The Panel on Take-overs and Mergers

Report on the Year ended 31st March 1973

MEMBERSHIP OF THE PANEL

Lord Shawcross (Chairman)	Nominated by the Governor of the Bank of England
Sir Alexander Johnston (Deputy Chairman)	Nominated by the Governor of the Bank of England
K. M. Bevins	Chairman, British Insurance Association
*J. M. Clay	Chairman, Issuing Houses Association
E. O. Faulkner	Chairman, Committee of London Clearing Bankers
Maurice Haddon-Grant	Chairman, The National Association of Pension Funds
The Viscount Harcourt	Chairman, Accepting Houses Committee
*D. H. Maitland	Chairman, Association of Unit Trust Managers
Sir Peter Menzies	Nominated by the Confederation of British Industry
A. G. Touche	Chairman, Association of Investment Trust Companies
Sir Martin Wilkinson	Chairman of the Council of The Stock Exchange

*Since the last Annual Report Mr. J. M. Clay and Mr. D. H. Maitland have been appointed in place of Mr. Peter Cannon and Mr. G. H. Fletcher.

Lord Pearce	Chairman of the Appeal Committee of the Panel

THE PANEL EXECUTIVE

John Hull	Director General
B. J. Denington	Deputy Director General
T. P. Lee	Secretaries
P. R. Frazer	
C. G. W. Kennedy	Assistant Secretary
I. L. Clarke	

FOREWORD

This Report outlines a further year of activity by the City Panel during which its work has, I believe, both increased in usefulness and gained in authority.

Without being in any way complacent, I am, for my own part, convinced that the system of voluntary self regulation which the City and industry established under the aegis of the Governor of the Bank of England remains more appropriate to the circumstances of this country than would be any statutory counterpart here of the Securities and Exchange Commission as it operates in the United States. It is true that occasionally some contrary opinion is expressed by publicists but our own study of the work of the S.E.C. and our not infrequent conversations with those who conduct it in the different climate of the United States leave us in no doubt that the introduction of a statutory system here would in fact be a retrograde measure. We believe this to be the general conclusion of informed opinion.

In a statutory system those concerned are entitled to exercise their ingenuity in so ordering their affairs as to avoid the application of prohibitory or inconvenient rules. If a particular course of conduct is not expressly forbidden it is permissible: there is no grey area. With the City Code broadening down from precedent to precedent and obligatory in the spirit as well as in the letter, immediate steps can be taken to stop abuses as soon as they are discovered, and the fear of possible action undoubtedly prevents many abuses arising. This flexibility, the advisory function, the great expedition of its work and the authority behind it, are not, I believe, capable of reproduction in a statutory system. There remain, however, certain matters such as insider dealing where the possibility of criminal proceedings is a necessary long stop. I am confident that, following the joint advice of the City Panel and the Council of The Stock Exchange, the Government will introduce the necessary legislation at an early date.

23*rd May,* 1973

REPORT ON THE YEAR ENDED 31st MARCH 1973

General

Activity in the field of take-overs and mergers continued at a high level throughout the year ended 31st March, 1973. In addition to the routine Quarterly Meetings, the Panel was convened seven times to hear appeals by parties to take-over transactions against rulings by the executive and once to consider a disciplinary case brought by the Director General involving an infringement of Rule 30 of the Code.

The Appeal Committee met once under the chairmanship of Lord Pearce. The meeting was held to consider an appeal from the Panel's ruling in the disciplinary case referred to above. The Committee dismissed the appeal.

A series of Panel meetings was also held on the subject of insider dealing. Following these meetings the Panel, in conjunction with The Stock Exchange, issued in February a public statement in connection with this matter to which reference is made later in this Report.

Statistics

The Panel executive was concerned with take-over or merger proposals made in respect of 353 companies (last year *377*) of which 260 (*319*) were companies whose securities were quoted on a Stock Exchange. In 31 (*44*) cases there were one or more rival offers and altogether there were 388 (*427*) proposals of which 356 (*384*) reached the stage where formal documents were circulated to shareholders. 3 (*14*) agreed offers failed and 8 (*5*) opposed offers succeeded.

These statistics and the information given below cover transactions where there was at least a public announcement of a firm intention to make an offer. A further 48 (*81*) cases still open at 31st March are not included in these figures. The executive was consulted in another 145 cases which either did not lead to public proposals or were transactions approved by shareholders involving control blocks of shares.

Category of documents

	1972/3	*1971/2*
Circulated by Exempted Dealers … … …	248	*292*
Circulated by Licensed Dealers … … …	26	*20*
Circulated by others exempted under the Prevention of Fraud (Investments) Act 1958 … … …	42	*31*
Circulated on the basis of specific authority from the Department of Trade and Industry … …	25	*26*
Scheme of Arrangement … … … …	15	*15*
	356	*384*

Outcome of the proposals

	1972/3	*1971/2*
Successful proposals involving control (including Schemes of Arrangement) … … … …	214	*231*
Unsuccessful proposals involving control … …	36	*59*
Unsuccessful Scheme of Arrangement involving control …	–	*1*
Proposals withdrawn before issue of documents (including offers overtaken by higher offers) … …	32	*43*
Offers and Schemes of Arrangement involving minorities and unconditional offers following the transfer of effective control	106	*93*
	388	*427*

(Note**: cases involving reverse take-overs of public by private companies have been excluded from these tables.)**

Profit Forecasts

In last year's Report it was stated that having kept records of profit forecasts covering a period of approximately 2½ years the Panel felt that this detailed exercise had served its purpose of establishing the degree of accuracy of forecasts in bid situations and a less far reaching examination would suffice in future. As was then promised, the Panel executive has continued to hold a watching brief over profit forecasts and this has been implemented by a system of random checks and sampling.

The Code

The revised edition of the Code has now been in operation for about 15 months and experience during this period has identified those Rules which cause the executive and practitioners the greatest problems in application and interpretation.

Rule 35 has been a particular source of difficulty. This Rule requires a person who, together with other persons acting in concert with him, acquires shares carrying 40 per cent. of the voting rights attributable to the share capital of a company to make an unconditional cash offer to all the other shareholders at the highest price paid for any of the shares so acquired within the preceding 12 months. The Rule was designed primarily to cover cases where effective control is achieved through a series of cash purchases in the market. It has however much wider, and sometimes unexpected, implications. A 40 per cent. controlling interest may for instance be acquired by the conversion of a convertible security or the exercise of a right to subscribe for shares under a share warrant. Again, in a large number of cases, the 40 per cent. interest results from the issue by a company of new shares in consideration for the sale of a business or other assets. Particularly difficult problems arise where a group of shareholders combine together in a take-over situation to resist a bid and one or more of them purchases shares so as to take the combined holding up to or beyond 40 per cent. The Panel has under consideration the issue of a Practice Note on the interpretation of this Rule.

The relationship between General Principle 8 (all shareholders of the same class of an offeree company must be treated similarly) and Rule 33 (an offeror who acquires more than 15 per cent. of the shares in an offeree company during the offer period or within 12 months prior to its commencement must make a cash offer for all the other shares) has also been the source of uncertainty amongst some practitioners. Prior to the introduction of Rule 33 the Panel held the view that a cash purchase of a "critical" block in the context of a paper bid would involve an offeror in an obligation under General Principle 8 to make a general cash offer for all the shares at the highest price paid for any of the shares purchased. What was or was not "critical"

had to be determined in the light of the circumstances of each particular case. The Panel regards Rule 33 as having established 15 per cent. as the "critical" percentage in all but very exceptional cases, such as where the sellers are directors or other insiders of the offeree company. Accordingly a general cash offer under General Principle 8 will normally be required only where the cash purchases exceed 15 per cent. of the relevant class of shares.

Inter-related with General Principle 8 and Rule 33 is General Principle 9 which provides that if, after a take-over is reasonably in contemplation, an offer has been made to one or more shareholders of an offeree company, any subsequent general offer "shall not be on less favourable terms". Several cases have come before the Panel executive in the period under review involving the purchase for cash by an intending offeror of a large block of shares (but not exceeding 15 per cent. of the share capital) in the offeree company in advance of a "paper" bid. Such purchases involve different considerations from similar transactions during an offer period as in the latter circumstances Rule 32 would apply if the purchase price exceeds the then current value of the offer. Nevertheless, except where the sellers of the shares are directors or other insiders of the offeree company, the Panel will not normally require a general cash offer provided that, after discussion with the financial advisers concerned, it is satisfied that there are sound reasons for the prior cash purchase and that the subsequent "paper" bid will, following its announcement, have a value at least equal to the cash price paid.

Practice Notes and Publication of Rulings

In July 1972 the Panel published Practice Note No. 7 which is a consolidation of a number of rulings of general interest, most of which were referred to in the appendices to previous Annual Reports. A synopsis of significant rulings given by the executive during the year is contained in the appendix to this Report.

Shut-out Bids

Rule 11 requires controlling directors to obtain the consent of the Panel before entering into a shut-out transaction. Since the introduction of this requirement in October 1971 the Panel's consent has been sought in some 150 cases. In exercising its discretion in shut-out cases the Panel applies the following general principles and guide-lines:

(i) While General Principle 11 states that directors in advising their shareholders should not have regard to their personal shareholdings or relationships with the company, Rule 9 stresses that shareholders in companies

effectively controlled by their directors must accept that in respect of any offer the board's attitude will be decisive.

(ii) The Code places no obligation on directors to hawk their company around the market place. The essential principle is that controlling directors should be entitled to sell their shares to whom they like if they do so in good faith without looking for any special personal advantage. Directors are entitled to take into consideration not only the interests of shareholders generally but also the interests of employees and of the company's business.

(iii) All shareholders are entitled to the same treatment. There must be no special terms for directors and the Panel is careful to ensure that this overriding principle is adhered to.

(iv) Prima facie, controlling directors will be concerned to obtain the best deal for themselves and in achieving this will automatically obtain the best deal for shareholders generally. In a case where the directors propose to accept the lower of two offers, particularly where both offers are wholly in cash, the Panel's examination of the directors' motives will be most stringent. It is axiomatic however that there cannot be any circumstances in which directors will be obliged to accept an offer if they do not wish to do so.

(v) In advising their shareholders directors have a duty to put themselves in a position to form a proper judgement and, accordingly, where there are two or more potential offerors they should inform themselves of the alternatives available unless circumstances make this impossible. In nearly all cases, therefore, the Panel requires the directors to give reasonable notice to a bona fide potential competitive offeror that a shut-out in favour of a preferred offeror is proposed.

(vi) The Panel requires directors proposing to enter into a shut-out to obtain competent independent advice and relies to a great extent on the views of the independent advisers whose duty it will be to consider the interests of the general body of shareholders. Only in exceptional cases does the Panel refuse its consent where to do so would be to override the commercial judgement of the directors supported by their advisers. The Panel would nevertheless refuse its consent to a shut-out where it considered that a time-limit imposed by the offeror for the acceptance by the directors of a shut-out commitment was unconscionably short.

(vii) The Code is not a "bidder's charter"; it is the shareholders of the offeree company who are to be protected by the shut-out rules. Thus no sympathy is due to self-described potential offerors who claim the right to compete simply on the basis of having expressed a vague and uncommitted interest.

Insider Dealing

The Panel has continued to carry out investigations into share dealings in take-over or merger situations where because of a sharp rise in the market price in the period prior to the announcement of the bid there were grounds for suspicions that dealings had taken place in breach of Rule 30. These investigations were in all cases undertaken with the full co-operation of The Stock Exchange. The Panel has however become increasingly conscious that in its surveillance of market transactions in connection with take-overs it is hampered not only by the use of nominee names but also by the absence of any statutory power to interrogate or demand production of documents. Further, no statutory defence of qualified privilege yet exists to protect any possibly defamatory statements the Panel might make in connection with its investigations. Although some insider dealing clearly does take place it is the Panel's view that the incidence of such dealing has been much exaggerated. It remains a fact however that there is much public disquiet as to the alleged extent to which unpublished price-sensitive information in relation to companies is used by insiders for their own personal financial advantage. A great deal of this disquiet is no doubt emotive and unjustified but its very existence is damaging to the confidence upon which a securities market must be founded. In the light of these circumstances the Panel, having in conjunction with The Stock Exchange carried out an exhaustive study of the whole problem during the course of the year, reached the conclusion that insider dealing, properly defined, should be made a criminal offence, enforcement being in accordance with normal Companies Act practices. A public statement announcing that the Panel and The Stock Exchange had so advised the Department of Trade and Industry in connection with the Secretary of State's review of possible amendments to Company Law was issued on 3rd February, 1973.

The Panel believes that the mere enactment of insider dealing as an offence under the criminal law would be, as it has been in the United States, a very powerful deterrent to anyone who might otherwise be minded to make dishonest use of information obtained by virtue of his confidential relationship with a company.

Rule 7 emphasises the vital importance of secrecy before an announcement of a take-over. The Panel considers that in many instances unusual market activity in the

securities of a company involved in merger discussions arises from a leak rather than from improper dealings by persons concerned with those discussions. A very great responsibility rests on directors of companies and their advisers to ensure that absolute security is maintained during the course of merger discussions.

Responsibility of Directors and the Contents of Offer Documents

The Code–and the Panel in administering it–is primarily concerned to protect the interests of shareholders. It is based on the traditional concept of British company law that the duty of directors is to act in all circumstances in the interests of the general body of shareholders. A developing public conscience demands a great deal more from the directors of public companies. The Confederation of British Industry, in its interim report on the responsibilities of the British public company published in January, states that few responsible businessmen today would hold that directors are required to act only in pursuit of the maximum profit for their company or that in doing so they must recognise only a responsibility to their shareholders. The Code says very little about these wider responsibilities of directors. In General Principle 11 it does however recognise that in advising shareholders in connection with a take-over directors should consider the interests of employees as well as those of shareholders. Further, Rule 15, in requiring that shareholders must be put in possession of all the facts necessary for the formation of an informed judgement as to the merits or demerits of an offer, provides in particular that an offeror must state its intentions in regard to the future of the offeree. The Panel is concerned that this provision of Rule 15 is not adequately observed by some offerors. Not only is it essential that offerors fulfil their obligations in this respect but it is the duty of the directors of offeree companies, in the case of agreed take-overs or mergers, to insist that they do so. The intentions of the offeror as to the future conduct of the offeree's business, and the likely effect of any such intentions on the future livelihood of the offeree company's employees, may be a significant factor for shareholders in deciding whether or not to accept an offer. The Panel regards this requirement of Rule 15 as a most important provision of the Code and, in this connection, it welcomes the requirements in the latest edition of "Admission of Securities to Listing", published by The Stock Exchange, for more detailed information in offer documents with regard to the intentions of the offeror as to the future of the offeree's business and the continued employment of its employees.

European Economic Community

The introduction to the present edition of the Code makes it clear that those who wish to have the facilities of the securities markets in the United Kingdom available to them should

conduct themselves in matters relating to take-overs and mergers according to the General Principles and Rules of the Code. The Code is applicable mainly to United Kingdom companies whose securities are quoted on The Stock Exchange but it also applies to unquoted public companies. The Panel has in addition regarded its jurisdiction as extending to foreign companies with securities quoted in this country. Entry of the United Kingdom into the European Economic Community is likely to lead to the gradual elimination of Exchange Control and other restrictions on the acquisition by European investors of United Kingdom securities and to an increase in the number of mergers between United Kingdom companies and companies based in other member countries. This, together with the development of a unified European capital market, will present new problems for the Panel. It is understood that the Commission in Brussels may shortly establish a working party to consider the drawing up of regulations covering the conduct of take-over and merger operations within the Community. The Panel executive has already had informal contact with officials concerned with this aspect of the Commission's work and has indicated its readiness to participate in the formulation of a European take-over and merger code. It is to be hoped that any European code will be sufficiently flexible to permit, within individual member countries, maximum scope for a voluntary self-regulating system.

Staff

As foreshadowed in the Foreword to last year's Report Mr. B. J. Denington succeeded Mr. W. S. Wareham as Deputy Director General with effect from 1st July, 1972. Mr. I. L. Clarke was seconded from the Bank of England in October 1972 for a period of two years as an additional Assistant Secretary. There were no other changes in the membership of the Panel executive during the year.

APPENDIX

Rulings and Interpretations of General Interest

There follows a selection of rulings given by the Panel executive during the year together with a number of general points of interpretation.

Rules 10 and 34

The Panel does not normally consider that effective control has passed if, after the relevant transaction(s), the holding of the purchaser and any persons acting in concert with him carries less than 30 per cent. of the voting rights attributable to the share capital of a company.

Rules 10, 34 and 35

The placing of a holding representing effective control with a number of persons having a common link, e.g., the discretionary clients of one bank or stockbroker, does not constitute a dispersal of such control.

Rule 11

(a) Although the requirement to clear a shut-out with the Panel rests on the offeree directors, offerors should ensure that this action has been taken.

(b) Where more than one approach has been received by an offeree board, the Panel will normally expect less preferred suitors to be given at least 48 hours to compete before the offeree directors give a shut-out.

Rule 14

Acceptance forms should not be published in newspapers.

Rules 14 and 16

Since the quotation in circulars or press advertisements of press comments relating to an offer will necessarily carry the implication that the comments are endorsed by the board, such press comments should not be quoted unless the board is prepared, where appropriate, to corroborate or substantiate them.

Rule 16

Where a profit forecast is given in a press announcement, the assumptions on which the forecast is based should be included in the announcement. This is of particular importance if the announcement is made after the offer document has been published and in such a case there should be a minimum of delay before a circular, including letters reporting on the forecast, is sent to shareholders.

Rule 17

"Directors" includes their spouses and infant children.

Rule 22

(a) The requirement that no offer shall be capable of becoming or being declared unconditional after 3.30 p.m. on the 60th day after the date the offer is initially posted should be interpreted to mean that a public announcement as to whether the offer is unconditional or has lapsed should be made not later than that time.

(b) Where an offeror states that in any event the offer will lapse after a specified date unless it has by then been declared or become unconditional, the offeror will not subsequently be permitted to extend the offer period.

Rules 22, 32 and 33

An offer may not be revised after the 46th day nor may shares be purchased above the offer price after that day except where (provided a "shut-off" notice under Rule 22 has not been given) the offeror purchases, in one transaction, shares at above the offer price which carry him beyond 50 per cent. and he immediately declares the offer unconditional.

Further, except as aforesaid, an offeror must not after the 46th day place himself in a position by purchases or acquisitions of shares whereby he would be required to make a cash offer under Rule 33.

Rule 33

The discretion given to the Panel in (b) to require an offer to be in cash in certain cases where less than 15 per cent. has been purchased in the previous 12 months will not normally be exercised unless the vendors are either directors of, or otherwise closely connected with, the offeror or offeree companies.

Rule 35

Where, following an acquisition involving the issue of new shares, 40 per cent. or more of the voting rights attributable to the share capital of the acquiring company comes to be in the control of one person or group of persons, the Panel is prepared to consider waiving the requirement for a general offer under this Rule if there is an independent vote at a general meeting convened to authorise the issue of the new shares.

(Further copies of this Report may be obtained from The Secretary, Panel on Take-overs and Mergers, P.O. Box No. 226, The Stock Exchange Building, London, **EC2P 2JX.**)