CORPORATE ACQUISITIONS & MERGERS

2ND EDITION

P·F·C·BEGG

Graham & Trotman

Corporate Acquisitions and Mergers

A Practical Guide to the Legal, Financial and Administrative Implications

2nd Edition

P.F.C. Begg

Foreword

by

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Foreword by Lord Hanson

I am very pleased to have been invited to write the Foreword to Peter Begg's useful and timely book.

Any business which regards itself as a "closed community" will never develop its full potential. The ability of public companies and private individuals alike to expand their business activities by acquisition — and when appropriate to take advantage of the opportunity to sell to others — is fundamental to the dynamism of the capitalist system. This is of vital importance for UK industry if it is to maintain, let alone improve, its competitive position in international markets.

The successful pursuit of acquisitions and mergers requires commercial judgement, determination, a clear understanding of the human factors involved and, last but not least, a thorough knowledge of the ground rules. Mr. Begg ranges over each aspect of the subject with clarity and precision. At a time of major changes, including the first steps into unfamiliar European territory, Mr. Begg's up-to-date and extensive coverage of the regulatory, legal and financial aspects of acquisitions will be particularly welcome. A clear and comprehensive index adds to the book's practical value.

Corporate Acquisitions and Mergers is not just a book for those of us directly involved in such transactions. I hope it will excite others to take a broader view of business horizons. I wish Mr. Begg's book every success.

Lord Hanson

Hanson

Chairman, Hanson Trust PLC

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Introduction

The value of acquisitions and mergers transacted in the UK in the course of 1985 soared to over £7bn, by comparison with £5.2bn in 1984 and £2.3bn in 1983, which was itself a record year. According to DTI statistics, over 1500 acquisitions were completed during these three years. The boom shows no signs of abating and, with even the largest companies proving susceptible to takeover bids the 1986 figures are expected to indicate an even higher level of acquisition activity.

Several factors lie behind this startling phenomenon. Companies have emerged from the recession with healthier balance sheets and have been able to turn their minds to expansion after several years of retrenchment and closure. A prolonged Stock Market boom coupled with rising corporate earnings and liquidity has provided the fuel to back the ever-increasing volume of bids.

And yet, while the negotiator in the US acquisition process has a whole armoury of reference works to call upon, his British counterpart remains curiously starved of suitable reference materials. Such textbooks as are available concern themselves generally with legal and financial theory and bear little relation to the rude practicalities of corporate acquisition activity. The basic mechanics involved, as well as important administrative issues such as pensions and insurance, are frequently disregarded.

The purpose of this book is therefore to provide a succinct and practical guide to the legal, financial and administrative issues which arise on acquisitions and mergers—of private companies and listed public companies as well as of business undertakings. It is intended primarily for directors and executives involved in the acquisition process, but it is hoped that bankers, lawyers, accountants and other professional advisers will find material of interest to them.

The pace of change of business law and administrative controls, as well as the structural upheaval of the securities industry, render this a complex task. Since the first edition of this book was issued early in 1985, an extensively revised edition of the City Code on Takeovers and Mergers has come into force, together with an amended edition of the Rules Governing Substantial Acquisitions of Shares. A new accounting standard (SSAP 23) on acquisitions and mergers appeared from April 1985. The 1985 Finance Act introduced some important tax changes, including a substantial reform of the system of stamp duty reliefs on share-for-share exchanges. No sooner were these in place than the Chancellor proceeded to dismantle them in his 1986 Budget. Finally the 1985 Companies Act (and related statutes) consolidated the whole of UK company law from 1st July 1985. These and other changes have necessitated some extensive revisions to the original text.

It should be emphasised that this book is not a substitute for professional advice. The object is to provide the business executive with a "feel" for the main legal, financial and administrative issues which arise in the course of acquisition and merger transactions. This will enable him to recognise those situations which require detailed professional advice and to formulate the questions on which advice is needed. It is hoped that many of these professional advisers, be they bankers, solicitors, tax consultants, accountants or actuaries, will also find this book of value. All too often professional advisers find it difficult to see the wood for the trees. Had they understood the wider context in which their advice was sought, they could frequently have made practical suggestions of immense value to their clients.

Needless to say, the author (who is a company lawyer) is not competent to write with authority on the whole range of specialisations covered by this book. I would like to acknowledge the contributions of a large number of friends and colleagues who have helped me to put it together. The virtues are probably theirs; the errors and omissions are probably mine.

April 1986 P.F.C. Begg

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The Regulatory Framework

2.01 It is an invariable, and sometimes irritating, habit of lawyers to insist on defining their terms. However the environment within which acquisitions and mergers are currently conducted within the UK is somewhat like a zoo. Different rules apply to different beasts, and it would be irresponsible to describe the zoo without first endeavouring to classify the beasts. Part of the problem is that the management not only change the rules with depressing frequency, but keep changing the names on the cages. The visiting public, having grown accustomed to the old familiar names, find it difficult to adjust and carry on using the old ones.

2.02 A company may be unlimited, limited by guarantee or limited by shares (the vast majority are limited by shares). Similarly it may be public or private (the vast majority are private). Before 1980, when things were still relatively simple, a private company was one which by its Articles restricted the right to transfer its shares, limited the number of its shareholders to 50 (excluding certain employees and former employees), and which prohibited any invitation to the public to subscribe for its shares. Any company whose Articles did not contain all three of the above provisions was automatically a public company, although to the man on the Clapham omnibus the term "public company" was generally synonymous with a company whose shares were quoted on the Stock Exchange.

2.03 One of the consequences of the UK's belated entry into the EEC was that by the time we joined, much of the work on company law harmonisation had already been done by the other Member States. Accordingly, when the Second EEC Directive on Company Law (which applied to public companies only) was implemented by domestic legislation in the UK, it was necessary to turn our old ideas and definitions on their head. The term public company was redefined in Section 1 of the 1980 Companies Act. A public company now had to be designated as such (usually by the abbreviated "p.l.c.") and to hold a certificate from the Registrar of Companies demonstrating that it met certain statutory requirements. The most important of these was that the company had a minimum issued share capital (currently £50,000) and that the shares had been paid up to the extent of 25%. Any company which did not meet this new definition of a public company was automatically a private company. A private company was no longer required to limit the number of its members or to restrict the right to transfer its shares, but by Section 15 of the 1980 Act it was prohibited by law from offering its shares to the public.

2.04 The second important distinction is between those companies whose shares are actively marketed and those in whose shares there is no market. This distinction is not a legal one, but is nevertheless vital for an understanding of the relevant regulatory controls. A public company may have a full "listing" or quotation on the Stock Exchange or its shares may (since 1980) have been admitted to the Stock Exchange's Unlisted Securities Market. In either case its affairs will be subject to surveillance and control by the Stock Exchange. In addition there is a third tier of companies whose shares are marketed by firms operating outside the control of the Stock Exchange in the so-called "over-the-counter" markets. Many of these firms, which are licensed dealers in securities approved by the DTI, have also joined informal self-regulatory groupings such as NASDIM and BIDS. These groupings, which are mostly of recent origin, are developing their own rules for member firms and for the companies whose securities they market.

2.05 To put all this in perspective, there are presently over 1,000,000 companies in England and Wales, of which some 5,500 are registered as public companies. Of these public companies about 4,400 are listed on the Stock Exchange (in addition to some 500 overseas companies) and less than 400 have been admitted to the USM. About 100 companies have shares which are traded in the "over-the-counter" markets. While the number of companies on these second and third tier markets is growing at a prolific pace, and while the level of activity to be found there (and the related press coverage) is proportionately far higher than on the fully-listed market the total capitalisation of all the companies traded on them is roughly comparable with the market capitalisation of a single listed company the size of Marks & Spencer.

2.06 Similarly most of the eye-catching takeover battles which are fought out in the pages of the financial press are between public listed companies. However, the newsprint devoted to these major deals creates a somewhat misleading impression. Of the acquisitions reported by industrial and commercial companies in the UK over the last 6 years (which have generally run between 450 and 550 per annum) less than 3% involve sums in excess of £25m, less than 10% involve sums over

£5m and less than 40% involve sums over £1m. It will therefore be readily apparent from the figures referred to above that the vast majority of acquisitions transacted in the UK are of private companies and that most of these are relatively small.

2.07 This book is intended to apply to any form of transaction in which control of a company or business passes from one person or group of persons to another person or group of persons. In particular it is intended to cover any of the following different types of transaction:

(i) a transfer by a company of its assets and undertaking to a third party (a "business transfer");
(ii) a transfer by a limited number of shareholders (typically a family or a holding company in a listed group) of the shares of an unlisted private company pursuant to a private sale agreement (a "share acquisition");
(iii) a transfer of shares of a company (whether public or private, listed or unlisted) which is implemented pursuant to a written offer to a substantial number of shareholders. Such a transaction is popularly referred to as a "takeover", in particular where the offer is made to shareholders of a listed company;
(iv) a transfer of any of the types referred to above, which is implemented by mutual agreement between the boards of the companies concerned, and in circumstances where such companies are of roughly comparable size and dominance. Such a transaction is commonly referred to as a "merger". Sometimes a merger is implemented by the formation of a new holding company, following which the shareholders of two existing companies exchange their shares for shares issued by the holding company.

2.08 It is a curious state of affairs, in a country generally recognised to be overgoverned and overregulated, that there is very little direct statutory control over the conduct of corporate acquisitions. It is true that the government exercises through the Fair Trading Act 1973 an effective right of veto over certain UK acquisitions which are substantial in terms of size or market share, but the method of implementation is apparently not a government concern. We have a vast body of law (primarily embodied in the 1985 Companies Act) regulating the constitution and operation of companies as well as the manner in which they are laid to rest, but there are virtually no *legal* sanctions to control the manner in which they are bought, sold and dismembered.

2.09 I say "virtually" because there are one or two exceptions to this general statement. The first of these is an obscure and almost obsolete statute known as the Prevention of Fraud (Investments) Act 1958. This was a consolidating Act which replaced a law of the same name enacted in 1939 to cope with a number of share pushing scandals prevalent at that time. The relevant provisions of that Act are Sections 13 and 14 which prohibit, respectively, the making of deceptive or misleading statements or inducements to purchase or sell securities, and the distribution by "unauthorised persons" of investment circulars containing offers to purchase or sell securities. An even more obscure statutory instrument known as the Licensed Dealers (Conduct of Business) Rules 1983 regulates (*inter alia*) the content of offer documents by dealers in securities who are "licensed" under the Prevention of Fraud (Investments) Act 1958. However, since the vast majority of acquisitions conducted through intermediaries are not conducted through licensed dealers, but through merchant banks or member firms of the Stock Exchange which are "exempt" from the above regulations, these Rules are not significant. The other exception is a historical anomaly from the 1948 Companies Act now in Section 428 of the 1985 Companies Act which deals with the situation when 90% acceptances from vendor shareholders have been obtained on an acquisition.

2.10 So far as private acquisitions of companies or businesses are concerned, that is virtually the end of the story. The law leaves the buyer and seller free to reach whatever bargain they choose, and each party must rely on the civil remedies available to him under the law of contract if things go wrong. So far as concerns acquisitions of or by public listed companies there are however a number of "self-regulatory" bodies which play an increasingly important role and whose rules must be observed. By "self-regulatory" bodies I mean organisations whose rules do not have the backing of the criminal law, but which can exercise effective disciplinary control over the activities of their members (e.g. by censure or exclusion from membership). Of these bodies the most important is the Stock Exchange, which has recently been appointed as the "competent authority" within the UK to adminster certain EEC listing requirements, but which is otherwise totally free from any governmental or statutory control. The primary function of the Stock Exchange is to regulate the conduct of member firms dealing on the market. However, in addition it imposes through the so-called "Continuing Obligations" (being in effect the terms on which the Stock Exchange grants companies a Stock Exchange quotation) a number of obligations on listed companies which go beyond those to be found in the Companies Acts. Some of these obligations relate to acquisitions and disposals by listed companies and their subsidiaries. These require full disclosure of certain transactions by way of circular and, in some cases, reference of major transactions to the company's shareholders for approval. These regulations are published in a volume entitled "Admission of Securities to Listing" (generally referred to as the "Yellow Book").

2.11 Since November 1980 it has also been possible for companies to be admitted to the Stock Exchange's Unlisted Securities Market ("USM"). The USM was the Stock Exchange's response to the failure of the new issue market, which since the peak activities of the early 1970s had become virtually moribund. This was due partly to the proportion of equity required to be in the hands of the public, partly to the high costs associated with obtaining a listing and partly to the increasingly onerous regulation of a listed company's affairs — particularly the extensive disclosure requirements. The USM was intended as a basis on which companies could be floated and traded under the aegis of the Stock Exchange in a way which bridged the gap between the full rigours of listing and the complete absence of any Stock Exchange control. It forms a separate, distinct market within the Stock Exchange. Entrants to the USM are required to sign a "General Undertaking" with the Stock Exchange along the same lines as the "Continuing Obligations", but as regards acquisitions and disposals the terms of the General Undertaking are considerably less onerous. The text of this General Undertaking and the regulations affecting companies admitted to the USM are set out in a rather slimmer volume issued by the Stock Exchange, simply entitled the "Unlisted Securities Market" (generally referred to as the "Green Book").

2.12 For the sake of completeness one should add that prior to the advent of the USM occasional bargains had been done in a wide range of securities for which there was no Stock Exchange listing. Bargains could be arranged between matched buyers and sellers, but subject to specific permission from the Council of the Stock Exchange under their Rule 163(2). In this way a lot of business was done in a variety of securities including football club shares and Wimbledon debentures, and as the new issue market declined, so the use and popularity of Rule 163 increased. However in preparing its rules for the USM the Stock Exchange took the view that the attractions of the new market would be seriously undermined if dealings under Rule 163(2) were not curtailed. Accordingly it announced that dealings under the rule would be limited to the purpose for which it was originally intended — that is to say for very occasional dealings.

2.13 The Stock Exchange "Yellow Book" requires those operating under its control to comply with the "City Code on Takeovers and Mergers" (the Code). The Code is separately administered by the Panel on Takeovers and Mergers, the second major self-regulatory body operating in this field. The Panel was set up in 1968 on the initiative of the Governor of the Bank of England to exercise control over a number of abuses which were prevalent at that time in the acquisition of quoted companies. The rules of the Code, like those of the Stock Exchange, are administered without recourse to legal sanctions, and in essence they are designed to ensure that all the shareholders of a company which falls victim to an acquisition are treated equally, that they are given sufficient information to decide whether or not to accept an offer for their shares and that improper tactics are not adopted to frustrate such an offer. The rules also govern much of the detailed content of offer documents.

2.14 Self-regulation is generally recognised to be a mixed blessing. The advantages are acknowledged to be flexibility, speed, and the ability to make occasional changes in the rules or shifts of emphasis in order to control prevalent abuses or to effect improvements. The problem is that such rules are essentially voluntary and founded on mutual trust. The fact that they are not enforceable by law has caused serious difficulties in dealing with individuals determined to flout the rules. The most persistent of these has been a Mr Jim Raper who (prior to a much-publicised reconciliation with the Takeover Panel in September 1983) had repeatedly refused to obey directions by the Panel to complete bids for certain quoted companies in which he had built up substantial share stakes. When Mr Raper finally accepted the Panel's authority and pledged himself to obey the City Code, his submission was claimed as a triumph for the self-regulatory system. However the taste of victory rapidly turned bitter when Mr Raper committed subsequent transgressions far more serious than his earlier misdemeanours.

2.15 While the City's self-regulatory authorities could be effective in controlling the activities of firms operating within their jurisdiction, the problem lay with the outlaws and fringe operators who were not participants in any recognised City "club". The only statute relevant to control their activities was the Prevention of Fraud (Investments) Act 1958, which was generally conceded to be outdated, inadequate and riddled with uncertainty. In any event it was inadequate to prevent a spate of frauds and scandals in the early eighties (including the collapse of the Norton Warburg securities firm) which left many private investors stripped of their life savings. There was widespread recognition that other entrenched abuses, such as insider dealing, could only be curbed effectively by the sanctions of the criminal law. Calls for a *legal* regulatory agency, along the lines of the Securities Exchange Commission in the USA, grew ever more insistent.

2.16 The City however has remained resolute in its determination to put its own house in order. Its fear is that stringent legal controls, such as those operated in the USA, might well reduce the attractions of London as a financial market and see business drift elsewhere. Thus in recent years it has taken a number of initiatives aimed at improving the effectiveness of its existing forms of regulation. One of these was the