigating action once it gained access to representatives of the Cadbury management team, which first occurred on the night of 18/19 January. Kraft was told on that night that the phased closure of Somerdale was well advanced, that money had been committed, and that both equipment and people had been, or were in the process of being, moved out. However, Kraft did not take this opportunity to seek further information from Cadbury in order to establish whether the closure was so far advanced that it was unrealistic to reverse it.

Kraft is hereby criticised for not meeting the standards required under Rule 19.1.

#### *Lazard*

Lazard & Co., Limited (“Lazard”) was lead financial adviser to Kraft and was responsible for advising Kraft in relation to the Code.

Paragraph 3(f) of the Introduction to the Code makes clear that financial advisers have a responsibility to ensure that their client and its directors are aware of their responsibilities under the Code and will comply with them. This responsibility is fundamental to the Panel system of regulation. In relation to statements made by parties to an offer, this responsibility is reinforced by Note 1 on Rule 19.1 in order to ensure that such statements are prepared with the highest standards of care and accuracy, as required under Rule 19.1.

Lazard discussed the statements relating to Somerdale with Kraft and explained that Kraft would need a reasonable basis for holding its belief, as well as honestly and genuinely believing it. Lazard conducted certain independent due diligence from public sources and the statements were tested through the verification process. In addition, Lazard took comfort from Kraft’s own expert operational knowledge in relation to factory closure programmes in the industry. However, in view of the prominence of the issue and the significance of the statements, Lazard should, in the

opinion of the Executive, have made further enquiry of Kraft as to the basis for its belief. Lazard made no such further enquiry and, as such, failed to discharge fully its responsibilities under Note 1 on Rule 19.1.

Whilst it is unfortunate that Lazard did not take this additional action, the Executive considers that the primary responsibility in respect of the Somerdale statements lay with Kraft and that, in all the circumstances, Lazard's conduct was not sufficient to merit public criticism.

26 May 2010