Take-Over Bids — The City Code on Take-Over and Mergers

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With the increase in popularity of the take-over as a means of acquiring control of public companies the City, during the 1960's, witnessed a number of not very edifying squabbles in contests for control of public companies. The Metal Industries and Gallagher affairs give a flavour of these goings on. In the first of these the respective boards of directors of Metal Industries, Ltd., and Thorn Electrical Industries wished to effect a merger. However, Aberdare Holdings, which was desirous of acquiring control of Metal Industries, Ltd. had other thoughts on the matter. After a stealthy market buying spree Aberdare Holdings succeeded in acquiring 53 per cent of the outstanding shares of Metal Industries, Ltd.[1] Not to be foiled

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[1] This was before the holders of 10 per cent of a company's equity share capital were made to disclose their interests. See now *Companies Act, 1967*, (Imp.) 15-16 Eliz. 2, c. 81, ss. 33 and 34. These provisions were introduced with the specific purpose of uncovering a "creeping take-over" through the market. See *Jenkins Cmt. Report*, Cmnd., 1749 (1962), at paras. 141-147.

in their proposed merger plans the directors of Metal Industries, Ltd., issued to Thorn Electrical Industries, the preferred suitor, five million authorized but unissued shares in return for a subsidiary of Thorn Electrical Industries. Thus at "a stroke of the pen Aberdare's 53 per cent of [Metal Industries Ltd.] capital had shrunk to 32 per cent".[2] The Gallagher affair was slightly more complicated but no less questionable.[3] Imperial Tobacco had attempted to dispose, by public distribution, of its sizeable holdings in Gallagher. The floatation was unsuccessful leaving the underwriters with a lot of unwanted Gallagher shares on their hands. Subsequently two rival bidders, Phillip Morris and American Tobacco, sought control of Gallagher. The second of these two companies, which made a partial bid for half of the Gallagher shares, was eventually successful. Its success was partially attributable to the fact that the underwriters, who had been left with the Gallagher shares after the unsuccessful Imperial Tobacco floatation, sold all their shares to American Tobacco at the bid price. This, however, violated the terms of the then prevailing *City Code* requiring parity of treatment of all offeree shareholders, in that the other Gallagher shareholders were only able to tender half of their holdings.[4] The wrongdoers went unscathed.

It was incidents like these that brought home to the City[5] the lesson that breeding and good manners were no protection against greed. Although as far back as 1959 voluntary guidelines had been laid down for the regulation of take-overs these, for various reasons, had proven ineffective. This ineffectiveness led to hostile criticism in the financial press and calls for a more resolute determination to police take-overs. Coupled with this the government entered the act. Veiled threats were made that if the City could, or would not, refurbish and effectively enforce its own self regu-

[2] Stamp and Marley, *Accounting Principles and the City Code*, (London, 1970), at p. 17.

[3] See Fortune Vol. 78, (Oct. 1968), at p. 79.

[4] Stamp and Marley, *op. cit.*, n. 2, at p. 31: "The lucky institutions on the network were quickly relieved of their entire holdings in Gallagher at 35s. a share — everybody else was being offered that price for only half their shares, with the other half apparently worth no more than 25s. in the open market at the time".

[5] The word City is a universally accepted colloquialism used to describe the major financial institutions in England, (Accepting Houses Association, Stock Exchange, Clearing Banks, Merchant Banks, etc.) which are predominantly located within the City of London, and the titular head of which is the Governor of the Bank of England. See: Ferris, *The City* (Pelican, 1965).

latory code of conduct then the government would have to take the task in hand.[6] These pressures led to the publication in 1968 to the *City Code* on Take-overs and Mergers which forms the basis of the present *Code*.[7] The *City Code* is issued by the 'City Working Party', a body convened by the Governor of the Bank of England and composed of the representatives of the major financial institutions in the City.[8] To guarantee observance of the *Code's* provisions and to censure, or otherwise deal with those who violate the terms of the *Code,* the Panel on Take-overs and Mergers has been created. Again the composition of this body reflects the various commercial interests operating in the City. More will be said on the Panel at a later point.

The *Code,* as will be seen in more detail later, is a voluntary system of self regulation. It is voluntary, however, in the sense that rules of professional organisations can be said to be voluntary. The organizations sponsoring the *Code* have incorporated its provisions as part of their own norms of professional conduct so that violation of the *Code's* provisions could lead to severe, if non-legal, consequences.

The *1968 Code* was revised in 1969.[9] Recently the *1969 Code* has also been revised to reflect the experience gained in its enforcement. It is proposed here to look at the more salient features of this new *Code*[10] in light of the problems which enforcement of the *1969 Code* gave rise to.

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[6] *Parliamentary Debates,* Vol. 772, Oct. 30, 1968, at pp. 89-90.

[7] For a readable history of the evolution of the City Code see Weinberg, *Take-overs and Mergers* (3rd ed. 1971), at pp. 122-135.

[8] These are:
The Accepting Houses Committee
The Association of Investment Trust Companies
The Association of Unit Trust Managers
The British Insurance Association
The Committee of London Clearing Bankers
The Confederation of British Industry
The Issuing Houses Association
The National Association of Pension Funds
The Stock Exchange, London

[9] Hereinafter referred to as the *1969 Code.* (See footnote 10 for address where a copy of the Code can be obtained). The *1969 Code* is conveniently reproduced in *Stamp and Marley, op. cit.,* n. 2, at pp. 188-202; Weinberg, *op. cit.,* n. 7, at pp. 437-466.

[10] Hereinafter referred to as 'the *Code*' or 'the *1972 Code*'. The 1972 is published by Panel and was issued in February 1972. Copies are obtainable from the Issuing Houses Association, 20 Fenchurch St., London.

I. Definition of Take-Over

One of the more intractable problems in the regulation of take-overs is to define what constitutes a take-over.[11] It is clear that effective control of a company can be exercised with a shareholding that confers less than *de iure* control.[12] Accordingly, bids which result in the offeror controlling a substantial but not a majority holding of the total shares, would normally be sufficient to transfer effective control of the offeree company. The point at which it is determined that effective control does pass is impossible to determine with any degree of precision and will, of necessity, involve an element of arbitrariness as it is dependent on such variables as the dispersal of share holdings and the level of shareholder involvement and interest in the affairs of their company. The *Code* overcomes these definitional problems by strongly discouraging partial bids. Rule 27 of the *Code* states that "generally speaking, offers for less than 100 per cent of the equity share capital of an offeree company not already owned by the offeror or any of the subsiriaries are undesirable".[13] To make such an offer the Panel's consent must be sought in advance. Rule 27 goes on to provide that it is only in "special circumstances" that a "partial offer not conferring voting control" can be made, a prohibition that is bolstered up by Rule 21 of the *Code* which forbids an offer from being declared unconditional[14] unless the "offeror has acquired or agreed to acquire... by the close of the offer 50 per cent of the voting rights attributable to the equity share capi-

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[11] *Report of the Attorney General's Committee on Securities Legislations in Ontario* 1965, (Hereinafter referred to as the *Kimber Cmt. Report*) at para. 3.09:

> The most difficult single question considered by the Committee in its study of take-over bids has been the formulation of a definition of that type of transaction to which any recommended procedural or substantive rules should apply.

[12] See generally Berle and Means, *The Modern Corporation and Private Property* (1968 rev. ed.), at pp. 66-84.

[13] Oddly the Rule does not also refer the holdings of 'associates' of the offeror. Such holdings are relevant for other purposes, for example, with respect to the obligation to disclose market purchases made during a bid. See Rule 31, *1972 Code*.

[14] The *1972 Code* defines 'unconditional' as follows: "References to an offer becoming or being declared unconditional include cases in which the offer has, as a result of the receipt of sufficient acceptances, been announced to have become or been declared unconditional, subject to one or more other previously stated conditions, including for example the creation of additional capital, the grant of quotation etc. etc., being fulfilled." (p. 7)

tal".[15] Nor can the offeror circumvent this prohibition on partial bids by limiting his offer to the holders of a single class of shares, for example, management shares,[16] but at the same time extending the offer to the whole of the class in question. This ploy is prohibited by Rule 21 of the *Code* which provides that where "a company has more than one class of equity share capital, a comparable offer must be made for each class".[17]

Thus the *Code* solves the definitional problems of what constitutes a take-over bid by compelling an offeror to bid for the total corporate capital of the offeree company. An obligation which extends to non-voting as well as voting shares. This not only forestalls the dangers inherent in an offeror obtaining control of assets for which he has paid only a fraction of their market value, but it also has a tendency to afford to all shareholders "an equal opportunity to sell their shares"[18] where there has been a bid for control of a company. This latter policy objective is more clearly

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[15] Rule 21 must be read in light of Rule 27 which states that where a partial offer "not conferring control" is permitted to be made then the offer "may not be declared unconditional unless acceptances for not less than" the percentage of shares bid for have been received. It will be very seldom that a partial bid for less than majority control will be permitted. Illustrative of the situation where it would be allowed are the unique facts in *Re Allied Breweries, Ltd.*, Panel release, Dec. 15, 1971. In that case fifty per cent of the shares of the offeree company, Trust Houses Forte, Ltd., were held by a trust which declared that it would not, and legally could not without a court order, exercise any voting rights attached to its shares with respect to a take-over offer. Thus because of this passive attitude on the part of the trustees actual voting control of the company could be obtained by acquiring half of the remaining fifty per cent of the share capital of the offeree company. In this situation the prohibition on making an offer unconditional unless it was accepted by 50 per cent of the offeree shareholders was ruled by the Panel to be inapplicable.

[16] See, e.g., *Rights and Issues Investment Trusts Ltd.* v. *Stylo Shoes Ltd.*, [1965] Ch. 250; [1964] 3 All E.R. 628.

[17] Rule 21 goes on to provide that an "Offer for non-voting capital should not be made conditional on any particular level of acceptance in respect of that class unless the offer for the voting capital is also conditional on the success of the offer for the non-voting capital". This prevents the holders of two different classes of securities from accepting the bid for one class but, for some ulterior reason, rejecting the bid for the other to the prejudice of the holders of that class. See: *British American Nickel Corp.* v. *O'Brien*, [1927] A.C. 369; *Re Holders Investment Trust Ltd.*, [1971] 2 All E.R. 289 for examples of economic conflict between differing classes of corporate securities.

[18] Andrews, *The Stockholders Right of Equal Opportunity in the Sale of Shares*, (1964-65), 78 Harv. L. Rev. 505, at p. 515.

manifest in the manner in which the *Code* regulates the two other possible means of acquiring corporate control, namely, (i) purchasing by private treaty a block of shares conferring effective control, and (ii) stock market purchases. The *1972 Code,* like the 1969, regulates the first of these by providing that where "effective control" is being transferred the selling shareholder "should not... do so unless the buyer undertakes to extend unconditionally within a reasonable period of time the same offer to the holders of the same class and a comparable offer to the holders of any class of equity share capital whether such capital carries voting rights or not".[19] The problems of regulating the sale of corporate control have been discussed elsewhere,[20] but it is submitted that this is the most satisfactory way of solving the problem. It is also the most draconic from the point of view of the participants involved in a sale of control transaction. In those American jurisdictions that have regulated this problem the regulatory device has normally taken the form of depriving the vendor-shareholders of any premium received for the control element attached to their shares.[21] The *Code,* as was pointed out above, goes farther by requiring that an offer, similar to that made to the controlling shareholders, be made to all the shareholders in the target company.

The other method of acquiring control of a company, through a programme of stock market purchases, has invariably been considered to be outside the purview of any controls regulating the conduct of take-over bids. This exemption has been considered self-evident in that "no special effort is made to force the offeree shareholder to sell. He bases his decision on the market price of the securities...".[22] Coupled with this either market movements in the prices of the shares in the target company, or the requirement of periodic disclosure, provided it is sufficiently regular,

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[19] Rule 10, 1972 Code. See also Rule 34 and Principle 9. When the detail of these rules are examined it will be seen that Rule 10 applies to director-shareholders transferring control whereas Rule 34 applies to a "purchaser [of holdings] which confer effective control". Both rules, however, appear to produce the same end result.

[20] Andrews, *op. cit.*, n. 18; Prentice, *Take-over Bids: Part IX of the Ontario Securities Act 1966,* (1971), 19 Am. J. Comp. L. 325, at pp. 341-346.

[21] *Perlman* v. *Feldman,* 219 F. 2d. 173 (2nd Circ., 1955). Cf. *Great Basin Metal Mines Ltd.,* Bulletin of the Ontario Securities Commission, Dec. 1966, at p. 5.

[22] *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements,* (1970), at p. 92 (Hereinafter referred to as *Ontario Securities Commission Report,* Feb. 1970).

should reveal whether or not some unknown is seeking control of the company. However, the exemption of market purchases from the regulatory controls placed on take-over bids is only evident if it is accepted that the "principal purpose justifying the statutory code regulating take-over bids is to ensure that the shareholders of the offeree company are given adequate relevant information and a reasonable period of time within which to assess such information".[23] Once the purpose of such regulation is also seen as furthering a policy of guaranteeing to all shareholders an opportunity to participate in any transfer of corporate control and, at least, to have an opportunity to evaluate the merits of all potential takeover offers, then the exemption of stock market purchases is not so self-evident. This is illustrated by the facts in *Re Venesta International Ltd.*,[24] a case which came before the Panel.

In that case Norcos made a take-over offer for Venesta, Ltd., which the directors of the offeree company endorsed. Consolidated, a shareholder in Venesta, Ltd., considered that the terms offered were inadequate. To defeat the bid Consolidated conducted a heavy purchasing campaign in the market and was eventually successful in frustrating the Norcos bid. Venesta, Ltd., thereupon referred the matter to the Panel on the grounds that Consolidated had violated Rule 33 of the *1969 Code* which required associates of an offeror or an offeree to clear any dealings in the market with the Panel as such dealings "may result in a *bona fide* offer being frustrated or may affect the outcome of a bid". The Panel found that Rule 33 had not been transgressed as it was only "intended to prevent the frustration of a *bona fide* offer by a third party whose interests are not shared by the general body of shareholders of the offeree company";[25] here the interests of Consolidated and the other shareholders were synonymous. The complainants, however, raised an alternative and, in many ways, a more interesting objection to the market purchases of Consolidated:

> They [the complainants] also argued that irrespective of any ulterior motive a purchaser of shares on the market who, whether in a bid situation or not, had as his objective obtaining control of the company whose shares he was buying must, if he did by such purchases obtain control, make an offer for the remaining shares. This on the ground that to stop at the purchase of 51 per cent must inevitably result in the 49 per cent minority shareholders being left, so to speak, out in the cold and would neglect the *Code's* requirement that all shareholders

[23] *Kimber Cmt. Report, op. cit.*, n. 11, at para. 3:15.
[24] Panel release, Jan. 6, 1972.
[25] *Ibid.*, at p. 6.

should be treated equally. They referred in particular to shareholders who had accepted the bid of Norcos and who were therefore unable to sell their shares in the market during the time when Consolidated and its associates were buying shares.[26]

The Panel rejected this argument on the grounds that "the present rules do not impose any obligation on an individual who has acquired control by a series of purchases in the market to endeavour to obtain the remaining shares. There have been many cases in the past where control has been acquired in this way".[27] The Panel, however, was clearly unhappy[28] about the preclusive effect, in a bid situation, of stock market purchases of a substantial block of shares in the offeree company and Rule 35 was inserted in the *1972 Code* to deal with the problem. The Rule provides that:

> Any person who acquires, whether by a series of transactions over a period of time or not, shares (together with shares of other persons acting in concert with such person) carrying 40 per cent of the voting rights (other than rights exercisable only in restricted circumstances) attributable to the share capital of the company must, except in a case specifically approved by the Panel, extend within a reasonable period of time an unconditional offer to the holders of the remaining equity share capital of the offeree company.

The offer has to be in cash (or a cash alternative has to be offered) at a price not less than the "highest price... paid by such persons for shares of that class within the preceding twelve months".[29] The Panel has jurisdiction to agree to an adjusted price where the "highest price" over the stipulated twelve month period is for some reason unsuitable.

The overall effect of Rule 35 is to compel any person who obtains effective control of a company to make a cash offer for the remainder of the shares in that company. The purpose of the Rule is to guarantee to all shareholders in the target company an equal opportunity to participate in any market purchasing pro-

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[26] *Ibid.*, at p. 4. The Norcos offer valued the shares of Venesta Ltd., at 52 p. Consolidated had purchased its shares in the market at prices ranging from 50 p. — 57 p.

[27] *Id.*

[28] *Ibid.*, at pp. 6-7. The original reason for excluding stock market purchasers from coverage by the Code was the assumption, falsified by events, "that as a matter of practice it would be impossible to acquire control of a company except over a very extended period of time, during which shareholders would be aware of what was happening and could take their own decisions regarding their personal investments". Panel release, Jan. 18, 1972.

[29] Where an offer is to be made for a class of shares in respect of which no acquisitions have been made then the Panel has to be consulted.

gramme which results in the transfer of effective control of their company and also, in part, to protect minority shareholders where there has been a transfer of effective control. Certain theoretical objections can be raised against Rule 35. It is arguable that it will deter persons from attempting to acquire control of moribund companies and thus eliminate the advantages flowing from a free market for the transfer of corporate control.[30] Now, those who wish to acquire control of a company through the market, will have to possess sufficient resources to make a cash offer for all the shares in the offeree company. The extent to which this will inhibit market acquisitions of control is unclear, and perhaps too much should not be made of the argument. Professor Andrews has persuasively demonstrated[31] that the regulation of the sale of corporate control so as to guarantee to all shareholders an equal opportunity to participate in any offer for the sale of controlling shares should not unduly inhibit such transactions. These arguments have equal validity in the case of stock market acquisitions of effective control. Even if bids are slightly reduced this is offset by the greater degree of fairness with which offeree shareholders will be treated.

The other policy objective of the *Code* referred to, to guarantee all offeree shareholders an opportunity to at least assess the merits of all *potential* bids, is clearly illustrated by the *Code's* treatment of "shut-out" bids. The "shut-out" bid and the problems that it gives rise to are exemplified by the Panel's ruling in *Re Grimshaw-Windsor & Blaskey*.[32] Grimshaw-Windsor, Ltd., was interested in acquiring control of Blaskey's Ltd., a quoted company, in which over fifty per cent of the share capital was controlled by the Blaskey family interests. The parties reached a tentative agreement on the sale of the shares and, because of unusual market movements in the shares of Blaskey's, Ltd., they issued a joint statement that "agreement had been reached on the terms for an offer". In actual fact no binding commitment on the part of the holders of the Blaskey family shares has been made. After the above announcement Leyland Paint and Wallpaper, Ltd., showed an interest in Blaskey's, Ltd., and eventually reached agreement with the holders of the Blaskey family interest where by the latter irrevocably accepted the offer of Leyland Paint and Wallpaper,

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30 See generally Manne, *Mergers and the Market for Corporate Control*, (1968), 78 J. Pol. Econ. 110.

31 Andrews, *op. cit.*, n. 18.

32 Panel Release, Sept. 22, 1971.

Ltd., before any details of the transaction were made public. Although the Panel considered that the shut-out bid of Leyland Paint and Wallpapers, Ltd., had resulted in the minority shareholders of Blaskey's, Ltd., being "deprived of the opportunity of receiving a higher price from Grimshaw-Windsor" there had been no violation of the terms of the *1969 Code*.[33] The Panel did, however, lay down certain guidelines as to how shut out bids were to be conducted in the future and these are now embodied in Rule 11 of the *1972 Code*. The rule states that:

> Since
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> a) a transfer of effective control falling within the provisions Rule 10; and
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> b) an irrevocable commitment by the directors of an offeree company and persons acting in concert with them to accept an offer
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> may exclude or reduce the possibility of a better offer from another source, no such transfer shall be effected nor, before formal submission of the offer to the general body of shareholders, shall any such irrevocable commitment be entered into, without the prior consent of the Panel.

The effect of this Rule will be to create conditions favourable for the development of an auction for the shares of any company which is the subject of a take-over offer. However, it is obvious that the rule will have little significant impact where controlling shareholders are determined to transfer their holdings to a favoured suitor irrespective of any more advantageous bid that might be forthcoming. But even in this situation the controlling shareholders who accept a lower offer will leave themselves open to adverse criticism and to preying attentions of the Panel. Although, in this context it should be emphasised that the Panel have ruled that subject to the "paramount requirement of good faith" [34] the principle of majority rule must prevail. In addition, where the majority shareholders also happen to be the directors (which would normally be the case) then they will have "to consider the interests of the general body of the shareholders" [35] and the board of directors will have to justify its good faith if it should prefer "a lower offer".[36]

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[33] The Panel have ruled that the directors of an offeree company are not "under a duty of hawk their business around the market place in the possibility that higher bids might be obtained" and that it was for "interested parties to put forward such offers as they wished". The latter will not be always feasible unless "shut-out" bids are controlled. See: *J. Coral Ltd.*, Panel release, June 18, 1971.

[34] *Ibid.*, at p. 5.

[35] *Ibid.*, at p. 4.

[36] Rule 9, 1972 Code.

The prohibition in Rule 11(b) on directors of an offeree company making an "irrevocable commitment" to an offeror before the offer has been submitted to the general body of the offeree shareholders is probably of greater significance than Rule 11(a). The statistics indicate that an offeree board's support will normally ensure the success of a bid and, conversely, its opposition will normally guarantee a bid's failure. Thus in 1970-71 out of 177 agreed bids only 5 were unsuccessful, while out of 47 bids which were 'finally opposed' only 8 ultimately proved successful.[37] Accordingly, a firm commitment by the directors of an offeree company would, from a practical point of view, greatly dampen the ardour of potential rivals who wanted to enter an opposing offer. Admittedly, Rule 11(b) does not conclusively prohibit the directors of an offeree company from eventually making an irrevocable commitment in favour of a particular offeror. But by regulating the timing of such a commitment, Rule 11(b) does make the lot of a rival bidder that little bit easier. Also, once a rival bid has been made then the board of directors of the offeree company will, as was pointed out above, have to "justify its good faith" if it recommends the lower of the bids and "in such circumstances competent outside advice must be taken".[38] Nor can the directors of an offeree company indirectly achieve the effect of a shut-out bid by discriminating in favour of a preferred suitor with respect to the disclosure of confidential information. Rule 12 of the *1972 Code* provides that "any information, including particulars of shareholders, given to a preferred suitor should on request be furnished equally and as promptly to a less welcome, but *bona fide* potential offeror".[39]

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[37] The figures for 1969-70 were: a) out of 212 agreed bids 3 failed, and b) out of 41 bids finally opposed only 3 succeeded. *Annual Report of the Panel on Take-overs and Mergers*, (London, 1971), at p. 5. The statistics for Ontario are less conclusive. See *Ontario Securities Commission Report*, *op. cit.*, n. 22, Table 7, at p. 194.

[38] Rule 10, 1972 Code. Thus in *Re J. Coral Ltd.*, the Panel stated that it was "not inconceivable that whilst the duty of Directors might require them to advise minority shareholders that some particular course would appear to be in their interest, where the directors come as individuals to exercise their own personal proprietary rights in their shares they might, for their own part, act differently". Panel release, June 18, 1971, at p. 4.

[39] Although this Rule is not free from difficulties, "it [i.e. the Panel] has also had to adjudicate, given the *bona fides*, on whether an offeree could reasonably withhold information from one bidder on the grounds that there could be permanent damage to its commercial interests in the extent of the bid failing and the bidder remaining a competitor". *Annual Report of the Panel on Take-overs and Mergers*, (London, 1969), at p. 8.

If the restrictions placed on the sale of corporate control by the Code interfere with the free functioning of the market for corporate control there can be no doubt that the preclusion of shut-out bids will make such a market more effective by dismantling a possible barrier to entry. Also, a little competition in this area would not be a bad thing. In 1970-71 out of 292 bids monitored by the Panel in only 36 instances were one or more rival bids made, roughly 12 per cent.[40] In addition, the encouragement of competitive bids will tend to afford some protection to the offeree shareholders in the situation where they are at their most vulnerable, that is, where the offeree board of directors recommend acceptance of the offer. The vulnerability of the offeree shareholders where the terms of a bid are endorsed by the directors of their company and no rival bids are made is clearly illustrated by the facts in the recent decision of *Gething* v. *Kilner*.[41] In that case the offeree board agreed to a take-over and the offer document stated that the offeree "directors have irrevocably undertaken to accept or obtain acceptances of the offer". At the time this document was circulated the offeree board had been advised, by their merchant bankers that the terms offered were inadequate. The offeree board did not inform the offeree shareholders of this until ten days after the offer document had been distributed, somewhat "belatedly" as Brightman, J., observed. Even then the directors of the offeree board disagreed with the view of their merchant bankers. In this situation the most effective protection for the offeree shareholders is for a rival bidder to enter the field; at the present there is no more effective alternative for evaluating the merits of a bid. Particularly is this so as the Panel repeatedly disclaimed any responsibility for passing on the financial merits of a bid.[42]

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[40] *Annual Report of the Panel on Take-overs and Mergers,* (London, 1971), at p. 5.

[41] [1972] 1 W.L.R. 337.

[42] "Neither the City Code or the Panel is concerned with the evaluation or commercial advantages or disadvantages of a take-over or merger proposition which may be decided by the company or its shareholders". *1972 Code,* at p. 5. See also *Re United Draperies Offer for Swears and Wells Ltd.,* Panel release, February 17, 1970, at 2: "The Panel has consistently refused to value or pass judgment upon the merits of particular offers. Not only has it not the machinery so to do but any such attempt would involve an unjustifiable interference with the freedom of shareholders to decide for themselves whether a particular offer is acceptable or not".

II. Scope of the Code

One of the immediate problems the Panel had to face in applying the *1969 Code* was to determine the scope of its application. In Practice Note No. 1 [43] it was provided that the *Code* would apply in all cases where both parties were public companies, whether quoted or not. It also regulated a bid a private company [44] for a public company. Normally, however, the *Code* is not applicable in the reverse situation except where "the relative sizes of the two companies and other circumstances are such that the transaction effectively constitutes a reverse take-over [45] and where change in effective control of the public company would result". Thus the *Code* applies to all situations where the offeree shareholders are in need of protection as it is not unreasonable to assume that the shareholders in a private company should be able to look after their own interests because of the cohesive manner in which the shares in such companies are held.

III. The Approach and Early Stages

The provisions of the *1969 Code* in this area have proven satisfactory; their counterparts in the *1972 Code* are briefly as follows. The offeror, whose identity must be disclosed,[46] must initially approach the offeree board,[47] which is entitled to be satisfied as to the *bona fides* of the offeror and "that the offeror is or will be in a position to implement the offer in full".[48] An announcement of the offer, preferably in the form of a joint statement,[49] should be made as soon as the parties "are agreed on the basic terms of an offer and are reasonably confident of a successful outcome of the negotiations".[50] If there is any "untoward movement" in the prices of the shares of the company, then an immediate announcement of the offer must be made.[51] The object of this is the obvious

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[43] Supp., *1972 Code.*

[44] For the definition of private company see: *Companies Act, 1948* (Imp.), 11-12 Geo. 6, c. 38, s. 28.

[45] For a description of the reverse take-over mechanism see: Weinberg, *op. cit.*, n. 7, at p. 62.

[46] Rules 2 and 8, *1972 Code.*

[47] *Ibid.*, Rule 1.

[48] *Ibid.*, Rule 3.

[49] *Ibid.*, Rule 6.

[50] *Ibid.*, Rule 5.

[51] *Ibid.*, Rule 5. Principle 5 of the Code provides that "It must be the object of all parties to a take-over or merger transaction to use every endeavour to prevent the creation of a false market in the shares of an offeror or offeree company".

one of safeguarding the integrity of the stock market by curbing speculative activity founded on rumour. Also, it partly protects the offeree shareholders by enabling them to make an informed decision with respect to the disposal of their shares. Once an offer has been made public then the Panel must be consulted before it can be withdrawn. In at least one reported case such permission has been refused.[52]

IV. Information Accompanying the Offer Document

The requirements of the *1969 Code* with respect to the information which must accompany all offer documents have, with minor modifications, been reproduced in the *1972 Code.* It is not proposed to go into them in any great detail. Rule 15 of the *1972 Code* requires generally that "shareholders must be put in possession of all the facts necessary for the formation of an informed judgment as to the merits or demerits of the offer",[53] and any document addressed to the offeree shareholders must be prepared "with the same standards of care as if it were a prospectus within the meaning of the *Companies Act, 1948*".[54] The more salient items of information which the offer document must contain are: [55] (i) the total holdings of the offeror, the offeror's (directors,) and those acting in concert with the offeror, in the shares of the offeree company,[56] (ii) the dealings of any of the above parties in the shares of the offeree company during the twelve month period preceding the bid, along with the dates and prices of such trades,[57] (iii) "information... about the offeror (including the names of its Directors) and its intentions in regard to the future

[52] *Re Norbury Insulation,* Panel release, April 2, 1971, at p. 3: "Subsequently that afternoon, Mr. Dick was informed that the Panel would not consent to the withdrawal of the Norbury Insulation offer". For a situation where a withdrawal was consented to see *Re Pergamon Press Ltd.,* Panel release, August 27, 1969.

[53] See: Principle 3, *1972 Code.*

[54] *Ibid.,* Rule 14. Although, as has been pointed out by the Panel, "whereas in a prospectus it is properly the practice to make a conservative estimate of profits, in this type of circular it may be doing a disservice to shareholders to err on the conservative side". See: Practice Direction No. 6 para. 3, supp., *1972 Code.*

[55] These requirements are elaborated on in more detail by the Stock Exchange rules. These rules are produced in Palmer, *Company Law* (21st ed.), at p. 1351.

[56] Rule 17(a), *1972 Code.*

[57] *Ibid.,* Rule 17(d). Also, if "no such dealings have taken place" this fact must be disclosed.

of the offeree",[58] and lastly, (iv) in the case of a non-cash offer whether the salaries of the offeror directors will be affected by the acquisition of the offeree company, obviously reflecting the fact that the offeree shareholders in this situation are being asked to invest in the shares of the offeror company.[59]

The Panel have applied a broad interpretation to the requirement that the offeree shareholders be put in possession of the "necessary information for an informed judgment". In the Pergamon case the Appeals Committee of the Panel considered that information given at the time of the bid could not be completely divorced from the information which the shareholders should have been given before the bid was ever made. Accordingly, the Appeals Committee upheld as correct a ruling of the Panel that the offeree shareholders had not been given adequate information in that a director of the offeree company had failed to disclose, over a period of time before the bid, the complete details of his commercial relationship with the offeree company.

A difficult problem, to which the requirement to make full disclosure to the offeree shareholders has given rise, has been with respect to the obligation to furnish the offeree shareholders with any necessary profit forecasts. Whilst the Panel have recognised that profit forecasts are not appropriate in all circumstances, nevertheless it considers that there may be "occasions where directors would be witholding valuable essential information from the shareholders if they were to abstain from giving a forecast of the immediate future results".[60] Indeed the Panel consider that the "directors' opinions on the immediate future profitability of a company are the most important single element in the formation of the decision to invest or disinvest in that company invest".[61] In order

[58] There are considerable arguments on the merits, and difficulties in application, of the requirement that the offeror disclose its intentions with respect to the future development of the offeree. See Burdney, *A Note on Chilling Tender Solicitations,* (1967), 21 Rutgers L. Rev. 609, at pp. 625-628; Prentice, *op. cit.,* n. 20, at pp. 354-355; *Electronic Specialty Co.* v. *International Controls Corp.,* 409 F. 2d 937 (2d Circ., 1969); *Susquehanna Corp.* v. *Pan American Sulpher Co.,* 423 F. 2d 1075 (5th Circ., 1970).

[59] Rule 19, *1972 Code.* For the technical reasons why a share exchange take-over is not considered a distribution of shares to the public requiring a supporting prospectus see, *Government Stock and Other Securities Investment Co.* v. *Christopher,* [1956] 1 W.L.R. 237; [1956] 1 All E.R. 490.

[60] *Annual Report of the Panel on Take-overs and Mergers,* (London, 1970), at p. 6. See also *Annual Report,* (London, 1971), at p. 7: "In the Panel's opinion responsible profit forecasts are a vital element in a shareholder's assessment of the worth of equity investments".

to minimise the incidence of over-forcasting and to improve the overall intelligibility of profit forecasts the *Code* lays down extensive directions as to their mode of compilation. Where profit forecasts appear in any circular sent to shareholders then "the assumptions, including the commercial assumptions, upon which the Directors have based their profit forecasts must be stated in the document".[62] The Panel have issued two Practice Notes [63] on how these assumptions should be articulated, the latest of which provides that the following general rules should apply in formulating such assumptions: [64]

a) the reader should be able to understand their implications and so be helped in forming a judgment as to the reasonableness of the forecast and to the main uncertainties attached to it;
b) the assumption should be, whenever possible, specific rather than general, definite rather than vague;
c) all embracing assumptions [65] and those relating to the general accuracy of the assessment should be avoided; [66]
d) the assumptions should relate only to matter which may have a material bearing on the forecast.

To what extent these guidelines will improve the accuracy of profit forecasts I am not in a position to judge. The Panel, however, have made a serious attempt to monitor the accuracy of profit forecasts,[67] which should go part of the way in encouraging greater caution and accuracy in their preparation. In addition, the Panel's involvement in this field should have the effect of making the accountancy profession more self-critical and have an impact somewhat equivalent to that of the S.E.C. on accounting standards in the United States.[68]

V. Mechanics of the Offer Procedure

As we have already seen the *Code* frowns on partial bids. Where one is permitted, then the offeror must make provision for *pro rata*

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[61] *Id.*

[62] Rule 16, *1972 Code.*

[63] Practice Notes No. 4 and No. 6, supp. *1972 Code.*

[64] Practice Note No. 6, para. 14, *id.*

[65] This is designed to cover the "There will be no significant unforeseen circumstances" type of statement.

[66] See: Practice Note 6, para. No. 6, supp., *1972 Code.*

[67] *Annual Report of the Panel on Take-overs and Mergers,* (London, 1971), at pp. 6-7.

[68] See generally Loss, *Securities Regulation,* (2nd ed. 1961, supp. 1969), Vol. 1, at pp. 331-335.

acceptance of all shares tendered pursuant to the offer.[69] This not only guarantees parity of treatment to all the offeree shareholders but it also removes the pressure to tender hastily inherent in a first-come, first-served arrangement. In addition the *1972 Code,* in common with most statutory controls on take-over bids, contains time for acceptance rules which are also designed to enable the offeree shareholders to make a considered decision and to give the financial press an opportunity to comment on the merits of the offer.[70] Basically these Rules require that the offer be kept open for 21 days, and confer on an "acceptor" the right to withdraw his acceptance after this twenty-one day period has elapsed if the bid has not been declared unconditional.[71] Some improvement could be made in the protection afforded by these rules by affording tendering shareholders an absolute right of withdrawal during the first 7 days immediately following the announcement of an offer so that if public scrutiny reveals inadequacies in terms of the offer a shareholder who precipitously tendered his shares could withdraw.[72] Once a bid has been declared unconditional it must remain open for acceptance for "14 days after the date on which it would otherwise have expired".[73] The Stock Exchange must be informed of this happening along with the details of the number of acceptances held by the offeror.[74] Where an "offer has elapsed, been extended, or closed" then this also must be conveyed to the Stock Exchange.[75]

The Rules also prevent an offeror having an indefinite call on the shares of the offeree shareholders who have tendered acceptances, a bid cannot remain open for longer than 60 days and cannot be declared unconditional after that date.[76]

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[69] Rule 27, *1972 Code.*

[70] See Prentice, *op. cit.,* n. 20, at pp. 334-336.

[71] Rule 22, *1972 Code.* Where the terms of an offer are revised then the offer must remain open for 14 days after the revision.

[72] See, e.g., s. 16: 02(2) of the proposed Canada Corporations Act, *Proposal for a New Business Corporations Law for Canada,* Vol. II (Ottawa, 1971); Appropriate corresponding provision would have to be made where there has been an alteration in the terms of the offer.

[73] Rule 23, *1972 Code.*

[74] *Ibid.,* Rule 24(b). Non-compliance with this requirement gives those shareholders who have tendered their shares a right of withdrawal, a right which can be terminated by the offeror if he gives the required notice. [Rule 25(b)]. Also, the Stock Exchange may suspend dealings in the shares of the offeree if there has been non-compliance with Rule 24.

[75] *Ibid.,* Rule 24(a).

[76] *Ibid.,* Rule 22. Where a competing offer has been made then the Panel has jurisdiction to extend the offer period beyond the 60 day limit.

VI. Mandatory Terms of the Formal Offer

Undoubtedly the major overall theme of the *1972 Code* is that of guaranteeing protection to the offeree shareholders, this "[G]eneral Principle runs through and covers the whole *Code*".[77] Some of the ways in which this objective is pursued have already been noted — the provision of adequate information, the removal of pressures to make a hasty acceptance, and the preclusion of shut-out bids. The *Code* goes further, however, and in certain circumstances regulates the substantive terms on which bids can be made by, in particular, requiring parity of treatment of the offeree shareholders. Principle 8 of the *1972 Code* provides generally that "[A]ll shareholders of the same class of the offeree company shall be treated similarly by an offeror". Greater particularity is given to this broad directive by Rule 10 of the *Code* which obliges those who transfer control of a company to ensure that a "comparable offer[78] [is made] to the holders of any other class of equity share capital whether such capital carries voting rights of not". Nor can this requirement to treat the offeree shareholders equally be circumvented by a preferential deal with a group of the offeree shareholders prior to the making of the general offer. Principle 9 of the *Code* provides that,

> If, after a take-over or merger transaction is reasonably in contemplation, an offer has been made to one or more shareholders of an offeree company, any subsequent general offer made by, or on behalf of, the offeror

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[77] *Re Adepton and William Hudson Ltd.*, Panel release, April 2, 1971, at p. 6.

[78] Measuring the comparability of the terms offered to differing classes of shares will not prove easy. Nor have the Panel required the offeree company, where different classes of shares are involved, to retain separate advisors for each class of shares. *Re United Drapers Offer for Swears and Wells Ltd.*, Panel release, February 17, 1970. In that ruling the Panel, perhaps too complacently, rejected the argument for separate advisors on the grounds that "[M]erchant banks do indeed very frequently discharge with complete impartiality and objectivity responsibilities in which there is an apparent conflict of interest and this is characteristic of English arrangements in many other fields". Arrangements, however, which have not always withstood judicial scrutiny. See *North and South Trust* v. *Berkeley*, [1971] 1 All E.R. 980. Also, the Panel's confidence would seem to be belied by the necessity of having to introduce a Code on take-overs in the first place. Nor is it completely satisfactory to dispose of any possible conflict of interest with the observation, more hopeful than realsistic, that "the duty of Directors is not to themselves but in the nature of trustees to the general body of shareholders". Formulating this duty is one thing, guaranteeing its observance is quite another.

> or his associates to the shareholders of the same class shall not be on less favourable terms.

Where a partial bid is allowed then the offeror must make arrangements for acceptances to be taken up on a *pro rata* basis.[79] An obligation which, we shall see, cannot be circumvented by stock market purchases during the bid.[80] The application of the requirement that all offeree shareholders be treated equally has given rise to difficulties in the context of purchases of offeree shares in the market during the currency of a bid, something which the Code does not prohibit. Take the facts in *Re Adepton and Williams, Ltd.,*[81] a hearing which was conducted before the Panel. In that case Adepton, Ltd., made a bid for the shares of William Hudson, Ltd., the consideration offered being non-cash, convertible unsecured loan stock of Adepton, Ltd. After the announcement of the bid Adepton, Ltd., pursued an aggressive, but quite permissible, buying campaign of William Hudson's, Ltd., shares in the market. The question which the Panel had to decide was whether or not these market purchases ran counter to the *Code's* requirement that all offeree shareholders be treated equally. As the Panel pointed out that while "[T]heoretically, all shareholders have a similar chance to sell" in practice this "similarity may be more theoretical than real".[82] Normally it will be only the "knowledgeable shareholders who are close to the market" [83] who will have the option of selling in the market or tendering their shares pursuant to the offer. By the time

> the small shareholder has received his advice, the offeror may well have withdrawn from the market and the market price of the shares will have fallen accordingly. Moreover, the offeror's technique will involve, as it did in the present case, his acquiring of only what he regards as a controlling interest in the company and although he is required to stand in the market for several days, he will certainly not be anxious to purchase further shares for cash once the controlling interest has been obtained.[84]

It was to provide a remedy for this situation that Rule 33 was inserted into the *Code.* The Rule provides that where an offeror

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[79] Rule 27, *1972 Code.*

[80] *Ibid.,* Rule 31.

[81] Panel release, April 2nd 1971.

[82] *Ibid.,* at p. 7.

[83] *Id.*

[84] *Id.*

(or any person acting in concert with it) [85] purchases for cash [86] "in the market or otherwise", within the twelve month period prior to the offer, shares of the class which are under offer and such purchases "exceeds 15 per cent of that class" then the other members of the class shall be entitled to a cash offer.[87] The price at which this cash offer is to be made is the "highest price ... paid for shares of that class acquired during the offer period and within twelve months prior to its commencement", although the Panel has a discretion, in the proper circumstances, to agree to an "adjusted price".

Rule 33 will have a far reaching effect on the future form of take-over bids. Its immediate effect will be to eliminate or, at least, greatly curb the practice of warehousing, that is, the accumulation, prior to the announcement of a bid, of shares in the offeree company by an offeror or those working in concert with an offeror. The only way in which the *1969 Code* had any bearing on this practice was to impose on an offeror the obligation to disclose its holdings in the offeree company together with the holdings of any person "acting in concert with the offeror".[88] The effect of Rule 33 will be to eliminate such pre-bid acquisitions unless the offeror is willing to make a cash offer, as even a modest market purchasing programme could bring an offeror within the terms of the Rule.

In a competitive bid situation Rule 33 could operate to tie the hands of some offerors. Firstly, it will favour offerors who have ready access to cash or who possess liquid reserves. Admitttedly, an offeror offering exclusively non-cash consideration should be able to obtain cash support for its bid if it is at all meritorious. It is not uncommon in take-overs, where a non-cash consideration is offered, for the offeror to arrange for a merchant bank to buy from the offeree shareholders whatever offeror paper they do not

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[85] A very functional definition is given to the concept of those deemed to be acting in concert with an offeror. This category will embrace those "individuals who actively co-operate to attain a common objective in relation to a take over or merger transaction". See: *1972 Code*, at p. 8.

[86] A "cash purchase" will be deemed to have taken place where the consideration for shares is a "debt instrument maturing for payment in less than three years". *Id.*

[87] The Panel is also given discretion by Rule 33(b) to order that cash be offered to the offeree shareholders where this is necessary in order to guarantee parity of treatment to the offeree shareholders even though the 15 per cent threshold has not been passed.

[88] See: now Rules 17(a)(iii), and, 18, *1972 Code.*

want to retain.[89] Nevertheless, the offeror who does not have ready access to cash will be prejudiced by Rule 33, although perhaps not unduly. Secondly, where some of the offeree shareholders are opposed to the bid they can buy in the market without any risk of having to make a general cash offer provided they avoid purchasing shares carrying 40 per cent of the voting rights attributable to the share capital of the offeree company. A holding of 40 per cent, or even much less by persons hostile to an offer, could seriously jeopardise the success of most take-overs. The only effective way in which an offeror can counteract defensive market purchases is to buy in the market itself, but if it does so it runs the risk of having to make a cash offer to the offeree shareholders.

Although Rule 33 effects the above distortions to the free market mechanism for transferring corporate control by way of a take-over bid, its benefits outweigh its shortcomings. It does undoubtedly guarantee parity of treatment to the offeree shareholders and it should also provide a measure of protection in circumstances where it is impossible to value the paper offered. All that an offeror who has passed the 15 per cent threshold level is obliged to do is to offer a "cash alternative" at not less than the highest price paid by it for the offeree shares either during the offer period or in the twelve months proceding the bid. Normally this will be less than the putative value of the paper offered and accordingly the offeree shareholders will plump for the paper.[90] However, the offeree shareholders will be more reluctant to adopt this course of action if the value of the offeror's paper is speculative; for example, where the offeror is smaller in size than the offeree[91] or where the paper being offered is novel or unseasoned. It is in these situations of speculative valuation that the existence of a cash alternative should afford much needed protection to the offeree shareholders.[92] Lastly, as was pointed out above, even where the

[89] The mechanics of this are illustrated in *Re Carlton Holdings*, [1971] 2 All. E.R. 1082, noted Prentice, (1972), 35 Mod. L. Rev. 73.

[90] Although as the Code permits parties involved in a take-over transaction to purchase shares in the market during the offer period the market price will have a tendency to creep up to the offer price.

[91] This was the situation in *Re Adepton and Williams Hudson Ltd.* The net assets value of the offeror group was £2,205,000 whereas the net tangible assets of the offeree were stated by the offeror in its offer document to be £8,814,000. Panel release, April 2nd, 1971.

[92] It is interesting to note that Rule 32 of the Code provides, for the first time, that "[I]f there is a restricted market in the securities of the offeror, or if the amount of already quoted securities to be issued is large in relation to the amount already quoted, the Panel may require justification of prices used to determine the value of the offer".

paper offered is speculative Rule 33 should not operate to curb meritorious bids as an offeror should, in such a case, be able to obtain suitable underwriting.[93]

Where an offeror's market purchases do not pass the 15 per cent threshold then, of course, a cash alternative will not have to be made available to the offeree shareholders. In this situation it is possible that the offeree shareholders who sell in the market will receive a higher consideration for their shares than the shareholders who tender their shares pursuant to the bid. To guarantee parity of treatment in this situation Rule 32 of the *Code* provides that any offeror (or any person acting in concert with the offeror) who purchases shares in the market during the offer period at above the offer price shall "increase its offer to not less than the highest price... paid for the share so acquired". The rigid application of this provision could lead to some far-fetched results in a hotly contested take-over bid situation. For example, in one bid a hectic scramble for a few remaining shares of the offeree company listed on the Birmingham Stock Exchange resulted in the shares being driven up from 11 shillings, the original offer price, to 65 shillings.[94] To have compelled the offeror to pay this inflated price to all the offeree shareholders would have been much too severe. Surprisingly the Panel does not under Rule 32, as it does under Rule 33, have any jurisdiction to set an adjusted price where for some reason the market price is inappropriate.[95] It is submitted that the Panel should be vested with such a jurisdiction.

The only other significant provision of the *Code* regulating the substantive terms on which take-overs can be made is Rule 36 which provides that,

> The offeror or persons acting in concert with the offeror may not enter into arrangements to deal or make purchases or sales of shares of the offeree company, either during the offer or when one is reasonably in contemplation, if such arrangements to deal, purchase or sales have attached

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[93] "We merely add that if [the offeror] its advisers and brokers, are correct in their confident assertion that their paper would be in great demand and the offer likely to be accepted by most of the [offeree] shareholders underwriting will not impose a severe burden". *Re Adepton and Williams Ltd.*, Panel release, April 2nd, 1971, at p. 10.

[94] Stamp and Marley, *op. cit.*, n. 2, at p. 15.

[95] There is, of course, a major distinction between the Rules. Rule 33 requires the offeror to offer the "highest price" paid in the 12 months period preceeding the bid, whereas Rule 32 only relates to prices during the offer period which by Rule 22 cannot exceed 60 days. Because of the expanded time span under Rule 33 there is obviously a greater need for some discretion to be vested in the Panel to arrange for an "adjusted" price.

thereto special favourable conditions which are not capable of being extended to all shareholders.

An example of the type of provision covered by this Rule is an arrangement by a purchaser to make good to a vendor any difference between the purchase price and the price of any successful offer or increased offer.[96] The wording of the Rule could also embrace collateral perks, such as severance payments to the members of the offeree board of directors for the loss of their offices. Although, where the details of these have been disclosed and there has been compliance with section 193 of the *Companies Act, 1948* then such payments would be quite permissible.[97]

VII. Role of the Offeree Board of Directors

At common law the directors of an offeree company probably have no duty to comment on a take-over offer as it does not involve any corporate interest but instead it affects the interests of the offeree shareholders.[98] The *Code,* however, modifies this position and stipulates that after an offer has been made public it is "essential" that a "letter setting out the views of the Board of the offeree company should be circulated as soon as possible".[99]

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[96] Weinberg, *op. cit.,* n. 7, at p. 183, footnote 87. This example was given with respect to Rule 32 of the 1969 Code which is equivalent to Rule 36. This, of course, is a form of 'shut-out' which guarantees early commitments despite any subsequent more attractive bids and will now, in some situations, be also covered by Rule 11.

[97] See generally Weinberg, *op. cit.,* n. 7, chap. 25.

[98] *Kimber Cmt. Report, op. cit.,* n. 11, at para. 3:13; *Broffe* v. *Horton,* 172 F. 2d 489 (2nd Circ., 1949). Although directors owe no fiduciary duty to the offeree shareholders it may be that some form of fiduciary duty comes into effect if the offeree directors *do* decide to issue any circular advising their shareholders with respect to a bid. In *Gething* v. *Kilner,* [1972] 1 W.L.R. 337, at p. 341 Brightman, J., was of the opinion that "the directors of an offeree company have a duty towards their own shareholders, which in my view clearly includes a duty to be honest and a duty not to mislead". This dictum was made in the context of a section 209 acquisition and therefore the duty referred to by Brightman, J., may only be the correlative right implied from that statutory provision. (See: *Companies Act 1948,* (Imp.), 11-12 Geo. 6, c. 38, s. 209). Cf. *Kardon* v. *National Gypsum Co.,* 69 F. Supp. 512 (E.D. Pa 1946); *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964). If the dictum of Brightman, J., is intended to signify a more far-reaching duty then it is difficult to rationalise it with *Percival* v. *Wright,* [1902] 2 Ch. 421.

[99] Rule 13, *1972 Code.* There can be no discrimination between the offeree shareholders as to the quantity or quality of information they receive. Principle 10, *1972 Code.* The effect of this rule will be to guarantee to all offeree shareholders the same quality of information as is received by institutional shareholders.

While this could cause difficulties where an offeree board is divided on the acceptability of a bid it has been argued elsewhere that the mandatory requirement of a circular from the offeree directors is preferable to the leaving of such a circular optional.[100] The *Code* adjures the directors of an offeree company in giving advice to "act only in their capacity as Directors and not have regard to their personal or family shareholdings or their personal relationships" [101] with the offeree company. Obviously, however, there will be tension between the responsibilities of the directors qua directors and their right to exercise their proprietary rights as shareholders; the *Code* does little to resolve this conflict. The most satisfactory solution, that the directors should appoint experts to advise the holders of any class of shares not held by the directors, has unfortunately been rejected by the Panel as not being required by the *Code*.[102] All that the *Code* requires is that the directors seek "competent outside advice" which does not entail the retention of separate advisors for each distinct interest in the offeree company. The directors of the offeree company must jointly and severally accept responsibility for any circular they send out and they must take all reasonable care to guarantee that the facts in the circular are fair and accurate and that no "material factors or considerations have been omitted".[103]

More specifically the *Code* requires any circular from the directors of an offeree company to contain the following information:

(i) the shareholdings of the offeree company in the offeror;
(ii) the shareholdings in the offeree company and the offeror in which the Directors of the offeree company are interested;
(iii) the shareholdings in the offeree company which any person acting in concert with the Directors of the offeree company owns or controls (with the names of such persons acting in concert);
(iv) whether the Directors of the offeree company and any person acting in concert with them intend, in respect of their own beneficial shareholdings, to accept or reject the offer.[104]

The volume and prices of the share dealings by any of the above named persons in the shares of either the offeror of the offeree company in the "12 months prior to the announcement of the

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[100] Prentice, *op. cit.*, n. 20, at pp. 349-352.
[101] Principle 11, *1972 Code.*
[102] *Supra*, n. 78.
[103] Rule 14, *1972 Code.*
[104] *Ibid.*, Rule 17(b). Rule 17(c) goes on to provide that if in "any of the above categories there are no shareholdings then this fact should be stated".

offer" must also be given. Lastly, details of the service contracts of the directors of the offeree company must be disclosed, a provision obviously designed to expose those contracts entered into as insurance against the consequences of a successful take-over bid.[105]

Perhaps the primary factor contributing to the introduction of the *City Code* was the use, by the directors of offeree companies, of what were considered improper defensive measures against take-overs. This matter is now dealt with by Principle 4 and Rule 38 of the *Code*. Principle 4 provides generally that the directors of an offeree company, once a *bona fide* offer has been communicated, should do nothing with respect to the affairs of the offeree company without shareholder approval which would either frustrate the bid or result in the shareholders of the offeree company being denied an opportunity to decide on the bid's merits. The type of conduct specifically covered by this prohibition is the now familiar tactic of issuing shares or options for shares to the offeree directors or their allies, the acquiring or disposal of assets of a "material amount", or the entering into contracts "otherwise than in the ordinary course of business".[106] Little comment is needed on these prohibitions as their desirability seems unarguable. The *Code* does not, however, proscribe certain other classic defensive ploys. Thus revaluations of assets are not only permitted, but almost positively encouraged.[107] So also promises of bigger and more regular dividends in the future. But these practices, although capable of manipulation for purely defensive purposes, also fulfill the valid purpose of informing the offeree shareholders of the value of their shares. Coupled with this the *Code* attempts to curb their abuse by regulating the basis on which they can be made.

VIIII. Market Purchases

The general principle of the *Code* is that it is undesirable "to fetter the market" and the *Code* therefore permits, with one exception, unrestricted dealings in the market in the shares of either

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[105] See also, Practice Note No. 2, supp. *1972 Code*. Even if directors are removed under s. 184 of the *Companies Act, 1948* (Imp.), 11-12 Geo. 6, c. 38 the section [184(6)] preserves any right of action they might have for damages for breach of contract.

[106] Rule 38,*1972 Code*.

[107] *Ibid.*, Rule 16. The significance of this is somewhat diminished in view of the fact that directors, since 1967, are obliged, annually, to give their shareholders an estimate of the market value of the company's assets. *Companies Act, 1967* (Imp.), 15-16 Eliz. II, c. 81, s. 16(1)(a).

the offeror or offeree company during the currency of a bid.[108] All dealings by the parties to a take-over and their associates,[109] in the shares of either the offeror or the offeree company, must be disclosed to the Stock Exchange, the press and the Panel. In addition dealings by associates "for account of investment clients" must be reported to the Stock Exchange and the Panel.[110] This obligation of prompt reporting (it must be made within 24 hours) and more importantly, dissemination of information,[111] provides the offeree shareholders with crucial information as to the possible outcome of the bid and also provides a foundation for determining whether or not other provisions of the Code become operative.

The take-over provides the participants with an ideal opportunity to indulge in insider trading. The thinking of the Panel on this is that where a potential offeror has not approached the offeree and, is therefore not in possession of confidential information unavailable to the rest of the market, then such an offeror should be treated as any other market purchaser and should be free to trade in the shares of the prospective target company. There can be little objection to this as even the most extreme advocate of market egalitarianism would not deprive investors of the rewards for superior acumen and ability. Once, however, there has been some contact between offeror and offeree then the Panel considers that the participants are precluded from trading in the shares of the offeree company until the bid has been made public or negotiations discontinued. Unfortunately Rule 30, which deals with the topic of insider trading, could have been drafted with greater clarity to achieve this result. The Rule provides that:

> No dealings of any kind (including option business) in the shares of the offeree company by any person or company, not being the offeror, who is privy to the preliminary take-over or merger discussions or an intention to make an offer may take place between the time when there is reason to suppose that an approach or an offer is contemplated and the announcement of the approach or offer or the termination of the discussions.

The phrase "an approach or an offer is contemplated" is one of indefinite purport and could easily be interpreted to prohibit an offeror from trading in the shares of any potential offeree company at a time when the decision to make an offer is purely tentative.

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[108] Rule 31, *1972 Code.* See generally Lowenfels, *Rule 10b — 13, Rule 10b — 6 and Purchases of Target Company Securities During and Exchange Offer,* (1969), 69 Colum. L. Rev. 1392.

[109] For the definition of "associate" see *1972 Code,* at p. 7.

[110] Rule 31, *1972 Code.* Practice Note No. 6, supp., *1972 Code.*

[111] See: Robbins, *The Securities Markets* (1966), at pp. 52-53.

This was not intended. At the most Rule 30 was only designed to prevent dealings once the intention to make an offer had firmly crystallized and had been formulated with some definitness so that all that remains is the formal approach to the offeree board.

Also, somewhat surprisingly, Rule 30 excludes offerors from its coverage. The corresponding Rule in *1969 Code* did not exempt offerors from its proscription of insider trading and their omission from the *1972 Code* does not reflect Panel thinking. Basically the view of the Panel is that "it is axiomatic... that inside information must never be used for personal gain".[112] Normally an offeree board will extract an undertaking from an offeror not to make use of any confidential information disclosed in the course of negotiations between the parties and the Panel considers that even where no such undertaking has been given an implied obligation of good faith exists.[113] Non-compliance with either the express of implied obligation of good faith would not be in keeping with the "spirit" of the *Code.*

As has already been noted one of the fundamental purposes of the *Code*[114] is to guarantee to all shareholders an equal opportunity to participate in any *bona fide* offer for the transfer of control of their company and afford them an opportunity to evaluate the merits of any competing offers where it is proposed to effect such a transfer of control. Policy objectives which explain, for example, the *Code's* prohibition of firm commitments, of allotments of shares by the offeree company during the currency of a bid, and on the restrictions surrounding the transfer of control by private agreement. Rule 37 is also designed to bolster up the operation of these prohibitions by proscribing certain types of market purchases which could operate to frustrate a bid. The Rule states that as market dealings by "an associate with a commercial interest in the out-

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[112] *Statement by the City Panel On Stock Exchange Dealings In the Course of a Take-Over Situation,* Panel release, April 2nd, 1971, at p. 1. This statement was made with respect to the 1969 Code but despite the altered wording of Rule 30 it still reflects the Panel's position. In the above ruling the director of an offeror company who indulged in insider trading was severely censured by the Panel and the Panel appears to have been able to extract an undertaking from him to submit the question of his continued suitability to hold office to the shareholders in general meeting and not to vote the shares which he controlled. Cf. the position at common law, *Mason* v. *Harris* (1879), 11 Ch. D. 97; *North West Transportation Co.* v. *Beatty,* (1887), 12 App. Cas. 589.

[113] This probably reflects the common law position. *Seager* v. *Copydex Ltd.,* [1967] 2 All. E.R. 415; *Coco* v. *A.N. Clark (Engineers) Ltd.,* (1969) R.P.C. 41.

[114] General Principle 1, *1972 Code.*

come of an offer" might frustrate an offer then such associate must consult the Panel in advance and "justify his proposed action as not being prejudicial to the interests of the shareholders as a whole". The type of situation this is designed to cover is, for example, purchases made to protect an "existing trading relationship" rather than in the "hope of securing an increased offer or a better competing offer".[115] In other words where an associate has an interest different from that of the other shareholders then any purchases in the market that he makes will be considered collateral to the legitimate purpose of protecting his investment and therefore violative of Rule 37.

The one situation in which market purchases are completely forbidden is where a partial bid is made, a prohibition which extends for 12 months after the closing of the offer period.[116] To permit an offeror to purchase in the market where the bid is a partial one could result in a reduction of the number of shares which an offeror is obligated to take up pursuant to his general offer.[117] This will create uncertainty in that offeree shareholders who tender their shares will be unsure of at least the minimum percentage of their shares which will be accepted if the bid proves successful.[118] It was to eliminate this uncertainty that the prohibition on market purchases during the currency of the bid was introduced.

IX. The Role of the Panel

Perhaps the most striking feature of the *City Code* is the role played by the Panel in guaranteeing the observance and enforcement of the *Code's* provisions. Since 1969 the Panel has had a permanent executive headed over by a director-general who, in the City pecking order, has been vested with considerable authority. The day to day affairs of the Panel are administered by this executive. Any party aggrieved by a ruling of the executive can appeal the decision to a meeting of the full Panel whose decision, on a question of the *Code*, is final. Where, however, the hearing before the Panel is disciplinary in nature, that is, it relates to a violation of the *Code's* provisions, then a further appeal lies to

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115 *Re Venesta International Ltd.* Panel release, January 6, 1971.

116 Rule 31, *1972 Code.*

117 This will depend on the terms of the offer. Normally where a partial bid is made offerors will reduce the percentage of shares they are willing to take up by the number of shares purchased in the market.

118 See generally *Ontario Securities Commission Report, op. cit.*, n. 22, at p. 94.

the Appeals Committee of the Panel.[119] The right of appeal to the Panel from a decision of the executive is not restricted to those immediately affected by the decision, but "is also given to aggrieved shareholders subject to certain safeguards designed to ward off frivolous cases.[120] What these safeguards are is not exactly clear but it appears that some reliance is placed in the fact that shareholder appeals cannot be made in person but must be in writing.

There has been little need to summon full meetings of the Panel or the Appeals Committee of the Panel to review complaints against executive rulings. For example, the 1970 Annual Report of the Panel states that rulings "given by the executive were accepted during the year in all but four cases; in one case the matter was resolved on further discussion, while the remaining three were the subject of appeals".[121] Part of the explanation for this relative infrequency of hearings before the Appeals Committee of the Panel is that since 1969 there has been a high degree of compliance with the *Code's* provisions and therefore little need for disciplinary proceedings.[122]

The Panel at the outset had to face certain problems in formulating the role it should perform in guaranteeing compliance with the *Code's* provisions. Basically the question posed was whether or not it should, on its own initiative,interfere in the course of a bid where it suspected non-observance of the Code's provisions, or whether it should "confine itself to enquiry after the event".[123] The Panel, rightly it is submitted, adopted the former approach. Because of the difficulties of unravelling a completed take-over, intervention after a bid has been completed might prove no more than an empty gesture. But this approach is not without its dangers. As the Panel recognised, in a contested bid situation expeditious intervention by the Panel is imperative if the intervention is to be at all effective, but this requirement of speedy intervention could easily result in the uninformed disruption of many take-overs.[124]

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119 An appeal to the Appeals Committee will also lie, with leave of the Panel, where the matter, although not disciplinary, will impose serious hardship on the person affected.

120 *Annual Report of the Panel on Take-over and Mergers,* (London, 1971), at p. 8.

121 At p. 5.

122 The Appeals Committee appears to have met only once in each of the years 1970 and 1971. See: *Annual Report of the Panel on Take-overs and Mergers,* (London, 1970), at p. 4 and 1971.

123 *Annual Report of the Panel on Take-overs and Mergers,* (London, 1969), at p. 4.

124 *Id.*

Particularly is this so as there is no obligation on the parties to a take-over bid to lodge their solicitation material with the Panel for pre-publication screening.[125] The shortcomings of intervention at the early stages of the bid have not, however, materialised in practice due, no doubt, to the fact that the parties, although not obliged to do so, have as a matter of practice consulted the Panel in advance.[126]

The Panel in carrying out its functions has rigorously eschewed any responsibility for advising on the commercial merits of a bid. It is to be doubted, however, if this position has been observed completely in practice or whether it is theoretically compatible with the Panel's responsibility under the *Code.* Thus, for example, the Panel would be intimately involved in assessing the commercial merits of a bid if it is requested under Rule 33 to recommend an "adjudsted price". Also, in the past the Panel in some of its rulings has come close to passing on the commercial merits of a bid. For example, in one ruling[127] the Panel was of the opinion that the market price of securities failed to give a true value of the securities because of the peculiar market conditions prevailing at the time. The above examples indicate that it will not be practical for the Panel to invariably adopt an abstentionist policy on the merits of bids; also, from a policy point of view, it is undesirable for the Panel to disclaim all responsibility for assessing the merits of a bid. On the whole, however, the major responsibility for evaluating the commercial acceptability of a bid must remain with the offeree shareholders.

The hall mark of the Panel's procedure is flexibility and informality. It is to be doubted if these could be duplicated if the work of the Panel were to be transferred to some government department. Government regulation has a tendency to rigidify and become

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[125] Rule 12, *1972 Code.* See, however, the Stock Exchange rules on *The Admission of Securities to Quotation* reproduced in Palmer, *Company Law* (21st ed.), Appendix 3, and 1970, supp. Paragraph 13 of the rules relating to new acquisitions (Palmer, at p. 1353) which provide that "Quoted companies are required to submit to the Department [i.e. the quotations department] drafts of all circulars to be issued by the company to its shareholders. It is recommended that drafts of circulars proposed to be issued to the shareholders of a quoted company by or on behalf of other organisations should also be submitted to the Department for approval".

[126] Consultation was as high as 50 per cent in 1969. See *Annual Report of the Panel Take-overs and Mergers,* (London, 1969), at pp. 7 and 9. See also *Annual Report,* (London, 1970), at p. 5; *Annual Report,* (London, 1971), at p. 6.

[127] *Re Adepton and Williams Ltd.* Panel release, 2nd April 1971. See Prentice, (1972), 35 Mod. L. Rev. 73.

bureaucratic. Also, if the *Code* were to become statutory in form, the broad discretion that resides in the Panel over many matters could not be easily vested in some government department. As against these desirable features the system of self-regulation embodied in the *Code* does possess one major shortcoming (more than amply demonstrated by the early history of the Code) and that is the difficulty of making the Panel's decisions felt — the problem of sanctions. The relative inability of the Panel, during the initial stages of the *Code's* existence, to discipline those who violated the *Code* was seen as the *Code's* Achilles heel and because of this many were cynical as to the viability of the whole system of self-regulation.[128] Since the introduction of the *1969 Code* there has been absolute compliance with the Panel's rulings due, in a large measure, to a realization that if self-regulation fails then the government will be forced to take a hand. The Panel has also taken pains to publicise the full range of sanctions at its disposal.[129] These are, a) disciplinary action by the professional organisations to which the participants in a take-over bid belong to. This would embrace most, if not all, of the important members of the financial community; b) suspension of the shares of any offending company by the Stock Exchange; c) representations to the Board of Trade to appoint an inspector under section 165 of the *Companies Act, 1948*,[130] to investigate the affairs of any given company or to take action under the *Prevention of Fraud (Investments) Acts, 1958*.[131] Finally Rule 26 of the *Code* requires that the "rights of the offeree shareholders under Rules 21-25 must be specifically incorporated in the offer document". Some of the above disciplinary measures have already been invoked. Dealings in certain shares have been suspended by the Stock Exchange [132] and the Board of Trade have, at the Panel's request, appointed an inspector to investigate the affairs of Pergamon Press, Ltd., and have also initiated two prosecutions [133] under the *Prevention of Fraud (Investments) Acts, 1958*. The effectiveness of the *Code*, however, will depend primarily on its acceptance and observance by the financial community and it is with respect to violations of the *Code* by members of this group that the remedies of the Panel are somewhat lacking. They

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128 See: Gower, *Company Law* (3rd ed.), at pp. 645-646.

129 See: *Policy Statement*, 28th April 1969.

130 *Companies Act, 1948* (Imp.), 11-12 Geo. VI, c. 38.

131 *Prevention of Fraud (Investments) Act, 1958* (Imp.), 6-7 Eliz. II, c. 45.

132 See, e.g., Panel release, 26th March 1971.

133 *Annual Report of the Panel on Take-overs and Mergers*, (London, 1971), at p. 5.

are either too severe — depriving a person of his livelihood — or somewhat empty — a reprimand. These responses lack the graduation and subtlety of damages or injunctive relief. So far the Panel have been able to do without them but it is in this area that the major shortcomings of the *Code* might be revealed.

Finally some mention must be made of the ongoing supervisory role played by the Panel. It has set up a programme to monitor the eventual success or failure of profit forecasts; [134] it has been active in seeking the assistance of the Stock Exchange in ferreting out any insider trading during the course of take-overs; [135] and lastly, it has assumed responsibility for updating the Code and for issuing periodic practice directions on its interpretation.

X. Conclusion

Many of the provisions of the *Code* would be immediately familiar to any lawyer having a passing acquaintance of the prevailing pattern of statutory regulation of take-over bids. The requirements that the offeree shareholders be treated equally, be relieved of the pressures to make a hasty decision, and lastly, be given sufficient information to make an informed assessment on the merits of a bid, are stereotype provisions in most extant schemes for regulating the conduct of the dramatis personae involved in a take-over bid.[136] There are, however, certain ways in which the *Code* is unique. Reflected in the *Code* is the general policy objective that all shareholders should have an equal opportunity to participate in any offer for shares in their company which carry effective control. This explains the Rules restricting the right to transfer corporate control and imposing obligations on any person who acquires control of a company through market acquisitions. It is this dimension to the regulatory philosophy of the *Code* which is relatively novel.

The other unique feature of the *Code* is the role assigned to the Panel. The weaknesses in the Panel's position have already been adumbrated. But it does possess certain strengths. It is highly questionable whether the traditional administrative-judicial apparatus for enforcing securities legislation will suffice in the context

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[134] *Ibid.*, at p. 6. See also the report on "The Use of Confidential Price — Sensitive Information", *Annual Report*, (London, 1970), at p. 10.

[135] *Ibid.*, at p. 8.

[136] See generally, Aranow and Einhorn, *State Securities Regulation of Tender Offers*, (1971), 46 N.Y.U.L.Rev. 767.

of take-over bids. Arguably, it is too slow to police take-over bids satisfactorily. What is needed is an organ which can expeditiously make an informed decision whether or not to interfere in the course of a bid without, necessarily, any prompting from outside. At the same time the nature of the intervention must be such as not to unduly impede the bid, as it is quite possible that the intervention might be unjustified or the alleged defect might be easily rectified. The Panel, on the whole, appears to fulfill these requirements.