PO-CH/NL/0089

PART B

Part B.

CONFIDENTIAL
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MARKET SENSITIVE, NOT FOR NAO Eyes

Begins: 22/7/87
Ends: 3/3/88

PO -CH /NL/0089
PART B

Chancellor's (Lawson) Papers:

MONOPOLIES AND MERGERS COMMISSION REVIEW OF RESTRICTIVE TRADE PRACTICES

Disposal Directions: 25 Years

31/7/95

PO -CH /NL/0089
PART B

BACKGROUND

b.f. 15

PARKER TO WALKER 22/7

CHIEF SECRETARY
22 JUL 1987
Mr Nolan
CX Mr Butler
Mr Monck Mr Burgner
Mr Moore Mrs Pearson
Mrs Brown Mr AM White

Foreign and Commonwealth Office

London SW1A 2AH

22 July 1987

Mr Tarkowski Mr Tyrie

Dear Timothy,

Review of Mergers and Restrictive Trade Practices Policy

As I mentioned to you, the Foreign Secretary has seen a copy of the memorandum on this subject which Lord Young submitted to E(A) on 13 July.

Sir Geoffrey Howe agrees with the course of action you propose. However, given the importance of EC competition law in the field of restrictive trade practices, he suggests that the last sentence of the penultimate paragraph of the draft announcement might be amended to read:

> "The review will work up specific proposals for fresh legislation in this area, taking account of EC competition law, and I expect to publish a consultative document early next year."

I am copying this letter to the Private Secretaries to the members of E(A) and Sir Robert Armstrong.

Yours sincerely,

Lyn Parker

(L Parker)
Private Secretary

Timothy Walker Esq
PS/Secretary of State for
Trade and Industry

RC2.32

CONFIDENTIAL

FROM: CATHY RYDING
DATE: 22 July 1987

CR
↓
LOMAX
22 July

MRS LOMAX

cc Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Monck
Mr Board
Mr D Jones
Mr Molan
Miss Wheldon - T.Sol

MIDLAND - CLYDESDALE AND MMC

The Chancellor was grateful for your minute of 21 July.

2. With one exception, the Chancellor is content for the paper to go (to be followed by a meeting as Sir Peter Middleton suggests, based on an annotated agenda). The exception is paragraph 14; which - if it means anything - would be taken to mean that we would not use the reciprocity powers to block a foreign takeover; yet that is what we assured Parliament we would do. The better line is surely the truth: there are always a number of considerations to be taken into account in any takeover, and the reciprocity dimension is one of them. But it is not always the decisive one.

3. The Chancellor also had one minor drafting suggestion on paragraph 7 which he suggests be redrafted as follows

> "The Government's policy on references was made clear during the course of the Banking Bill debates, ..."

CR

CATHY RYDING

ps3/29K

CONFIDENTIAL

cc Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Monck
Mrs Lomax
Mr Scholar
Mr Gray
Mr Neilson
Mr Cropper

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

24 July 1987

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

TAKEOVER PANEL

Thank you for your letter of 13 July.

I share your hope that the Takeover Panel will now be able adequately to regulate the market with the help of the measures which the review identified.

But I remain concerned that we are less well prepared than we ought to be to move fast if the present position becomes untenable or if (perhaps as a result of judicial review) the balance of advantage shifts decisively towards a statutory system. So I welcome your suggestion that we should review the need for work on a statutory system next Spring.

NIGEL LAWSON

4147/021 NH

CONFIDENTIAL

BF for meeting 23 Sept

FROM: P S HALL
DATE: 17 September 1987

1. MR ILETT
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Mr Byatt
Mr Cassell
Mr Monck
Mr Burgner
Mrs Lomax
Mr Hawtin (re: para
Miss Peirson
Mr Scholar
Mr Gray
Mr McIntyre
Mr Cropper
Mr Call
Mr Tyrie

Mr Munro - IR

BRIEF E(A)(87) 32

E(A)(87)32 TAKEOVERS AND MERGERS: PENSION FUND SURPLUSES
Memorandum by the Secretary of State for Social Services

Recommendation

I suggest you agree with the Secretary of State for Social Services that legislative action to impose restrictions on the use of pension funds surpluses would not be justified in the forseeable future.

Background

2. E(A) on Monday are to discuss Mr Moore's note on pension funds and takeovers. The discussion has in effect been postponed since last Spring and the DHSS paper is similar to that which FIM2 and Inland Revenue officials discussed in draft with DHSS officials at the time.

3. You will recall that the attempt in 1986 by Hanson Trust to strip the surplus out of the Courage Pension Scheme gave rise to major concern; there was a discussion at the NEDC meeting chaired

by the Prime Minister; and Professor Thomas of NEDO wrote to you on 24 March enclosing a guidance note for companies which suggested ways of protecting pension funds against predators. Surpluses on winding up can be very large, particularly as final salary schemes include provision for future salary increases but beneficiaries' entitlements at winding up are based on current salaries.

4. Subsequently, officials have broadly concluded that pension fund surpluses are not as vulnerable as is suggested in some quarters:

- recent trust case law - in particular a judgement against Hanson - is encouraging;

- many trustees are already amending trust deeds, eg to make benefits non-discretionary;

- an increasing number of employers have already cut their contributions significantly or are operating contribution holidays; and

- the new Revenue rules should help prevent excessive surpluses in the longer-term.

5. The caveats we place on this are that employers should be wary of:

- incurring liabilities which they cannot afford;

- losing all control over benefit levels; and

- breaching the Takeover Code provisions (Rule 21) (designed to protect shareholders' interests and prevent "poison pill" tactics) by suggesting amendments to pension schemes after a bid is received.

6. In addition, the outcome of a trust law case in circumstances rather different to those of Hanson (eg where the acquiring company

retains the company whose scheme has the surplus - Hanson, of course, sold off Courages) would be more uncertain. This is understandable. In such circumstances there may be little or no difference between, for example, a contribution holiday by the previous or the new owners.

7. If a major case arose in future in which the acquiring company successfully wound up the acquired company's pension scheme and stripped out the surplus the Government would have to consider taking further action. But there should not be a commitment to legislate in such circumstances. Any legislation to protect beneficiaries would be fraught with difficulty:

- it would affect "good" and "bad" alike;

- it would increase burdens on employers and restrict their ability to adjust to changing circumstances within the firm and the pension fund; and

- it could discourage employers from setting up private schemes when it is Government policy to encourage them.

Lines to take

8. **Pension fund surpluses and takeovers:**

- "surplus stripping" by predatory companies is clearly an emotive and politically sensitive issue;

- the Government will wish to be seen to be concerned about the protection of scheme members' pensions;

- however there have been no publicly controversial cases since Hanson;

- the Government can point to action it has already taken in the Revenue rules; and

- as DHSS suggest, the Revenue rules, the outcome of the Hanson

case and measures already open to trustees should be allowed to take their course; ie specific, complex legislation to protect surpluses may not be necessary.

9. **Annex on local authority pension schemes** (Note by DoE): the concern is about politically notivated investment rather than surpluses. You might just note that DoE Ministers are reviewing a possible strengthening of investment policy controls and will no doubt bring forward proposals in due course.

10. **Responsibility for pensions within Government** (not discussed in the paper): if there were time, you might also mention that the present overlapping of responsibilities across many departments is unsatisfactory (eg the personal pension/AVC proposals involved HMT, DHSS, DTI, IR, the Government Actuary's Department and the Lord Chancellor's Department). In the longer term we might aim for a simpler allocation of responsibilities, particularly if we ever move towards purpose built pensions legislation (rather than the confusion of Trust, Social Security, Tax, Financial Services and Company Law which governs pension funds at present).

P S Hall

P S HALL

4147/029 NH

CONFIDENTIAL

FROM: P S HALL
DATE: 18 September 1987

1. MR ILETT
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Byatt
Mr Cassell
Mr Monck
Mr Burgner
Mrs Lomax
Miss Pierson
Mr Scholar
Mr Gray
Mr McIntyre
Mr Cropper
Mr Call
Mr Tyrie
Mr Munro - IR

SUPP BRIEF E(A)(87) 32

E(A)(87)32 TAKEOVERS AND MERGERS: PENSION FUND SURPLUSES

I understand you would like a further note on why legislation to protect beneficiaries would affect companies whose motives were "good" as well as those whose motives were "bad".

2. Over the last few months DHSS officials have been considering whether it would be possible to use legislation to prevent predators "surplus-stripping". However they have not been able to think of an approach which would affect only predatory asset-strippers.

3. For example restricting refunds cf surpluses following takeovers in general would affect agreed as well as contested takeovers, and companies who were not reducing beneficiaries' entitlements as well as those that were. A narrower approach might be to restrict surpluses only in the event of the winding up of the scheme in the taken over company (where we think the worst cases of "surplus-stripping" might occur). But we cannot be sure that winding up the previous scheme is always going to be against beneficiaries' interests. The new employer might offer a replacement scheme which

provided benefits which were as good or better.

4. Alternatively one might try to determine when beneficiaries' interests were being harmed and to forbid this. But again for a number of reasons this would affect "good" employers as well as "bad". Given variations in actuarial practices, there would have to be greater central control of such matters as the valuations (as was necessary when the Finance Act 1986 introduced new rules on surpluses). Beneficiaries might be given a legal right to the surplus, which they do not have at present. Even if specific restrictions were not imposed in primary legislation, but instead it was left to a statutory body to determine when refunds could or could not be made, that body would still have to have rules which set out when refunds could or could not be considered. Compliance with those rules would affect pension funds as a whole.

5. This does not mean that legislation should be ruled out in any circumstances. For instance, if "surplus-stripping" and winding up of schemes by predators became widespread it might be necessary to consider imposing restrictions affecting many or all pension schemes. But recent events have not so far justified this. If eventually there is Government action, it might most appropriately be taken in the context of a comprehensive review and reform of pension fund regulation.

Peter Hall

P S HALL

2184/001

CONFIDENTIAL

BRIEF E(A)(87) 33

FROM: N MONCK

DATE: 18 September 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Byatt
Mr Burgner
Mrs Lomax
Mr P Gray
Mr Ilett
Mr C Fletcher
Mr Wynn Owen
Mr Cropper

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY - E(A)(87)33

Lord Young's paper proposes that he should confirm existing policy on merger references to the MMC, ie that

> "The primary, though not exclusive, criterion should be [a merger's] potential effect on competition taking into account international aspects".

The announcement would be made first in a speech and then in the annexed draft Parliamentary Answer. The paper foreshadows later legislative proposals on mergers (paras 6 and 7) and a Green paper on restrictive trade practices (para 9). It also says that DTI officials will be looking for ways of improving the special provision on newspapers (paras 10-11 of the paper and Annex A to this brief).

2. Confirmation of existing reference policy was agreed at the Prime Minister's meetings on 24 March and 5 May (recorded in Mr Norgrove's letters of those dates). Although the announcement is far from impressive as a record of achievement, this brief recommends you to agree generally but to raise some points on the content of further work in the Review. The line has been agreed with FIM.

The Paper

3. This version of the paper, which we did not see in draft, in some ways differs from the earlier version (E(A)(87)28) which Lord Young circulated in July but which was never discussed. This version:

(a) goes further (in para 6) in dismissing the radical option of unifying the MMC and the Office of Fair Trading. It is no longer proposed to do work on that in the rest of the Review. This reflects DTI Ministers' views; they are satisfied with their progress in shortening the length of MMC references to three or perhaps even two months in straightforward cases at least. Actual achievement so far has not been better than four months but DTI are hopeful;

(b) no longer refers to the definition of the public interest in the Fair Trading Act and powers to control unwelcome foreign takeovers. Nothing is said about further work on this in the Review, despite the assurances that have been given (see Annex C to this brief - top copy only - provided by FIM). As before the statement does not mention these;

(c) no longer refers to leveraged bids. The statement still does not mention these, although it was assumed at the Prime Minister's May meeting that it would do so.

4. DTI Ministers want to wrap up the Mergers Review except for further work on speeding up the MMC and the procedural changes mentioned at the end of para 6. These are minor but useful, especially giving increased scope for negotiations between the parties to mergers and the authorities.

5. The only real gain from the work so far is speeding up the whole reference process. The OFT and MMC together used to take seven months or more. If this can be cut to three or four months the tendency for bids to be stopped in their tracks by a reference alone irrespective of the result should be diminished. These hopes have not yet been achieved in practice and the time taken will still be longer for difficult cases like GEC/Plessey. But if the promise is performed, the concerns about the bias in favour of conglomerates and about competition policy hindering international competitiveness would be weakened.

The Meeting

6. The main issue at the meeting may well be criticism by Mr Rifkind and perhaps Mr Walker of existing reference policy. They may say that there should be more references on grounds of effect on regions, employment or R & D aspects, which would be inconsistent with the Government's decision on Pilkington. Similar concerns are reflected in the CBI Task Force Report which says that references

may be justified by "national defence interests or major regional concerns". Your main concern will presumably be to support Lord Young against such pressures. On that assumption I suggest you do not make the "optional" points set out below at the meeting of E(A), but might make them to Lord Young afterwards.

Line to Take

7. (a) Welcome DTI's success in speeding up MMC. Keep up pressure for achievement;

(b) Support existing reference policy. Must be primarily about competition. If we indicate readiness to refer on other grounds, it will prompt stronger pressures for intervention in market for all sorts of unjustified reasons;

(c) Essential, however, that Review should honour pledges (Annex C) to consider definition of public interest in the legislation and powers to control unwelcome foreign takeovers. Work must be done but no easy solutions;

(d) Look forward to progress on (i) accounting for mergers and (ii) reform of restrictive trade practices' legislation;

Optional Points

(e) Desirable to confirm publicly that highly leveraged bids may be referred (though not normally on those grounds alone). A possible draft addition to the statement covering this and public interest, which we prepared in July but do not now advise you to press, is at Annex B;

(f) Is it right to give up radical idea of combining OFT and MMC before we are sure MMC really will deal with straightforward cases in two months?

N MONCK

SUMMARY

The Task Force found that at the heart of the problem lies a communications and educational gap between companies; their owners and those providing finance. Though many companies have established good links, their example needs to be followed more widely. In West Germany, France and Japan effective communications are facilitated by an industrial structure that is, in effect, controlled by the banks. But this has come at the cost of rigidities which are now being removed, and are causing some stress in these economies.

DIRECTION OF LATER AMENDMENTS

The Task Force believes that the communications challenge here at home can be met by

(i) Companies making more effort themselves to keep the market informed about their longer term strategic intentions and spending on research and development, as well as training and other aspects of innovation in particular. A voluntary approach is far preferable to statutory intervention which will introduce unwarranted inflexibility and legal complexity.

(ii) Financial analysts being better trained in the skills necessary to provide a strategic assessment of a company's prospects, particularly at the more senior level. At present, the quality of analysts can appear very uneven.

(iii) Non-executive directors playing a greater part in company affairs, providing a link between owners and management and a possible channel of communications with firms' professional advisers. Independent non-executive directors should comprise a sizeable minority on all but the smallest public company boards and strengthen then by adding to their range of skills and experience.

[Executive directors normally]

Discussions with

(iv) [Closer terms of reference for] pension fund trustees, [which reflect] their responsibilities as shareholders, in addition to their responsibilities to employees and pensioners for the performance of the fund.

about

(v) Institutional links between the City and Industry being strengthened. [A 'Ginger Group' of major institutions perhaps working through the Bank of England could provide a means of drawing the attention of Chairmen of any major concerns in the City about their companies performance.] In any event, the CBI plans to strengthen its own ability to contribute to and follow up the debate on City and Industry relations.

Delete

Other steps will be required to correct the underlying economic causes of short-term bias. The CBI plans to address many of these issues by setting out its views on "A Strategy for Industrial Competitivenss". The Government also has an important role to play, not least in ensuring tht public sector purchasing is used to promote long run industrial competitiveness.

The Task Force also considered ways in which mergers and acquisitions are regulated and accounted for. It concluded that:

(vi) The Department of Trade's current proposals for the revision of the Takeover Panel were a step in the right direction, but the Task Force felt that the surveillance powers and sanctions available to the Takeover Panel [should] be strengthened further

may need to

(vii) The market and shareholders should be left to decide the outcome of contested bids, except where competitive or national strategic issues are involved, eg national defence interests or major regional concerns. In such cases, the Secretary of State would retain the power to refer a bid, provided detailed reasoning is given. But competition and merger policy must not stand in the way of UK based firms achieving or retaining international competitiveness and a scale of operations appropriate to what is now a global market.

(viii) No attempts should be made to "tilt" the playing field in favour of defendants. All the many proposals to this end considered by the Task Force were found wanting. Nevertheless, a greater transparency of shareholdings is desirable and disclosure should be encouraged.

(ix) Merger and acquisition accounting standards should be tightened, so that bidding companies cannot use merger accounting rules for acquisitions. At present it is possible to inflate earnings and mask the true effect of acquisitions, by what amounts to creative accountancy.

The report of the Task Force will be debated at the CBI Annual Conference in Glasgow in November; and any subsequent recommendations will be reviewed by the CBI's National Council immediately after the Conference Debate. The Task Force itself plans to meet again, early in 1988, to review progress. The issues involved are too pressing to permit any relaxation.

CHAPTER

3 - MERGERS AND THE MARKET

130 The Task Force fully recognises that improvements in communications and management performance are not a sufficient answer to the need to improve City/Industry relations. The evidence cited above notwithstanding, there remain real concerns among CBI members at the power of the market, the uncertainty of long term commitment, and the effective disregard of the other stakeholders in a business when decisions affecting a company's future are being determined.

131 Contested takeover bids arouse particular passions - especially when set in the context of the gradual accretion of financial and management power in London and the South-East and the demise of independent companies based elsewhere that are able to contribute to the local community. It is worth recalling that recent successful urban renewal initiatives in such North American cities as Atlantic City, Baltimore, Cleveland, Philadelphia and Pittsburgh could not have been undertaken if some world class local businesses had not been willing and able to contribute. Many Scotsmen are concerned that their country has become a branch economy; the same sentiment is widespread in the North of England and South Wales in particular.

132 In the USA and the UK merger and acquisition deals worth $180 billion and $25 billion were recorded in 1986. However, whilst acquisitions have historically (on average) added value for shareholders, they are clearly not a prerequisite for industrial success, since contested takeovers are virtually unheard of in West Germany and Japan. The present merger wave, like that of 1968 and 1972, is coinciding with a bull market in shares, rising profits, and the ability of companies to assume more debt to finance acquisitions. It has lasted longer than its predecessors and has now run for approximately three years. It is slightly larger in terms of the real value of acquisitions than in other peak years, but a major characteristic not revealed by bald facts and figures is the bitterness, intensity, commitment and publicity with which many of the takeovers have been pursued, not to mention the increased expense. Of the record number of mergers investigated by the MMC in 1986; only four were approved. Two were refused and six laid aside because of questions of competition and public interest.

133 It has been suggested that one of the factors that has been partly responsible for the recent level of takeover activity is the role of "deal orientated" advisers. As profitability has improved and with a sustained bull market, companies have ample cash, and the facility to borrow large additional sums backed by highly rated paper. Acquisition and subsequent asset disposal or re-structuring often appears to provide much greater short-term benefits than could be achieved by applying cash or borrowing facilities to direct investment in plant equipment or research and development.

134 It is certainly true that in the intensely competitive period in the financial world of the last three years that fees for merger and acquisition activity have played an increasingly important part in the earnings of merchant banks and stockbrokers. In addition, the traditional longstanding partnership between client and merchant banker is changing, partly as a result of the amalgamations following Big Bang and partly because of the readiness of client companies to use a new adviser for a particular deal. This in turn has increased the incentive among corporate finance advisers to generate new business in this way. Many companies known to be interested in growth by acquisition receive either from their retained advisers or from others suggestions for possible takeover targets. One Finance Director was recently quoted as saying that he received up to six freelance unsolicited merger and acquisition proposals in a day.

135 But the charge that the City alone is responsible for high levels of takeover volume cannot stand up. The fact always remains that it is the boards of industrial and commercial companies who have to take the decision to make an acquisition. They have the responsibility for accepting advice and proposals and in due course initiating the bid that may follow them.

136 A related concern is the effect of advancing financial technology and the growing sophistication of the deals used to finance acquisitions. International markets in interest rate swaps and rate caps have made higher gearing and increased debt more acceptable. Highly leveraged deals have dominated the United States takeover scene and such packages could extend, with more frequency, to Europe and particularly to the United Kingdom.

137 The United Kingdom remains probably the most open market in the world. With vast sums of money accumulating worldwide, not just across the Atlantic, there are those whose ability to raise finance in international markets and to stretch financial sophistication to the utmost may be matched by their unwillingness to co-operate with the self-regulatory system for takeovers in the United Kingdom. There are genuine fears that appeals to abide by not only the letter, but also the spirit, of the City Takeover Code are unlikely to cross international boundaries. Pressure on advisers to push rules to the limit will inevitably continue and there will be increasing pressure to use the rules creatively rather than simply to accept the established interpretation.

138 Such concerns, coupled with doubts about whether all takeovers have been based on industrial logic, meant the Task Force could not ignore this issue. They also led some members of the Task Force to consider if changes should be made so that mergers and acquisitions were more difficult to achieve. In the context of mergers and acquisitions, it was important to distinguish between (a) tightening up the conduct of acquisitions to remove abuses, and (b) 'tilting the (acquisitions) playing field' in favour of the bidder or defendant. Specifically, the Task Force concluded that:

(i) The proposals of the Department of Trade and Industry for strengthening the regulation of takeovers should reduce the scope for abuse inherent in the current arrangements.

(ii) The market should be left to decide the outcome of contested bids, except where regional, competition and strategic issues are involved.

(iii) No attempt should be made to "tilt the acquisition playing field" in favour of the bidder or defendant; all the proposals to this end considered by the Task Force were found wanting. Nevertheless, a greater transparency of shareholdings is desirable and disclosure should be encouraged.

(iv) Merger and acquisition accounting standards should be tightened.

STRONGER TAKEOVER REGULATION

139 The Task Force considers that the present system of takeover regulation should be strengthened in an attempt to curb abuses and undesirable practices, but that the basic approach towards takeovers and mergers should remain neutral. Self-regulation is strongly favoured as opposed to statutory control, as it has the advantage of flexibility and allows a quick response to changes in the commercial environment. The Task Force is in favour of the Takeover Panel keeping its non-statutory status, and of its disciplinary measures being backed by the statutory powers of the SIB (though some members feel that more legal backing may have to be introduced in the future).

The Takeover Panel

140 At present many of the procedures relating to takeovers are governed by the Takeover Panel, a non-statutory body made up principally of representatives from The Stock Exchange, investment institutions and clearing banks. The Panel administers and enforces the City Code which is a set of rules governing the ways in which takeovers and mergers are conducted. The Stock Exchange expects that all listed companies involved in takeovers and mergers should adhere to the rules. The Code has as its basis the equal treatment of shareholders. The first general principle states that:

> "All shareholders of the same class of an offeree company must be treated similarly by an offeror".

Another important concept is that an offer to all shareholders must be made before the 30% ownership threshold is passed. The Code does not concern itself with either promoting or deterring takeovers. The Task Force believes that this approach is correct.

141 The Takeover Panel is part of the City's system of voluntary self-regulation. It has no statutory powers. If, following a complaint, a breach of the Code is discovered, the Panel may have recourse to private reprimand, public censure or, in a more flagrant case, to further action designed to deprive the offender temporarily, or permanently, of his ability to enjoy the facilities of the securities markets. Until recently the Panel has been regarded as relatively successful, the most frequent complaint being its over cautious and legalistic style. However in view of the way the rules have recently been stretched its status has come into question. The discussion has centered on whether the Panel should remain an independent body which relies on businessmen playing by the rules or whether it should have statutory backing. However, the issue is not simply whether a statutory system is better than a non-statutory one, as the law has been stretched or flouted recently too; the more pressing question is the effective resourcing and policing of the existing rules and the law.

142 The Task Force considers that the Takeover Panel needs to be made more effective in order to cope with the changing City environment as there now appears to be less respect for non-statutory rules. The lack of effective surveillance of share dealing in the past and also the lack of intermediate sanctions between public censure and de-listing have been particular weaknesses. The proposals put forward by the Department of Trade and Industry (DTI) for the reinforcement of the Takeover Panel in 1987 meet many of our concerns, and because of this the Task Force fully supports them. The measures are aimed at strengthening the regulation of takeovers, and it is intended that there will be improved monitoring and investigative capabilities given to the Panel. These will further add to the arrangements already in existence with The Stock Exchange. These proposals will also make available the sanctions of the Securities and Investment Board and recognised self-regulating organisations, and they will require authorised investment businesses to co-operate with inquiries and investigations carried out by the Panel.

143 The new DTI proposals should be considered in the context of the Financial Services Act as it is this Act which led to the formation of the Securities and Investment Board and the self-regulatory organisations, which feature in the DTI proposals. The Act establishes a framework which includes wide-ranging statutory powers, most of which can be transferred by the Secretary of State to a designated agency, funded by the financial services industry, such as the Securities and Investments Board. The provisions of the Act mean that when it is fully enforced new sanctions will be available. It will be a criminal offence to carry on investment business without authorisation. The penalty for doing so can be a prison sentence of up to two years. It will also be possible to withdraw authorisation from an investment business. Moreover, at the discretion of the courts, contracts made by unauthorised persons may be declared void and their firms thus exposed to financial loss from aggrieved parties. This structure of the new system is such that most businesses will obtain authorisation through recognised self-regulatory organisations such as the SA, FIMBRA, IMRO and LAUTRO (Securities Association, Financial Intermediaries Managers and Brokers Regulatory Association, Investment Management Regulatory Organisation, and Life Assurance and Unit Trust Regulatory Organisation).

144 In supporting the DTI proposals the Task Force is endorsing the continuation of this system of self-regulation. Self-regulation requires the practitioners to consent to the system and in the case of the City Code to adhere to the principles as well as to the detailed rules. However, in a competitive world the City must recognise that the goodwill and confidence of those seeking to raise funds is a perishable commodity. The expectation of high standards of professionalism and business ethics has been the cornerstone of its success in the past.

145 As this report has already shown, companies can use a number of international financial centres to raise funds; London's share of the world market for financial services is already under pressure. The Big Bang and increased competition bring new pressures and greater potential awards and inevitably, some will be tempted to cut corners. But only their colleagues, and just possibly their clients, will know who they are. They must be ruthlessly exposed and dealt with harshly by the City itself, if its financial standing is not to be prejudiced. Both parties need to recognise that they have both a legal and moral responsibility to preserve the spirit as well as the letter of the Code if self-regulation is to survive.

CONCERN FOR THE NATIONAL INTEREST

146 The preceeding discussion on the Takeover Panel has emphasised non-statutory control. The Task Force believes that in relation to the question of takeovers and mergers in general the role of the Government should be to decide on questions of competition and other issues of wider public interest which the financial markets may not take in to account. CBI's policy on merger legislation has recently been submitted as part of the Government's review of competition law and policy. Whatever the Government concludes will have to take account of proposals which have existed for some time in Brussels for pre-merger control by the European Commission where trade between Member States is affected. The fact that the UK is increasingly part of the unified market of Europe can not be absent from any examination of competition policy for the longer term.

147 The Task Force supports the broad thrust of the latest CBI submission and supports the objectives of merger policy developed in it including:

a Competition and merger policy must not stand in the way of UK-based firms achieving or retaining international competitiveness. The need to compete within the global market needs to be given proper consideration.

b The need for greater predictability in merger policy to enable companies to frame business strategies with confidence.

c The need for increased speed in dealing with investigations.

d A system in which detailed reasoning accompanies decisions for or against the referral of a merger bid on grounds of public interest should be introduced.

148 With the wider international spread of production, a growing number of markets are characterised by a high degree of competition from other countries. The existence of a national monopoly of production in one such market is therefore unlikely to exclude competitiveness and may be necessary, in certain cases, if UK firms are to retain international competitiveness. Whilst control is essential in sectors in which there is little international competition, the focus of policy should be on preventing abuse of market dominance or a reduction in competition which is not compensated for by competitive gains.

149 In order to increase the speed of the referral process the Task Force endorses the proposal made by the CBI that a form of opposition procedure should be introduced in UK merger policy. This would seek to expedite the preliminary investigation of mergers. For example, bids notified to the regulatory authorities would be allowed to proceed unless opposed within a fixed period of, say, 30 days. Unless the regulatory authorities made known their intention to investigate, the merger would be allowed to proceed. Similar procedures exist in other countries and would help speed up decisions. Such an opposition procedure should not preclude the continued practice of providing confidential guidance.

150 Experience both here and in other countries suggests it is not possible to codify criteria for reference of bids covering all possible circumstances. There are also cases in which genuine issues of wider public interest arise. The Government should therefore retain discretionary powers to intervene in the public interest. Thus when the OFT/MMC decides against investigation on the narrower test of its impact on competition at home and abroad, the Secretary of State should retain the power to refer a bid on other grounds, provided detailed reasoning is given. Such reasoning would help to ensure that there is an opportunity for open public debate on wider issues of public interest in merger policy decisions.

151 One such issue is the extension of foreign ownership of UK companies. The Bank of England imposes specific restrictions on overseas holdings in UK Clearing Banks in excess of 15%. Following a similar logic, there should perhaps be a similar check to prevent foreign ownership extending too far throughout British Industry, particularly in the case of strategic industries. Under the 1975 Industry Act the Government can block the takeover of a key company. Although this power has to be exercised sparingly because of the UK's international obligations governing reciprocity of access to overseas markets, it is frequently alleged that foreign investment rules and takeover practice in other countries raise similar obstacles for British firms seeking to acquire an overseas company. The task of getting countries to live up to international obligations under the EEC and OECD tends to be a long term one which has to be pursued with determination. In the short-term the Government should be willing to act vigorously when UK companies are under threat of takeover as apart of a concerted strategy and these concerns ought to be registered by the relevant CBI Committees.

"LEVEL PLAYING FIELD"

152 The Task Force believe that takeover bids need to be conducted against the background of a calm and rational stock market. Instead, there is often frenetic activity which was until recently spurred on by advertising companies. Undesirable practices include putting unfair pressure on target shareholders by telephoning them during the period of a bid and activities designed to artificially increase the value of the agressors' shares. There may also be a strong temptation for large shareholders to opt out of their responsbility to rationally decide the future of a company by selling in the market during the period of a bid.

153 The role of the arbitrageur, who aquires a major stake to "put a company into play", is particularly regretable and has come in for special criticism. The Governor of the Bank of England in a speech to the Yorkshire and Humberside Branch of the CBI last March said in reference to such activity:

> "The aim is to pressurise a company's management into action dedicated solely to a favourable impact on the share price in the short-term, partly or even primarily at the expense of the future. The consequence is often a protracted period of unfocussed uncertainty which inflicts quite unnecessary damage, weakening a company's management and distracting them from longer-term objectives, sapping the morale of its workforce, and making employees feel individually insecure to the point of leaving".

154 The introduction of tax disincentives could perhaps be considered in an effort to make the market calmer around the period of a bid. It might, for example, be made more costly to sell shares when over a certain percentage of the equity has been held for less than one year.

155 Recognising the strength of feeling within industry against hostile takeovers, the Task Force specifically considered four possible means of deterring unwelcome bids:

(i) Imposing additional costs on the unsuccessful bidder

(ii) Restricting dealings in shares during the bid period

(iii) Shortening the bid period

(iv) Making the disclosure of holdings more transparent

In each case practical problems, and the feeling that actively deterring hostile bids would not always be to the benefit of all stakeholders in a company, meant that the Task Force could not support the measures proposed. However, further consideration should be given to ways of improving the transparency of shareholdings through greater disclosure. The arguments are rehearsed below.

Imposing Additional Costs on the Unsuccessful Bidder

156 The costs to the target company of an unsuccessful bid could be imposed upon the bidder in a number of ways. One suggestion was that the offeree's expenses in defending an unsuccessful hostile bid up to a maximum liability of say 1% of the offer value, with a suitable minimum should be paid by the unsuccessful predator. Another, was that a bidder could be required to put on deposit in joint names a sum related to the size of the acquisition to be made which would be forfeited to the target company if a particular level of acceptances were not received.

157 The Task Force concluded, however, that increasing the expected costs of a bid would reduce the likelihood of bids, and this would not be in the interest of shareholders. A substantial minority of contested bids fail, and in the event of failure the direct costs to the offeror can be substantial (these costs may be recouped, it is true, in some instances by profits on the disposal of shares in the target company). The apportionment of costs could be particularly onerous if a second bidder became involved. Although some members of the Task Force have sympathy with the aims of the proposal the majority of the members felt that the arguments listed above were decisive.

Restricting Dealing in Shares During the Bid Period

158 Another proposal under debate was that dealings in the shares of both the offeror and offeree could be prohibited during the bid period, except in the case of hostile bids wholly for cash, or in securities with no equity element. - Quotation of both companies could be suspended immediately following the announcement of a bid. To avoid hardship and inconvenience to small investors, dealing could be allowed by or on behalf of individuals in a specific maximum amount at a price fixed for the whole of the bid period, at the levels applicable to offeror and offeree when the bid was made.

159 An important consideration however is that a total or partial ban on share dealings during the period of bid would deny shareholders vital information about how other market participants view it. Indeed, it is possible that the suspension of share dealing could benefit the predator, as the information revealed by the target company in defence would not be reflected in the share price.

160 A related issue is whether advisers should be suspended from dealing in the shares of a company they are councelling, from the date of a bid, as a means of preventing stock price manipulation. Whilst some members of the Task Force agreed with the sentiment of this proposal, practical difficulties exist. In particular, adivsers who have purchased shares and have not been a party to the deal would perhaps be unnecessarily penalised. Also, the fact that the measure would be retrospective could give rise problems of enforcement. Making the disclosure of holdings more transparent would be the most fair and efficient way of ensuring that this type of problem does not arise.

Shortening the Bid Period

161 Shortening the bid period would reduce the distracting effects of hostile bids on the management of the offeree and offeror companies. that a bidder may make a profit on the disposal of the shares of a target company. Although some members of the Task Force have sympathy with the aims of the proposal the majority of the members felt that the arguments listed above were decisive.

162 However, shortening the period of a contested bid could benefit the bidder rather than the target company. Whereas the former can prepare arguments and offer documents, agree tactics and produce advertising material well in advance, target companies are often taken unawares and have to react at short notice and under very considerable pressure. Time is likely to be more valuable, therefore, to the target company than to the bidder.

Making the Disclosure of Holdings more Transparent

163 Most nominee holdings are an administrative convenience for the fund managers concerned and do not involve any further intent. However, there are two sets of circumstances in which boards of directors wish to know the identity of significant shareholders in their companies. First, for the general purpose of communication with shareholders and second, to have warning of a shareholder who may wish to build up a stake in the company in order to launch a bid for it. With this in mind the Task Force considers that the provisions relating to the disclosure of beneficial owners behind nominee holdings should be tightened up in the near future to make it easier for companies to ascertain the ownership of their shares. Moreover, companies should have easier recourse to disenfranchisement of those who refuse to reveal their identity for no good reason. The Task Force recognises that there may be practical difficulties in across the board enforcement of such a policy particularly in relation to bearer shares or ADRs. Under present rules the threshold for revealing the identity of a beneficial ownership is 5%. The Task Force supports the new DTI proposal of a reduced deadline for the disclosure of interests of 5% or more. Consideration might also be given to lowering the threshold further, say to 3%.

164 In relation to takeover bids a special problem area is where parties associated with companies engaged in a takeover battle buy stakes in order to boost the share price. It is important for the operation of the market that such dealings are made transparent and the Task Force supports the Takeover Panel's new requirement that in the course of a bid, dealings by shareholders having 1% or more are disclosed.

TIGHTER MERGER AND ACQUISITION ACCOUNTING

165 Merger and acquisition accounting is of particular interest to the Task Force because the controversy that surrounds this topic relates to the quality of companies' communications with their shareholders. The variety of methods of accounting for mergers and acquisitions makes it possible for two firms of a similar size, undertaking acquisitions in similar circumstances, to report widely differing profit trends depending upon the accounting method used. The variable reporting of profits can mislead inexpert investors who do not fully understand the implications of the method chosen. The picture can be complicated also by the use of writedowns and provisions which can raise profits in

future years. The laissez-faire atmosphere in this area of accounting has often had the effect of disguising to a significant degree the full cost of acquisition. This adds to the risk that some mergers and acquisitions may have taken place for the wrong reasons. Another inadequacy of the present system is that private companies are at a disadvantage because merger relief and merger accounting favour those whose shares are readily marketable.

166 An outline of the main methods of accounting available to businesses undertaking a combination is given in Appendix D together with some of the problems associated with each. Regulation in the area of accounting standards is by Statement of Standard Accounting Practice (SSAP), and is voluntary for companies though binding on their auditors. The Task Force supports this method of regulation as it is able to adapt to changing circumstances quickly and we support the need for a review of merger and acquisition accounting practice by the accountancy bodies. The Accounting Standards Committee will be undertaking such a review later this year.

167 In order that the CBI could put forward recommendations for change on the issue of merger and acquisition accounting, a Consultation Paper was circulated widely in July 1987. The comments expressed as a result will be summarised and form the basis for recommendations which will be sent to appropriate bodies. The recommendations listed below are those of the CBI Working Party on Merger and Acquisition Accounting and not of the Task Force. Nevertheless, they represent a case which needs to be answered in the Task Force's view. Broadly summarised the proposed changes are:

a Most business combinations should be regarded as acquisitions. the consequences of an acquisition never to be passed through the profit and loss account, the method of elimination preferred is amortisation over a realistic useful life through the profit and loss account.

b Acquisition accounting should be applied in respect of all acquisitions.

c Merger accounting, and its associated techniques such as merger relief, should be applied in respect of all true mergers.

d Each technique should be sufficiently well defined to prevent abuses in the way they are applied.

e There should be one specified method of accounting for goodwill. As most of the anomalies and abuses that arise from goodwill result from the elimination against reserves, thereby permitting part of the consequences of an acquisition never to be passed through the profit and loss account. The method of elimination preferred by the CBI Working Group is amortisation over a realistic useful life through the profit and loss account.

168 To implement these changes, the CBI Working Party on Merger and Acquisition Accounting believes that SSAP 22 and SSAP 23 should both be withdrawn and replaced as a matter of high priority by a SSAP on mergers and a SSAP on acquisitions, including goodwill and fair values.

169 The SSAP on mergers should define a merger as a combination in which there is no dominant party; and merger accounting should be the required method of accounting for all mergers. The benefits of the merger relief provisions of the Companies Act should only be available when merger accounting is required. If necessary an amendment to the law should be made.

170 The SSAP on acquisition should define an acquisition as any business combination other than a merger; and acquisition accounting should be the required method for all acquisitions. The SSAP should require goodwill to be written off through the profit and loss account over its useful life.

THE FUTURE OF REGULATION

171 Self-regulation should continue to be the main way in which the City is controlled. The non-statutory status of the Takeover Panel should be retained and its powers of surveillance strengthened. Its ability to enforce a variety of sanctions should also be increased. The Task Force supports the DTI review of the Takeover Panel, but acknowledges that if the strain on the present system continues from those who are not prepared to abide by the spirit and the rules of the City Code, further statutory regulation could not be resisted.

172 In the field of merger and acquisition accounting a number of recommendations have been made. It is hoped that if implemented these would make the financial information presented to potential investors in the market-place a more straight-forward representation of the financial state of companies. The Task Force has not had the opportunity to examine these complex proposals in detail but feels that they merit thorough consideration by means of the CBI's detailed consultations with its members which are now in hand.

ANNEX A

NEWSPAPER MERGER REFERENCES

Under the Fair Trading Act a transfer of a newspaper or of newspaper assets to a newspaper proprietor which would give that proprietor an average daily circulation of 500,000 paid for copies or more is unlawful unless the written consent of the Secretary of State is provided. Before he decides whether to give his consent the Secretary of State must refer the merger to the MMC for investigation unless the newspaper being purchased has a daily circulation of less than 25,000 copies or he is satisfied that it is not economic as a going concern. In the case of the latter exception he must also be satisfied that the urgency of the matter justifies a non-reference. If the acquired newspaper is not intended to continue as a separate publication the Secretary of State must give his consent to the merger.

2. The MMC have a maximum of three months to report on newspaper references with a possible single extension of up to three months and, as with mergers in general, they must report whether the merger is not in the public interest but taking particular account of the need for accurate presentation of news and free expression of opinion.

3. The scope of DTI's review of these powers has not been decided. It could be as narrow as a review of administrative changes, combined with a reduction in the time limit on references. Alternatively, it could consider legislative changes, either focussing on the narrow issue, highlighted in the 'Today' case, of whether the power to consent to a merger without a MMC report in urgent cases should remain in its present form, or going wider and examining the case for retaining a special provision for newspapers or conversely the case for extending the provision to cover other parts of the media.

CONFIDENTIAL

ANNEX B

SUGGESTED AMENDMENTS TO STATEMENT (JULY DRAFT)

Insert after present para 3

As the House knows, the review will also consider whether the existing public interest criteria in the fair trading legislation needs amendment. But I repeat the assurance I gave in another place that it will not be weakened.

Insert before present para 4

I should also tell the House that following the MMC report on Elders IXL's bid for Allied Lyons the Government have examined whether any changes are needed in policy towards highly leveraged bids (ie takeovers which involve heavy borrowing). The Government is satisfied that there is no case at present for further new powers or other changes. I would not normally regard high leveraging on its own as a ground for reference. However I will continue to consider referring such bids when I believe that a high degree of leveraging, combined with other features, might pose dangers to the public interest.

23/18

ANNEX C

Mr
Mr
Mr
M. Ward
Mr Jones G

ANNEX C

Rt Hon Paul Channon MP
Secretary of State for
Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

B59
+
B70

19th January 1987

Dear Paul,

BANKING BILL

As you know, I am presently taking the Banking Bill through Committee. At the meeting of the Committee on Thursday 15 January, considerable anxiety was expressed about the nature and extent of the powers of the Monopolies and Mergers Commission and in the review of existing law and policy on mergers which you announced last June. I undertook (Official Report, col 148) to draw the debate to your attention, and accordingly enclose a copy of the official proceedings. As you will see, although amendment no. 69 was narrowly defeated, one Conservative supported it and three abstained.

Yours
Ian

attached.

IAN STEWART

matters of public interest. I also referred to the fact that the Financial Services Act 1986 contained provisions on reciprocity which covered banking as well as other types of financial transaction.

Those are the two main points to emerge from this debate. The hon. Member for Thurrock (Dr. McDonald) mentioned the potential implications of a takeover of a major British bank by a Japanese bank. That is a sensible illustration. The reciprocal financial arrangements between Japan and the United Kingdom—or, indeed, between Japan and many other countries—are not satisfactory in general. That is the background, about which I shall say more in a moment.

On the Monopolies and Mergers Commission and Government competition policy in general, most members of the Committee will be aware that my right hon. Friend the Secretary of State for Trade and Industry announced a review of existing law and policy on mergers in June last year. In a written answer he said:

"The review will investigate both the scope for changes in policy under existing legislation and the desirability of changes in the law."

My hon. Friend the Member for Stafford has already referred to that matter and I know that he has been closely involved in it.

My right hon. Friend also said:

"The Government believe that in general existing competition law has operated effectively and served the economy well. However, mergers policy has attracted attention in recent months, particularly in the light of the present high level of merger activity. In addition, the restrictive trade practices legislation has now been in operation for 30 years, and it has been criticised on a number of grounds, such as its inflexibility and its limited effectiveness in controlling seriously anti-competitive agreements between firms. I therefore believe it would now be right to undertake a review of these areas."—[*Official Report*, 5 June 1986, Vol. 98, c. 615–16.]

The review centres on the provisions of the Fair Trading Act 1973 and the Government's policy on how they should be applied. The proposed takeover of a major British bank would almost certainly qualify for reference by the Secretary of State to the Monopolies Commission. It is almost inconceivable that the proposed takeover of one of the high street banks would not trigger such a reference. In practice, that is bound to be the case.

The present statutory obligation of the commission is to consider whether the proposed merger qualifying for investigation under those terms may be expected to operate against the public interest. Clearly the public interest includes both the domestic and the international public interest. The national interest, as well as other domestic questions, must be considered. The commission is bound to take into account all matters appearing to be relevant.

In the case of the Royal Bank of Scotland, it is true that one of the grounds used by the commission, and contained in the report of the Committee of London and Scottish Bankers was that

"the takeover would have damaging effects on career prospects, initiatives and business enterprise in Scotland."

I must say to my hon. Friend the Member for Stafford that factors other than career prospects are involved, even in the quotation from this document. However, that is far from being the end of the story. It gives a wrong impression of what the commission decides. The commission's report said that it took account not only of the adverse effects on Scotland but of the transfer of ultimate control of a significant part of the clearing system outside the United Kingdom which would have the adverse effect of opening up policies of divergence of interest which would not otherwise arise. That, of course, is a divergence of national interest.

12.30 pm

In the only case where that has been tested in practice, the unreformed, unreconstructed mergers' provisions have already dealt with the main anxiety expressed by Committee members.

My right hon. Friend the Secretary of State for Trade and Industry has said that he is

"anxious that the review should be open to wide public debate and should benefit from all the expert knowledge available, whether inside or outside Government. I therefore intend to invite a number of outside experts to act as consultants on particular issues. In addition, I invite all interested organisations and individuals to contribute their view in writing, in the first instance no later than the end of July."—[*Official Report*, 5 June 1986, Vol. 98, c. 615–16.]

However, this matter is under active consideration and I propose to draw my right hon. Friend's attention to this morning's debate as it will form an important part of the arguments to be taken into account in the review. Let me remind my hon. Friends that the review is designed to investigate the scope for changes in the policy under the existing legislation and the desirability of changes in the law.

I do not pretend to be an expert on the wider subject of competition policy. However, I impress upon the Committee that the questions of competition policy and the national interest and all other matters which are relevant criteria for the Monopolies and Merger Commission do not apply just to banks. It would be wrong to separate consideration of how national interest powers should apply to banks from consideration of how those powers should work for other types of companies or in other sectors.

I was interested in what the hon. Member for Thurrock said about the position of banking and the implication that in some ways it was a special case. I am not convinced that banking is a special case. Indeed, I am unconvinced that it would be wise to have a separate regime for banking. It would be better to deal with questions of national interest as they become apparent in the corporate sector through a review which already exists and is directed at this question.

If legislation were required, it would come from the Department of Trade and Industry and would cover banks along with any other organisations. As the definition of a bank is changing, along with the nature of other financial organisations, the Committee should be very cautious about considering a separate procedure for one sector.

Mr. Cash: Will my hon. Friend accept that there is already a different regime for banks? In the same way insurance companies are covered by the Insurance Companies Act 1982. In critical and pivotal parts of the

ps3/57T

CONFIDENTIAL AND PERSONAL

BF 23/10

FROM: J M G TAYLOR
DATE: 16 October 1987

MR MONCK

NEWSPAPER TAKEOVERS

The Chancellor had a word with you about this. The law governing newspaper takeovers was clear. But it was less certain what, if anything, could be done to prevent an individual acquiring de facto control of a newspaper by acquiring control over other activities of the group to which the newspaper belonged.

2. He invited you to provide advice. He was content for you to consult discreetly, as necessary, with DTI.

J M G TAYLOR

2183/037

CONFIDENTIAL

FROM: N MONCK

DATE: 16 October 1987

CHANCELLOR OF THE EXCHEQUER

MR MURDOCH, THE FINANCIAL TIMES AND THE FAIR TRADING ACT

You asked about the possibility that Mr Murdoch might be able to get effective control as the (possibly delayed) result of a move which was not itself caught by the special newspaper powers in the Fair Trading Act or by the other powers. As agreed, I have talked to DTI officials about this. The information I got is far from conclusive and not reassuring. It seems clear that, partly because responsibility is split between the OFT and, within the DTI, between the divisions dealing with mergers in general and newspaper mergers, there has been no attempt there to think ahead about the loopholes Mr Murdoch might use and whether there is anyway of closing them. I suggest that you should have a word with Lord Young or, if he is still in China, with Mr Clarke proposing that this work should be done.

2. DTI's latest information, dating from March, is that Mr Murdoch has 14.7 per cent of the Pearson shares. As the attached extract from the latest Pearson Report shows, the FT group is a 100 per cent-owned Pearson subsidiary. It includes FT business information (FTBI) which in turn includes the Investors Chronicle and various American operations.

3. I also attach the special newspaper provisions in the Fair Trading Act. Section 58(1) makes it a crime to transfer a newspaper or newspaper assets to a newspaper proprietor (in a size category which certainly includes Mr Murdoch) unless the Secretary of State has given his consent which may be conditional. Section 57(4) defines a controlling interest as control of one-quarter of the votes.

4. Section 59(3) gives a special expression of the public interest relevant to newspapers, "the need for accurate presentation of news and free expression of opinion".

5. Mr Murdoch's 14.7 per cent shareholding in Pearson is apparently not caught by the newspaper provisions. The OFT is, however, considering whether it amounts to "material influence". This term is used in a definition of a merger that qualifies for reference to the MMC in the general merger provisions of the Act. There is no numerical definition of this but in practice the OFT usually looks

at shareholdings of between 10 and 20 per cent and reaches a view, among other things, on the basis of the number and nature of other shareholders. On the face of it, it does not seem likely that the OFT will decide that the 14.7 per cent amounts to material influence.

6. One possibility which might be open to Mr Murdoch would be to acquire a controlling interest in the Pearson holding company but to sell over 75 per cent of the shares in the FT subidiary. This would not escape the newspaper provisions. In principle, however, if the effect were to give Mr Murdoch effective control of the FT, it ought to be caught under the material influence part of the general mergers provisions. The trouble in practice might be that the extent of the effective control would be hard to demonstrate and the OFT's recommendation on the questions whether this amounted to a qualifying reference and whether it should be referred would therefore be uncertain.

7. Another possible obstacle to Mr Murdoch would be to make a monopoly reference of national newspapers to the MMC. Such references cover the questions whether (a) a monopolies situation exists and (b), if so, whether any action or omission by the monopolist operates or may be expected to operate against public interest.

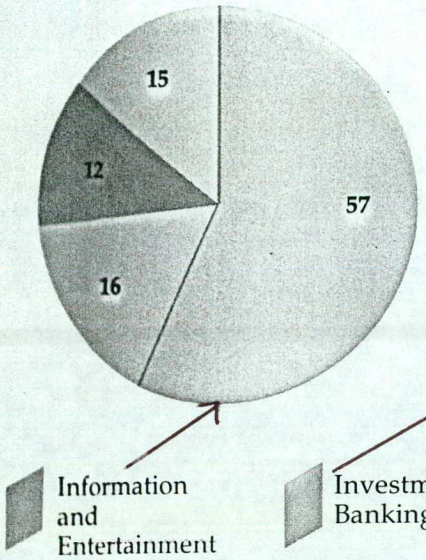
8. DTI think it is unclear whether the MMC would conclude that the present situation or Mr Murdoch's potential behaviour is or may be expected to be against the public interest. They might perhaps conclude that any increase in his share of ownership or control or material influence ought to be referred to them when it occurs. But it is not clear that this would be a more effective barrier than the other powers.

9. This is all based on a combination of telephone conversations with DTI officials and the attached pieces of paper. It is not therefore reliable. But for what it is worth it suggests that your anxieties are justified and that it would be well worthwhile for you to talk to one of the DTI Cabinet Ministers to propose that they commission work on the existence and size of the loopholes or, if they are broadly as I have described them, on the scope for action to block them under existing legislation or, failing that, new legislation.

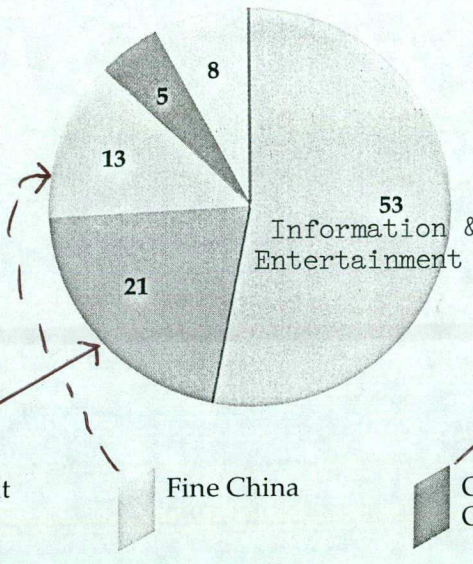
N MONCK

Geographical and Sector Analysis 1986

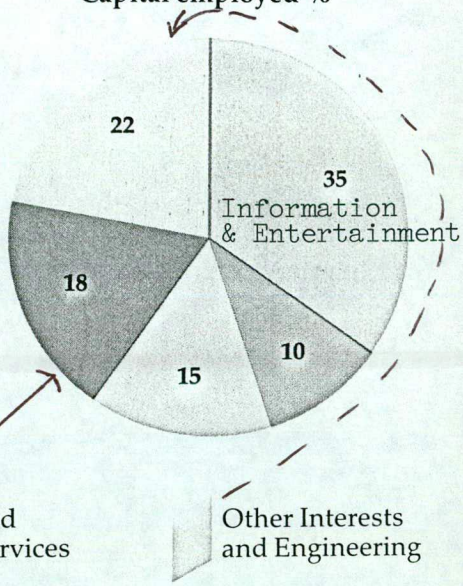
Sales %



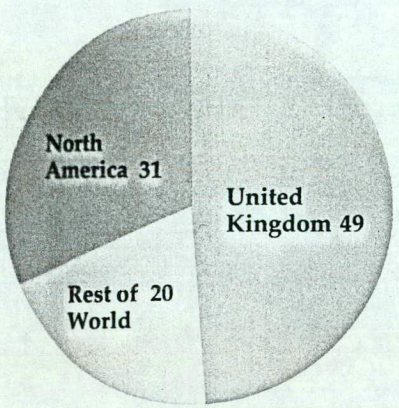
Profit before interest %



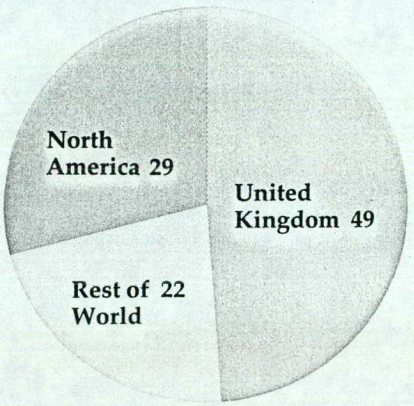
Capital employed %



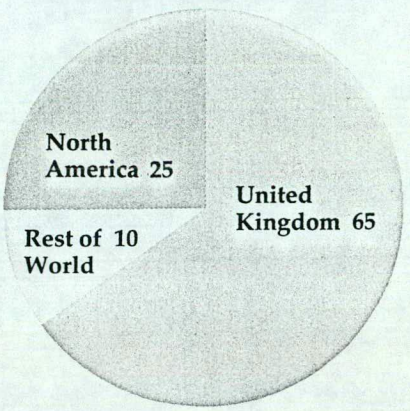
Sales %



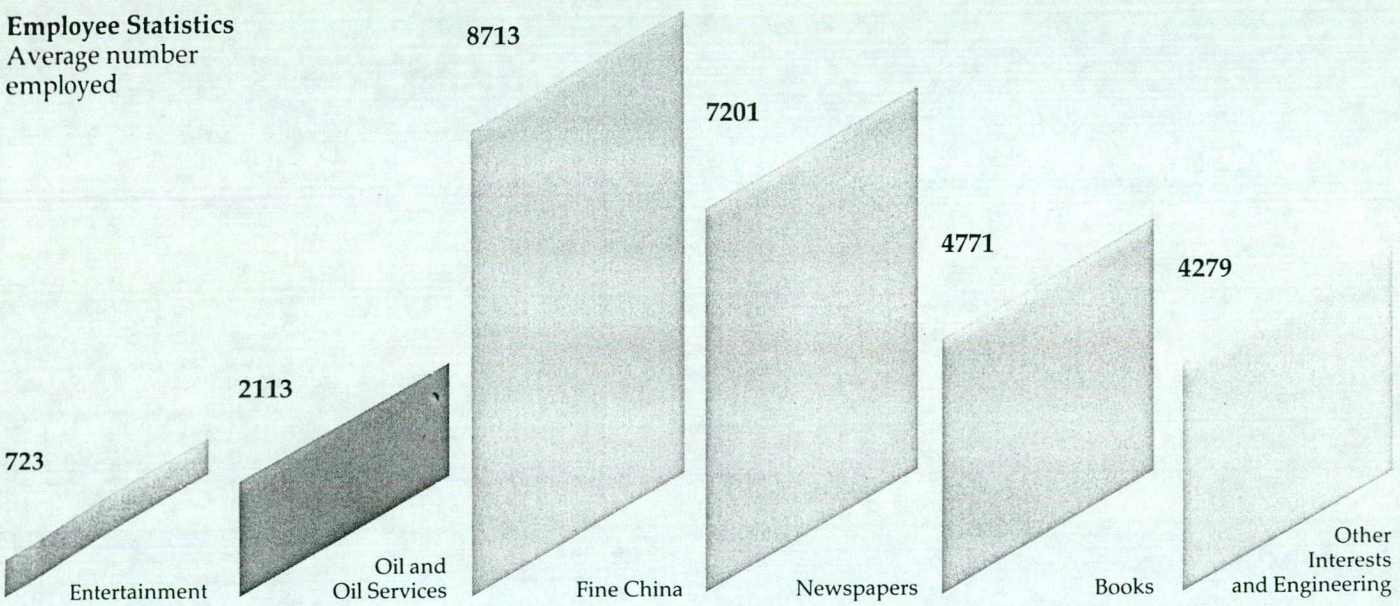
Profit before tax %



Net Assets %



Employee Statistics
Average number employed



Information and Entertainment

This figure of the Duchess of York, wearing the only genuine replica of her wedding dress, was put on show at Madame Tussaud's the day after the wedding. On the left is Michael Herbert, chief executive of Madame Tussaud's and on the right is Lindka Cierach, who designed the dress.

This, the largest of Pearson's four business areas, has three main strands, newspapers, books and entertainment. The flagship of the newspaper businesses is the highly profitable Financial Times, which has the prospect of substantial international growth in the years ahead. Newspaper interests also include a slimmed down group of provincial evening and weekly papers, both paid-for and free. The book companies, enlarged by the acquisition of New American Library, comprise one of the largest such groups based outside the USA. Combined sales of the book companies in 1986 would have been nearly £350 million. The entertainment division combines day-time family entertainment interests, predominantly Madame Tussaud's, with growing interests in other media. Pearson is one of the five partners of BSB, to which the Independent Broadcasting Authority granted the Direct Broadcasting by Satellite franchise in December. Goldcrest, however, is no longer an associated company and negotiations are in progress which, if successfully concluded, will considerably reduce Pearson's stake in the company.

	1986 £m	1985 £m
Sales	**547.1**	486.4
Profit before interest	**70.3**	49.9
Trading margin	**12.8%**	10.3%
Capital employed	**210.0**	192.7
Capital expenditure	**28.6**	22.9

Newspapers

Financial Times
Westminster Press
The Economist

Financial Times

In 1986 the Financial Times group produced its highest ever trading margin. For the third year in succession, the newspaper's circulation, advertisement volume and profit were at record levels.

The circulation gain of 9·2 per cent was achieved despite a cover price increase, the first since 1983. Since the production and distribution of a newspaper is a team effort, the circulation increase reflects great credit on all the staff, but particularly those who create the newspaper – the Editor and his worldwide team.

With so much financial activity in 1986, it would have been surprising if the paper had not carried a record amount of advertising. There were, however, additional reasons to be encouraged by the performance. The *FT* increased its market share and now carries nearly 50 per cent of all display advertising placed in the quality dailies. Two independent research surveys rated the paper's sales force the best in Fleet Street.

The FT's Editor, Geoffrey Owen (RIGHT), with Barry Riley, Financial Editor and Rhys David, Surveys Editor, examining the 48-page City Revolution survey which was included in the paper to mark "Big Bang".

In July a plan for adopting new technology and web-offset printing was announced. On 1 January 1988 the *FT* will become a fully front-ended newspaper. Front-ending means that the journalist's or the advertising department's original typing is captured electronically by a computer eliminating the need for it to be re-keyed by a printer.

In July 1988 the printing and publishing operation of the *FT* will move to London Docklands to a new building, the construction of which has just started. Web-offset presses will be used which will have the capacity to print 56-page newspapers as well as colour. Taking account of the larger and more flexible building now planned and the expenditure already made on the SII front-ending equipment, the total cost of the investment will be nearly £70 million.

Not only will these developments mean that the quality of reproduction will be vastly improved but they will also ensure that the *FT* maintains its competitive edge against other domestic papers and the *Wall Street Journal*.

FT Business Information also produced record results. Turnover rose by a fifth and trading profit increased sharply. A major contributor to this was the *Investors Chronicle*, the circulation of which, at over 51,000, has nearly doubled since 1982 and the growth is continuing. International Reports, the New York based newsletter business, flourished after overcoming post-acquisition difficulties.

In the area of electronic publishing, FTBI is now a substantial business. The on-line text retrieval service launched early in 1986 by McCarthy Information, an FTBI subsidiary, is off to an encouraging start. The on-line

statistical service, Finstat, is now established. The *FT* became available on Lockheed Dialog in the USA in December, and abstracts of both the *Financial Times* and *Investors Chronicle* are now available through Reuters. Most of the world's principal on-line host services now carry the *FT*. During 1987 FTBI is investing further in magazines and electronic publishing.

Westminster Press

Westminster Press made considerable progress in 1986 and trading profit rose by 17 per cent over the previous year.

The company's strategy is to concentrate its effort and investment on paid-for daily and non-suburban weekly newspapers which are market leaders, and to ensure that these are supported by strong free publications. As a result, eight divisions have been sold – Bedford, South Shields, Chertsey, Barrow, Uxbridge, Sidcup, Gravesend and The Hillingdon Press. The company is now composed of 14 separate businesses – 13 newspaper divisions and one general printing division – with 3,900 employees. It is in much better shape.

The 13 newspaper divisions are now publishing and distributing nearly 5 million copies weekly – 9 per cent more than they did in 1985.

Free newspapers were launched in Darlington, Durham and York and the Brighton division launched a free magazine. Other divisions have increased their output of special supplements. New web-offset presses at Bath and Swindon began making regular use of colour.

Modernisation of the group continued, and at Brighton, Bradford and Watford direct inputting of copy is being carried out both by advertisement and editorial staff. A programme for reducing the high production costs at all divisions was started in 1986 and is continuing in 1987. The Westminster Press head office structure was re-organised, reducing costs by over £1 million a year.

Westminster (Florida) Inc., the company's newspaper business in the USA, made good progress. A programme of centralising production and consolidating various duties and responsibilities resulted in a major reduction in costs during the year.

Responding to changing market needs, the trading centre at Naples, Florida, was sold and a number of minor publications that were performing unsatisfactorily were closed. The effect has been a significant improvement in profit.

The Economist (50%)

The worldwide circulation of *The Economist* continues to grow and reached an average weekly sale of over 300,000 – for the first time – in the second half of 1986. The circulation doubled in the 1960s and 1970s and is on course to do so again in the 1980s. However, publishing is ever more competitive and the costs of growth will put pressure on margins.

The Economist group continues to expand its business information activities and in July 1986 took over Business International. BI assists internationally minded businessmen and women, wherever they are based, to monitor, understand and anticipate changes in the political, economic and business environment affecting their operations. It does so through the printed and spoken word, via newsletters, roundtables, presentations, and electronic databases. The Economist's intention is to make BI, in time, the premier supplier of international business information, analysis and counselling. Nearly all BI's revenue comes from outside Britain.

At the end of the year, the borrowing powers of the company were increased to facilitate its continuing development.

LEFT
The Westminster Press's Bradford division is now utilising its plant more effectively, having been selected as one of the contract printers for "The Independent".

Frank Barlow, chief executive of the Financial Times group and Westminster Press (LEFT), with Hew Stevenson, deputy chief executive of Westminster Press, in the press room at the Wessex Newspapers division of Westminster Press in Bath.

Subsidiaries, Partnerships and Associated Companies at 31 December 1986

Subsidiary Companies

The principal subsidiaries are listed below, together with the percentage of ordinary share capital held if it is less than 100%. All were incorporated or registered in England, unless otherwise stated, and operate principally in the countries of incorporation or registration.

Information & Entertainment	Longman Holdings Ltd		
	The Penguin Publishing Company Ltd		
	Financial Times Group Ltd		
	Westminster Press Ltd		
	*Madame Tussaud's Ltd		
Fine China	Royal Doulton Ltd		
Oil & Oil Services	Camco, Inc.	USA	65·4%
	Lignum Oil Co.	USA	
	*Whitehall Petroleum Ltd		
Other Interests	Société Civile du Vignoble de Château Latour	France	53·5%
	*West Thurrock Estate		
US holding company	Pearson Inc	USA	

*Direct subsidiaries of Pearson plc.

Partnerships and Associated Companies

The principal partnership interests and associated companies of the group are set out below.

	Company name and issued share capital		*Percentage held*	*Latest accounting year end*
Information & Entertainment	Cedar Fair			
	Interest in partnership net assets	USA	33·4%	31 December 1986
	The Economist Newspaper Ltd			
	5,040,000 equity shares	UK	50%	31 March 1986
	100 trust shares		Nil	
	Longman Nigeria Ltd			
	4,000,000 ordinary shares	Nigeria	40%	31 December 1986
	Yorkshire Television Holdings plc			
	33,059,875 ordinary shares	UK	20·9%	30 September 1986
Investment Banking	The three Lazard Houses principally through an interest in Lazard Partners Limited Partnership (USA) of 50% *and* through direct interests in the three houses giving net beneficial interests of:			
	Lazard Brothers & Co., Ltd			
	Ordinary shares	UK	50%	31 December 1986
	5,000,000 7% participating preference shares		80%	
	Lazard Frères & Co.			
	Interest in partnership profits	USA	9·8%	31 December 1986
	Lazard Frères et Compagnie and Maison Lazard et Compagnie			
	Interest in partnership profits	France	9·9%	31 December 1986
Oil & Oil Services	Compressor Systems Inc.			
	5,358,112 shares of common stock	USA	35·9%	30 September 1986
Other Interests	Blackwell Land Company Inc.			
	237,446 shares of capital stock	USA	37·4%	31 December 1986
	$3,800,000 10% notes 1991		20%	

The figures included in the financial statements are for the year ended 31 December 1986 (except for Yorkshire Television Holdings plc, for which the results are for the year to 30 September 1986) and have been based on audited accounts at the latest accounting year end adjusted where necessary by reference to unaudited management accounts for the subsequent period to 31 December 1986.

specified in the report as mentioned in the preceding subsection; and those powers may be so exercised to such extent and in such manner as the appropriate Minister considers requisite for that purpose.

(3) In determining whether, or to what extent or in what manner, to exercise any of those powers, the appropriate Minister shall take into account any recommendations included in the report of the Commission in pursuance of section 54(3)(*b*) of this Act and any advice given by the Director under section 88 of this Act.

(4) Subject to the next following subsection, in this section "the appropriate Minister" means the Secretary of State.

(5) Where, in any such report as is mentioned in subsection (1) of this section, the person or one of the persons specified as being the person or persons in whose favour the monopoly situation in question exists is a body corporate fulfilling the following conditions, that is to say—

(*a*) that the affairs of the body corporate are managed by its members, and

(*b*) that by virtue of an enactment those members are appointed by a Minister,

then for the purpose of making any order under this section in relation to that body corporate (but not for the purpose of making any such order in relation to any other person) "the appropriate Minister" in this section means the Minister by whom members of that body corporate are appointed.

(6) In relation to any such body corporate as is mentioned in subsection (5) of this section, the powers exercisable by virtue of subsection (2) of this section shall not include the powers specified in Part II of Schedule 8 to this Act.

PART V

MERGERS

Newspaper merger references

57.—(1) In this Part of this Act

Meaning of "newspaper", "transfer of newspaper or of newspaper assets" and related expressions.

(*a*) "newspaper" means a daily, Sunday or local (other than daily or Sunday) newspaper circulating wholly or mainly in the United Kingdom or in a part of the United Kingdom;

(*b*) "newspaper proprietor" includes (in addition to an actual proprietor of a newspaper) any person having a controlling interest in a body corporate which is a newspaper proprietor, and any body corporate in which a newspaper proprietor has a controlling interest;

and any reference to the newspapers of a newspaper proprietor

PART V

includes all newspapers in relation to which he is a newspaper proprietor and, in the case of a body corporate, all newspapers in relation to which a person having a controlling interest in that body corporate is a newspaper proprietor.

(2) In this Part of this Act " transfer of a newspaper or of newspaper assets " means any of the following transactions, that is to say—

(*a*) any transaction (whether involving a transfer or not) by virtue of which a person would become, or would acquire the right to become, a newspaper proprietor in relation to a newspaper;

(*b*) any transfer of assets necessary to the continuation of a newspaper as a separate newspaper (including goodwill or the right to use the name of the newspaper);

(*c*) any transfer of plant or premises used in the publication of a newspaper, other than a transfer made without a view to a change in the ownership or control of the newspaper or to its ceasing publication;

and " the newspaper concerned in the transfer ", in relation to any transaction falling within paragraph (*a*), paragraph (*b*) or paragraph (*c*) of this subsection, means the newspaper in relation to which (as mentioned in that paragraph) the transaction is or is to be effected.

(3) In this Part of this Act " average circulation per day of publication ", in relation to a newspaper, means its average circulation for the appropriate period, ascertained by dividing the number of copies to which its circulation amounts for that period by the number of days on which the newspaper was published during that period (circulation being calculated on the basis of actual sales in the United Kingdom of the newspaper as published on those days); and for the purposes of this subsection " the appropriate period "—

(*a*) in a case in which an application is made for consent under the next following section, means the period of six months ending six weeks before the date of the application, or

(*b*) in a case in which a transfer or purported transfer is made without any such application for consent, means the period of six months ending six weeks before the date of the transfer or purported transfer.

(4) For the purposes of this section a person has a controlling interest in a body corporate if (but only if) he can, directly or indirectly, determine the manner in which one-quarter of the votes which could be cast at a general meeting of the body corporate are to be cast on matters, and in circumstances, not of such a description as to bring into play any special voting rights or restrictions on voting rights.

PART V

Prohibition of certain newspaper mergers.

58.—(1) Subject to the following provisions of this section, a transfer of a newspaper or of newspaper assets to a newspaper proprietor whose newspapers have an average circulation per day of publication amounting, together with that of the newspaper concerned in the transfer, to 500,000 or more copies shall be unlawful and void, unless the transfer is made with written consent given (conditionally or unconditionally) by the Secretary of State.

(2) Except as provided by subsections (3) and (4) of this section and by section 60(3) of this Act, the consent of the Secretary of State under the preceding subsection shall not be given in respect of a transfer until after the Secretary of State has received a report on the matter from the Commission.

(3) Where the Secretary of State is satisfied that the newspaper concerned in the transfer is not economic as a going concern and as a separate newspaper, then—

(*a*) if he is also satisfied that, if the newspaper is to continue as a separate newspaper, the case is one of urgency, he may give his consent to the transfer without requiring a report from the Commission under this section;

(*b*) if he is satisfied that the newspaper is not intended to continue as a separate newspaper, he shall give his consent to the transfer, and shall give it unconditionally, without requiring such a report.

(4) If the Secretary of State is satisfied that the newspaper concerned in the transfer has an average circulation per day of publication of not more than 25,000 copies, he may give his consent to the transfer without requiring a report from the Commission under this section.

(5) The Secretary of State may by order made by statutory instrument provide, subject to any transitional provisions contained in the order, that for any number specified in subsection (1) or subsection (4) of this section (whether as originally enacted or as previously varied by an order under this subsection) there shall be substituted such other number as is specified in the order.

(6) In this section " satisfied " means satisfied by such evidence as the Secretary of State may require.

Newspaper merger reference.

59.—(1) Where an application is made to the Secretary of State for his consent to a transfer of a newspaper or of newspaper assets, the Secretary of State, subject to the next following subsection, shall, within one month after receiving the application, refer the matter to the Commission for investigation and report.

(2) The Secretary of State shall not make a reference to the Commission under the preceding subsection in a case where—

PART V

(*a*) by virtue of subsection (3) of section 58 of this Act he is required to give his consent unconditionally without requiring a report from the Commission under this section, or

(*b*) by virtue of subsection (3) or subsection (4) of that section he has power to give his consent without requiring such a report from the Commission, and determines to exercise that power,

or where the application is expressed to depend on the operation of subsection (3) or subsection (4) of that section.

(3) On a reference made to them under this section (in this Act referred to as a " newspaper merger reference ") the Commission shall report to the Secretary of State whether the transfer in question may be expected to operate against the public interest, taking into account all matters which appear in the circumstances to be relevant and, in particular, the need for accurate presentation of news and free expression of opinion.

Time-limit for report on newspaper merger reference.

60.—(1) A report of the Commission on a newspaper merger reference shall be made before the end of the period of three months beginning with the date of the reference or of such further period (if any) as the Secretary of State may allow for the purpose in accordance with the next following subsection.

(2) The Secretary of State shall not allow any further period for a report on such a reference except on representations made by the Commission and on being satisfied that there are special reasons why the report cannot be made within the original period of three months; and the Secretary of State shall allow only one such further period on any one reference, and no such further period shall be longer than three months.

(3) If on such a reference the Commission have not made their report before the end of the period specified in subsection (1) or of any further period allowed under subsection (2) of this section, the Secretary of State may, without waiting for the report, give his consent to the transfer to which the reference relates.

Report on newspaper merger reference.

61.—(1) In making their report on a newspaper merger reference, the Commission shall include in it definite conclusions on the questions comprised in the reference, together with—

(*a*) such an account of their reasons for those conclusions, and

(*b*) such a survey of the general position with respect to the transfer of a newspaper or of newspaper assets to which the reference relates, and of the developments which have led to that position,

as in their opinion are expedient for facilitating a proper understanding of those questions and of their conclusions.

PART V

(2) Where on such a reference the Commission find that the transfer of a newspaper or of newspaper assets in question might operate against the public interest, the Commission shall consider whether any (and, if so, what) conditions might be attached to any consent to the transfer in order to prevent the transfer from so operating, and may, if they think fit, include in their report recommendations as to such conditions.

Enforcement provisions relating to newspaper mergers.

62.—(1) Any person who is knowingly concerned in, or privy to, a purported transfer of a newspaper or of newspaper assets which is unlawful by virtue of section 58 of this Act shall be guilty of an offence.

(2) Where under that section the consent of the Secretary of State is given to a transfer of a newspaper or of newspaper assets, but is given subject to one or more conditions, any person who is knowingly concerned in, or privy to, a breach of that condition, or of any of those conditions, as the case may be, shall be guilty of an offence.

(3) A person guilty of an offence under this section shall be liable, on conviction on indictment, to imprisonment for a term not exceeding two years or to a fine or to both.

(4) No proceedings for an offence under this section shall be instituted—

(*a*) in England or Wales, except by, or with the consent of, the Director of Public Prosecutions, or

(*b*) in Northern Ireland, except by, or with the consent of, the Director of Public Prosecutions for Northern Ireland.

Other merger references

Mergers references to which ss. 64 to 75 apply.

63.—(1) Sections 64 to 75 of this Act shall have effect in relation to merger references other than newspaper merger references; and accordingly in those sections " merger reference " shall be construed—

(*a*) as not including a reference made under section 59 of this Act, but

(*b*) as including any merger reference relating to a transfer of a newspaper or of newspaper assets, if the reference is made under section 64 or section 75 of this Act in a case falling within section 59(2) of this Act.

(2) In the following provisions of this Part of this Act " enterprise " means the activities, or part of the activities, of a business.

Merger situation qualifying for investigation.

64.—(1) A merger reference may be made to the Commission by the Secretary of State where it appears to him that it is or may be the fact that two or more enterprises (in this section referred to as " the relevant enterprises "), of which one

NEWSPAPER TAKEOVERS

ps3/68T

PERSONAL AND CONFIDENTIAL

Put with Pr3. pr Lord Young dictated 23/10 (25/10)

28/10

FROM: J M G TAYLOR
DATE: 19 October 1987

(Ld Young back m 25/10)

MR MONCK

MR MURDOCH, THE FINANCIAL TIMES AND THE FAIR TRADING ACT

The Chancellor was grateful for your minute of 16 October. He will have a word with Lord Young on his return from China.

J M G TAYLOR

psl/3A

FROM: A C S ALLAN
DATE: 16 November 1987

CHANCELLOR

BILATERAL WITH LORD YOUNG

Four points for you to discuss with Lord Young.

Markets

2. Lord Young clearly felt he needed to leap in, with a pretty bullish minute about the City's performance.

Chairmanship of the SIB

3. I think the Governor saw Goodison last week. I shall get a debrief for you tomorrow (John Footman was away today).

Newspaper takeovers

4. How to stop Mr Murdoch getting control of the Financial Times.

MISC 133: Deregulation and tax

5. The importance of getting tax off the agenda for MISC 133.

ACSA

A C S ALLAN

CABINET OFFICE

With the compliments of

G. W. MONGER

To be attached with
Brig's send 20/1/88
for E(NI) meeting
today

70 Whitehall, London SW1A 2AS
Telephone 01 ~~233~~ 270-0156

CONFIDENTIAL

NOT FOR NAO EYES

MINISTER
FOR PUBLIC TRANSPORT

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB
01-212 3434

My ref M/PSO/15081/87

Your ref

cc- M. Wilson
M. Monger

Lord Young of Graffham
Secretary of State for Trade
and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

23 DEC 1987

Dr Crawley o/r
Cos 30/12.

Dear David,

LONDON UNDERGROUND: MMC REFERENCE UNDER SECTION 11 OF THE COMPETITION ACT 1980

Thank you for your letter of 11 December agreeing that the London Underground section 11 inquiry scheduled for January should be deferred until the middle of 1988.

You suggest that a reference of BR's Provincial sector should be made early in 1988, to take LUL's vacated slot. This raises issues of timing and substance.

On timing, a reference in February or March, as you contemplate, would give BR management (and MMC themselves) very little time to prepare, and would come at a time when the Board has not yet completed its response to the Commission's report on the NSE re-reference. I think that industries can reasonably expect to be given more than a few weeks' notice of a major reference, and that we are much more likely to obtain a useful report if both BR and the MMC are given adequate time to prepare. I do not therefore consider that a reference of Provincial would be practicable until at least the second quarter of 1988, if not later.

On substance, my officials have already indicated to yours that, in principle, Paul Channon and I would be prepared to contemplate the inclusion of BR Provincial in the 1988 programme of references, provided colleagues appreciate the considerable political and presentational risks that would be involved. The MMC will certainly be critical of the large losses incurred by the sector, and of the lack of progress on bus substitution; they may well raise awkward questions about the justification for Government subsidy, as they did in their report on the NSE re-reference, and as exemplified in recent cases; and an announcement of a reference

might be seen by our opponents as an attack on the size of the network particularly in Scotland and Wales. However, provided colleagues recognise and accept these risks, I see no overriding difficulties in announcing our intention to refer BR Provincial during 1988. So I do not think it would be prudent to commit ourselves to a reference of Provincial until colleagues have had an opportunity to consider the political and other implications of involving the MMC in a scrutiny which will inevitably extend to Government policy; and there has been some collective consideration of the 1988 programme of references. I gather that so far Provincial is the only potential candidate for 1988.

I am sending copies of this letter to the Prime Minister, E(NI) colleagues, Peter Walker, and to Sir Robert Armstrong.

Yours ever

David

DAVID MITCHELL

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GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switsfwrdd)
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Cysylltwch ag Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switchboard)
01-270 (Direct Line)
From The Secretary of State for Wales

Mr Mellor
Thanks. CD 18/1

The Rt Hon Peter Walker MBE MP

Mr Monger
Yes - confirmed this afternoon. JSM 18

CONFIDENTIAL

cc - Mr Wilson
Mr Monger

12 January 1988

NOT FOR NAO EYES

Mr Nelson
Cc: the Welsh Secretariat at ECNI

David Mitchell copied to me his letter of 23 December, which indicates that you are proposing a reference to the MMC of British Rail's Provincial Sector early this year.

CD 18/1

David, in his letter, referred to the considerable political and presentational risks that would be involved in the announcement of a reference. I strongly endorse his view. I am afraid that the reference itself would be seen in Wales as an attack on the size of the network here and would be likely to provoke a considerable political storm. Given the length of time between the announcement of a reference and the conclusion of a response to it, our opponents would have ample opportunity to mount what could well be an extremely damaging campaign. Indeed, I am sure some of our own supporters would be made extremely uneasy by what they will see as a threat to some very sensitive railway services.

As to the outcome of the reference this could, as David Mitchell suggests, face us with very real difficulties. A high proportion of Welsh passenger rail services fall within the Provincial Sector. During the last decade there has been much progress in providing improved services and reducing operating and maintenance costs. Much of this has been achieved with local authority support, as well as support by Mid Wales Development and the Wales Tourist Board approved by my predecessor. As you probably know our 1987 Manifesto for Wales effectively reaffirmed commitment to the present provincial sector network in the Principality.

I do not think therefore that the opportunity to slot a reference of Provincial Sector into the vacated London Underground place in your programme justifies the political damage which a reference would inflict and I am afraid that I cannot support your proposal.

I am copying this letter to the Prime Minister, E(NI) members and to Sir Robin Butler.

Lord Young of Graffham
Secretary of State for Trade and Industry
1-19 Victoria Street
London SW1H OET

100/G/IEP/1/23

CONFIDENTIAL
MARKET SENSITIVE

From: J MACAUSLAN
Date: 14 January 1988

CHANCELLOR

cc Sir P Middleton
Mr Monck
Mr Burgner
Mr Ilett

BARKER AND DOBSON BID FOR DEE CORPORATION

I will attend a meeting of the Mergers Panel tomorrow morning (Friday) to discuss whether the Barker and Dobson bid for Dee should be referred to the MMC. This note records for your information the main issues.

2. The main immediate issue is the financing. The bid is highly leveraged, with initial capital gearing of about 200%, reducing (through massive asset sales) to 40% a year later. The gearing looks even higher if goodwill is stripped out of shareholders' funds. And there is an unresolved question whether borrowing exceeds the limit set in the loan agreement. The lending banks deny it, and say they would lend anyway. But they have not exposed all the arguments on this; and the Bank thinks this weakens the case for leaving the question to the market.

3. You will remember that after the Allied Lyons/Elders bid, you got agreement that the Secretary of State would not normally regard high leveraging on its own as a ground for reference. This formulation is reflected in the latest draft of the DTI "Brown Paper" on mergers. The principle that bids can be referred on grounds of leveraging alone is therefore assured whatever the outcome in this case.

4. There is no immediate competition issue of any significance. But the assets to be sold include Gateway superstores; if bought by one of the other big names, competition issues could arise.

Such a sale would probably have to be referred. If there were no other buyers, and the sale failed as a result, there would be employment consequences.

5. At the Mergers Panel, MAFF will argue for a reference; the Bank have not yet made up their mind. There are some factual questions to be resolved; I think the issue evenly balanced, and will be guided by the answers to those questions and by the discussion; I do not expect to try to force the decision one way or the other.

JOHN MACAUSLAN

3691/41/sh

CONFIDENTIAL

FROM: T TARKOWSKI
DATE: 20 JANUARY 1988

1. **MRS BROWN**
2. **CHANCELLOR** ✓) **Separate**
   FINANCIAL SECRETARY) **Copies**

cc Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Moore
Mr Odling-Smee
Mr Turnbull
Mr Burgner (brief 1)
Miss Peirson (brief 1)
Mr M Williams (brief 1)
Mr A M White (brief 1)
Mr Bent (brief 2)
Mr Guy
Mrs Diggle (brief 1)
Mr Hood (brief 1)

E(NI) 21 JANUARY: BRIEF

The agenda for E(NI) on 21 January is:

I. References to the Monopolies and Mergers Commission (MMC) in 1988

II. Privatisation of Scottish Transport Group

2. Briefs on each (the latter provided by Mr Guy) are attached.

3. E(NI) may recall that a review of the MMC's nationalised industry work was commissioned some time ago by the then Secretary of State for Trade and Industry. This work is now reaching conclusion and will be put to Ministers by Easter. It does not detract from the need to agree a solid programme now for 1988.

4. E(NI)(88) 2 is a background paper requested by E(NI) in July. DTI have put it forward for information. Any questions that arise can sensibly be covered in the Review.

Tanweer Tarkowski

T TARKOWSKI

BRIEF ON MMC REFS

3691/42/sh

1988 PROGRAMME OF REFERENCES TO THE MONOPOLIES AND MERGERS COMMISSION (MMC)

1. Objectives

Agree on minimum of five references in 1988 likely to lead to significant efficiencies. Already have **London Underground.** Treasury candidates are **British Rail (provincial), Northern Ireland Electricity Service, Thames Water Authority, UK Atomic Energy Authority (UKEA)** and **Civil Avaition Authority.**

2. Line to take

i. **Support** DTI Ministers strongly on importance of strong credible programme of external efficiency scrutinities. PAC criticisms partly justified: tendency to defer scrutiny for short-term reasons.

ii. Already have **London Underground** (agreed by E(NI) last July). Will now be referred later in the year. Need at least four more.

iii. Treasury propose (not strict priority order - all merit reference for differing reasons):

a. **British Rail (provincial network).** Recipient of huge public funds (£500 million). Destined to remain in public sector for at least this Parliament. Will continue to absorb over £400 million in public expenditure well into next decade. Provincial network still never looked at by MMC. Every household will pay about £20 a year in subsidy for lines which most of them will have no interest in.

[Chief Secretary argued strongly for reference in December. DTp conceded the principle but are worried by presentational risks and Peter Walker is strongly against. Mr Clarke will argue strongly for a reference. (See Annex)]

b. **Northern Ireland Electricity Service.** Never referred, despite having a virtual monopoly of energy supply in Northern Ireland. (town gas supply terminates by 1988). Small, high-cost, oil-dependent system. Tariffs pegged to highest in England and Wales through subsidy (£80 million before fall in fuel price, though no subsidy since). Timely before efficiency targets are set to replace 5 year programme which expires in March. Concern over size of capacity margin of 35-40%. Major capital programme in prospect to replace/convert existing power stations. Would be Northern Ireland's first reference (cf Welsh Water last year and Scottish Electricity in 1986).

[Mr King may parade proposals for privately financed lignite fired generation (decisions to be announced early 1988), and previous consultancies (in 1983) as objections. These should be dismissed.]

c. **Thames Water Authority.** Never referred, but a major business (turnover £550 million). Both we and DOE officials have worries about internal management and costs. So far, only 5 out of 10 water authorities have been referred, 3 of which are already overdue for re-reference. Very high costs compared with other WAs (highest operating cost per Km of main, fastest post-1981 increase in sewage treatment costs) despite considerable cost advantages (high population density).

[Mr Ridley will probably object because of impending privatisation. But an early reference would be complete well over a year before the first water sale, which may well not be Thames anyway. The 1985 BAA reference didn't prevent sale in 1987.]

d. **UK Atomic Energy Authority.** Never referred. But we have long-standing worries about management structure and efficiency. Salutary to have outside scrutiny now that major step to trading fund status accomplished. DEn should be pressed, since we are not pushing for

an electricity (England and Wales) or Coal reference in 1988.

[DEn may pray in aid partial management re-organisation in 1987. But we fear this may not have been sufficiently thorough. New Chairman (began April 1987) now well in post so cannot accept honeymoon arguments.]

e. **Civil Aviation Authority.** Last referred 1983. Monopoly supplier of traffic control and other services to airlines. Can pass on costs to its customers so low incentive to efficiency. Small, but still a spender of public money: wrong to turn blind eye to smaller bodies.

3. **Any proposals from other Departments**

Prepared to agree further references (up to say 7 in all counting London Underground) **provided** they do not substitute for major references Treasury proposes.

[Sponsor Ministers must not be allowed to offer minnows as substitutes. But there are occasional genuine volunteers. Smaller references still worthwhile in themselves. Reference can always be shortened from 6 months to 4 for small bodies].

CONFIDENTIAL

ANNEX

BRITISH RAIL (PROVINCIAL SECTOR)

A British Rail (provincial) reference is a major Treasury priority. It is also likely to be the most contentious proposal.

Background

Need Transport candidates for 1988 MMC programme. London Underground reference to be deferred pending Kings Cross enquiry. Want Provincial reference (i) in its own right (ii) to fill gap from Underground deferral. Mr Mitchell has refused to accept without collective discussion. He fears political damage because reference will look like attack on size of Provincial Sector and MMC criticisms may have political dimension. More likely he fears MMC will justifiably criticise large losses, high subsidy and lack of progress in making economies by bus substitution. He is playing for support form Scots and Welsh.

Line to Take

Strongly support early reference into Provincial Sector efficiency.

If believe in having a heavily subsidised provincial rail network (BR project loss of £435 million for Sector in 1988-89), should not be afraid of scrutinising its efficiency. The losses made by Provincial Sector are the major component of public expenditure on BR and will become proportionately even more important when Inter City moves to profit and NSE losses reduce. Cannot sustain position that the Provincial Sector should be immune from efficiency scrutiny. Average subsidy of £3 for every £1 in income expected next year. Need to see whether it gives value for money towards transport policy objectives.

Other Departments

DTI will support case for reference

Welsh will oppose (Mr Walker has written), probably also Scots.

DTp will probably try to avoid early reference by playing to Welsh and Scottish fears that MMC will criticise maintaining Celtic fringes of Provincial Sector.

Supplementary points to make

i. Even if MMC report raises political questions, does not preclude maintenance of status quo on grounds of broader social policy. Could then take credit for supporting Provincial. Least it would illuminate the options for the future; nothing to fear in that;

ii. Manifesto commitment to size of network (if it exists in those terms) is not a reason for ducking scrutiny of efficiency with which it is operated;

iii. Rural networks not only an issue for the communities they serve. If it is right for every household in UK to pay around £20 next year towards grant to subsidise the Provincial Sector, we should not be afraid of having attention drawn to it, and taking credit for policy on it. [If this proves broadly unpopular, suggests some rethink of policy necessary anyway.]

iv. **Settle to Carlisle Line** (if raised) [Since only reasons for keeping it open are for tourism and heritage, only right that cost should be met from tourism/heritage provision. Mr Channon has asked colleagues to find resources. Mr Ridley has made suggestion. Waiting to hear outcome of that exercise.] Do not want to give BR signal that their 'raison-d'etre' is providing concealed cross subsidies for non-transport purposes. Some point must apply to rest of Provincial Sector - aim is to find most efficient way of meeting transport needs, not to maintain railway status quo per se. MMC is supposed to help with that.

MONGER, BRIEF ON E(NI)(88) 1 E(NI)(88) 2

20/1/88.

CONFIDENTIAL

Reference No E 0492

CHANCELLOR OF THE EXCHEQUER

1988 Programme of Nationalised Industry References to the Monopolies and Mergers Commission

(E(NI)(88)1; E(NI)(88)2)

DECISIONS

You will wish the Sub-Committee:-

a. to agree which nationalised industries should be selected for referral to the Monopolies and Mergers Commission (MMC) in the 1988 programme;

b. to agree that this programme be announced as soon as possible;

c. to note the wider range of public sector bodies identified as eligible for referral in E(NI)(88)2; and

d. to agree that the review of the MMC's nationalised industry work commissioned in June 1986 should be submitted to the Sub-Committee by Easter at the latest.

BACKGROUND

2. In 1981 the Government announced its intention of providing the MMC with up to 6 nationalised industry references a year, with each industry being referred once every 4 years. Between 1980 and 1984 references averaged 3 a year; there were 6 in 1985 and 3 in 1986 The 1987 programme was finally settled at the Sub-Committee's last meeting on 22 July (E(NI)(87)2nd Meeting). It comprises Post Office Counters, the Welsh Water Authority, British Coal's investment programme and the London Underground. It was agreed in correspondence in December that the Underground reference would have to be deferred until the summer because, until then, the Underground's management would be occupied by the aftermath of the King's Cross fire.

3. In E(NI)(88)1 the Chancellor of the Duchy recommends a substantial programme of at least 4 references. Mr Mitchell indicated in a letter of 23 December to Lord Young that he would be prepared to include BR Provincial in the 1988 programme, provided there had been collective consideration of the political risks involved. Mr Walker wrote to Lord Young on 12 January to oppose such a reference in view of the presentational risks in Wales (correspondence attached). No further candidates have so far been offered by departments. E(NI)(88)2 provides a complete list of bodies eligible for reference, including a number of smaller bodies not previously identified in this context. This was requested at the last meeting.

4. When the 1986 programme was settled, it was agreed that the Secretary of State for Trade and Industry would review the effectiveness of these MMC scrutinies. DTI officials eventually produced a draft report last month. Treasury officials are about to suggest substantial revisions. A deadline should be set for completion.

ISSUES

5. You will wish to endorse Mr Clarke's proposal for a credible programme of at least 4 substantial references. These references are worthwhile in their own right and are useful in a Parliamentary and PAC context. The Treasury have identified 5 possible candidates. They wish at least 4 to be selected, and if possible all 5. There are also other possible candidates, in particular from the list of bodies now identified as qualifying for a reference.

Possible candidates

6. The candidates the Treasury have identified are:

a. British Rail Provincial. This has already been suggested by Transport. It is a major area, never before reviewed. It is the recipient of huge Government funding, and is precisely the kind of activity for which MMC scrutiny is

designed. No reference of an activity consuming £500 million of public money each year will be without some presentational risks, but the Government has not shied away from such sensitivities in the past (eg: inclusion in the 1987 programme of British Coal). Mr Clarke is expected to support this reference strongly.

b. Northern Ireland Electricity Service. There has never been a Northern Irish reference before (cf: Scottish electricity boards and Welsh water). With withdrawal of town gas, NIES is in a strong monopoly position. Although uncertainty remains over proposals for new generating capacity, this is but one aspect of the business. If Mr King resists because of this, you might wish to suggest that suitable drafting of the terms of reference ought to be capable of overcoming his difficulties. NIES's new chief executive, Tony Hadfield, has now been in post for 2 years. With the fall in the oil price two years ago, NIES has ceased to require a Government subsidy and its business prospects look better than for sometime - so reference should not be particularly unwelcome. Mr King must be expecting that colleagues will propose NIES; he may be prepared to agree.

c. Thames Water Authority. This is a large water authority which has never been referred. Treasury officials believe it has relatively high costs, contrary to the public image Thames Water have worked to create. The reference could be completed by early 1989, well over a year before the first water sale. Thames is now unlikely to be privatised first, in any event. Mr Ridley is not offering any other reference from his department's bodies. He may therefore be prepared to agree (I understand that, for tactical reasons, the Treasury have not given his officials advance notice), given that Thames' Chairman, Roy Watts, has caused such difficulties for Ministers recently.

d. United Kingdom Atomic Energy Authority. This has also escaped reference to date, and is the most appropriate Energy candidate - unless Mr Parkinson wishes to offer an electricity candidate instead, which seems unlikely. The UKAEA receives substantial Government funding (£170 million in 1987/8). Its trading fund will have operated for over two years when the reference would be undertaken, so a scrutiny in 1988 would be well timed to assess whether the Authority is developing a more commercial approach.

e. Civil Aviation Authority. The CAA's supply of navigation and air traffic control services was referred 6 years ago in 1982. A re-reference of these monopoly activities is probably the most appropriate form for the scrutiny. Re-references are intended to form a crucial part of the strategy for MMC scrutinies, and this would be the only one this year. Given the CAA's size it may be sensible to agree a shorter 4 month reference.

Other candidates

7. If there is a need to look for other candidates - either because some of those in paragraph 6 cannot be accepted or to add to them to bring the workload nearer the MMC's capacity of 6 references - the text for discussion might be Annex D of E(NI)(88)2, which lists bodies not yet referred to the MMC. The major bodies in this list do not in fact seem suitable, either because of likely privatistion or because there is a closely related reference, but some of the minor bodies may be worth consideration:

a. The Tote. The Home Secretary agreed last year that the Tote could be referred if necessary, although in 1986 the Prime Minister had been doubtful about a reference, probably because it would be too small. We understand

however that the Home Secretary may shortly propose an efficiency study by outside consultants, as an alternative to early privatisation of the Tote in its present monopoly form.

b. Smaller DTI bodies. Mr Clarke as demandeur might be in a weak position to resist pressure on those.

c. Smaller DOE bodies. At the last meeting it was Mr Ridley who suggested further consideration of bodies other than nationalised industries. He might be responsive to the suggestion that some of the smaller DOE bodies should be referred. One of the possibilities he mentioned, the Ordance Survey, has turned out not to be eligible but the other, the Historic Buildings and Monuments Commission, or English Heritage, does qualify.

d Agricultural Marketing Boards. A reference here might help to promote a new look at the current system of agricultural protection. If the possibility is raised Mr McGregor may say that the Government will need to review the marketing boards as their contracts expire in the next few years. But this need not rule out an MMC review. Indeed an MMC review could help the Government take its decisions.

Next Steps

8. You will probably wish to agree that the detailed terms of each reference should be agreed between the Chancellor of the Duchy, the Financial Secretary, and the relevant departmental Minister. You will also wish to agree that, as soon as the terms of reference are settled, the Chancellor of the Duchy should make an announcement.

9. DTI's review of the effectiveness of the MMC's nationalised industry work needs to be concluded. Further discussion between officials is needed as the next step, so a substantive discussion

is not appropriate at this meeting. You may wish to suggest a deadline of Easter for the submission of this review to the Sub-Committee. The remit dates back as far as June 1986. Some Ministers may suggest that an MMC reference would be inappropriate for some of the newly identified bodies listed in E(NI)(88)2, particularly if they are already subject to efficiency scrutiny in other ways. You may wish to suggest that this be sorted out as part of the review, with the expectation being that one scrutiny body be identified for each organisation listed in E(NI)(88)2.

HANDLING

10. You will wish to invite the Chancellor of the Duchy of Lancaster to introduce his two papers. The Financial Secretary, Treasury will wish to respond, and identify the candidates he has in mind. When the Ministers responsible for potential MMC candidates are asked for their views, they could be asked first whether they wish to suggest any candidates from the list of bodies newly identified to be eligible.

G W MONGER

Cabinet Office
20 January 1988

3693/2/sh

CONFIDENTIAL

MARKET SENSITIVE

FROM: MS P M LEAHY
DATE: 29 JANUARY 1988

Ch/ Content with lines to take? ok

1. MR D J L MOORE
2. CHANCELLOR

I will be going to this meeting with Mr Leahy. 29/1.

cc Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr McAuslan
Mr M L Williams
Mr Wynn-Owen

MERGERS PANEL MEETING ON MONDAY 1 FEBRUARY

The Panel is meeting at 2.30 pm on Monday to discuss BP's bid for Britoil and Hanson Trust's bid for George Armitage and Sons.

BP/Britoil

2. Department of Energy argue against referral of this bid as in their view there would be no adverse competition or public interest consequences arising out of it. Scottish Office have said they would support a reference in the hope that as a result BP would be bound to their commitments to Scotland.

3. We ~~will~~ might be expected to comment on the implications of the Special Share for the Mergers Panel's deliberations. Mr Moore's letter of 26 January to the Secretariat said that we could not at this stage add to your statement on 11 January. It also said that we saw the considerations relating to the Special Share as distinct from the Mergers Panel's remit. The Mergers Panel paper for the meeting says that it is not clear that the relationship between BP and the Special Shareholder and its impact on Britoil is an aspect of the situation which the MMC could usefully investigate. If we were pressed on the implications of the Special Share however we propose to resist expanding on what has already been said publicly.

4. On the general issue of a reference we propose to support the Department of Energy in arguing against a reference to the MMC.

Hanson Trust/George Armitage

5. This proposed merger would have very little impact on competition. No representations have been received against it taking place. On the advice of IAE, we will therefore argue against a reference to the MMC.

Conclusion

6. It would be helpful to have your agreement to these proposed lines to take during the morning of Monday 1 February.

P M LEAHY

006/3293

CONFIDENTIAL

FROM: JILL RUTTER
DATE: 18 February 1988

MR MacAUSLAN

cc:PS/Chancellor
PS/Financial Secretary
Mr Anson
Mr Monck
Mr Burgner
Mr Moore
Mr Turnbull
Mrs Lomax
Mrs Brown
Mr Waller
Mr Guy
Mr Wynn-Owen
Mr Call

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY

Francis Maude came to discuss with the Chief Secretary yesterday evening his proposal for charging bidding companies for the cost of OFT and MMC investigations. He was anxious to add such a proposal to the DTI brown paper but was facing resistance from his officials who had told him that the Treasury were raising difficulties with the proposal.

2 His aim would be to raise more than the present gross expenditure on this work - with the aim of producing a better service.

3 Based on the note you provided the Chief Secretary said he had no objections in principle to what Mr Maude was proposing. But it was important that the detail was sorted out because it did raise issues for PES, estimates and running costs. Officials should examine these questions urgently.

JILL RUTTER
Private Secretary

568/10/SC

CONFIDENTIAL

FROM: M A WALLER

DATE: 19 February 1988

CHIEF SECRETARY

cc. PS/Chancellor
PS/Financial Secretary
Mr Anson
Mr Monck
Mr Burgner
Mr Moore
Mr Turnbull
Mrs Lomax
Mrs Brown
Mr MacAuslan
Mr Deaton
Mr Guy
Mr Wynn Owen
Mr Slaughter
Mr Call

CHARGING COMPANIES FOR OFT AND MMC MERGER INVESTIGATIONS

As requested in Ms Rutter's minute of yesterday we have discussed the question of charging for OFT/MMC merger investigations with DTI officials.

2. On the basis of a very quick examination of DTI's proposals there seem to be no major policy difficulties. What DTI are proposing is to limit the cases subject to a charge to those qualifying mergers which meet the assets test (i.e. in which the target is valued at over £30m) and which involve the acquisition of a controlling interest (i.e. 51% or more).

3. On the charging structure while it would be fairest to charge according to the amount of work involved case by case DTI believe that this would be hopelessly burdensome on OFT and MMC and might also give rise to disputes and even legal challenge. They therefore propose a much simpler system, involving three bands of charges, relating to the size of the assets being acquired. At the moment the bands they propose are £5,000, £7,500 and £10,000. These are calculated to recover the current annual costs of OFT and MMC mergers work (estimated at £1.5m) and a further £0.5m required to finance the improved service proposed in the DTI Brown Paper. But the precise band figures would depend upon analysis of the asset values involved in previous years and the likely effect of the discounts which will be made available for those who pre-notify. Despite some inequities we think this structure is broadly acceptable; you can go along

with it if DTI are prepared to defend it. But DTI Ministers should put the proposal in writing to colleagues in E(A).

4. As far as expenditure classification and control are concerned, GEP advise that any receipts can be treated as negative public expenditure and therefore appropriated in aid. The big question then becomes how the receipts should be apportioned between the Exchequer and OFT/MMC. Mr Maud has made it clear to you that he would only be prepared to institute charging if it results in extra funds being made available for an improved merger control procedure. We understand from DTI officials that by this Mr Maud means that the additional costs that he will incur to institute improved merger control procedures should be met from the receipts rather than being offset by savings elsewhere on the OFT/MMC PES provision. DTI accept that there is no case for OFT/MMC being allowed to keep receipts covering the existing level of spend on merger control activity.

5. At this stage we have no means of knowing whether the additional expenditure/activity costing £0.5m is entirely justified and cost effective. But we know that OFT's PES settlement last year was tight and that they are under considerable pressure in a number of key areas of activity. On balance, therefore, we think you can agree to the principle of the additional costs associated with the Brown Paper proposal being met from charges subject to the overall level of activity in OFT and MMC being reviewed once the new procedures are in place and have a chance to run in, say within 2 years of implementation.

Conclusion and Recommendation

6. A practical and defensible system of charging for mergers work looks to be possible. We think it is justified on policy grounds and represents a welcome, if small, extension of charging arrangements. In order to secure this change we recommend you agree to the additional costs of improved merger control procedures being met out of receipts from charging. I attach a short draft letter for your to send to Mr Maud on these lines.

M A WALLER

CONFIDENTIAL

DRAFT LETTER TO THE HON. FRANCIS MAUDE

CHARGING FOR OFT/MMC INVESTIGATIONS

As agreed at our meeting on Wednesday evening, our officials have examined proposals for charging bidding companies for the cost of OFT and MMC investigations. I understand that, while there are a number of detailed issues still to be resolved, the work carried out so far has revealed no insuperable practical problems. If you and colleagues were content with the detailed proposals, the Treasury would have no objections.

2. We discussed on Wednesday the question of how the receipts from the charges were to be applied. You said that your aim would be to raise more than the present gross expenditure on this work in order to finance the improved merger control procedures outlined in the Brown Paper. I understand that the current level of OFT/MMC merger activity costs some £1.3m but that you would be aiming to levy charges which would raise some £1.8m, the additional £0.5m being allocated to the meet the higher cost of providing a better service. Clearly, I could not agree to the whole of these additional receipts being used to increase the PES provision for OFT and MMC - this would put the funding of these bodies in a much more favourable position than they are at present. On the other hand, I am prepared to allow the £0.5m additional costs of better procedures to be met from receipts so that OFT/MMC are in no worse or better position than they are at present. My agreement is subject to there being a re-examination of the cost effectiveness of the management of OFT/MMC merger activity once the new procedures have had a chance to settle down, say 2 years after implementation. This examination could be carried out in the context of the normal Survey procedures and timetables.

3. On this basis I would be content for you to announce the intention to charge for mergers work in the RTP Brown Paper. As I said on Wednesday, I feel sure that it would be right to put your proposal in writing to colleagues on E(A).

JOHN MAJOR

4314/009

CONFIDENTIAL

FROM: P WYNN OWEN

DATE: 22 February 1988

1. MR BURGNER

2. CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Culpin
Mrs Lomax
Mr Moore
Mr Odling Smee
Mr PeretzMr Turnbull
Mrs Brown
Mr MacAuslan o.r.
Mr Waller
Mr Call

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY

Lord Young minuted the Prime Minister on 16 February with drafts of his Green Paper on Restrictive Trade Practices (RTP) and his Departmental Policy Paper on Mergers policy, seeking clearance for the latter by tomorrow and the former by Thursday. He plans to publish Mergers on Thurday 3 March and RTP on Wednesday 9 March.

2. This minute summarises the two papers and offers a draft letter for you to send with comments.

BACKGROUND

3. The review of mergers and RTP policy began in June 1986 and the Treasury has been on the Steering Group throughout. In September 1987 E(A) agreed the main conclusions on mergers. Last month the main conclusions, on both mergers and RTP, were published in the White Paper "DTI - the Department for Enterprise".

4. The publication dates (3 and 9 March) are deliberately separate, since DTI felt that co-publication would risk mergers gaining more attention, despite the much more radical nature of the RTP changes. You might consider whether publication of RTP six days before the Budget causes you any difficulties. The draft letter attached assumes it does not.

MERGERS

5. DTI see this Departmental Policy Paper as something just short of a White Paper. They are seeking space for the necessary legislative changes in 1988/89, which we support.

6. The main tenets of mergers policy remain unchanged and the few significant alterations should be familiar to you:

(i) Non-mandatory pre-notification - this voluntary procedure should help speed the process, with automatic clearance within four weeks for those who pre-notify. Mergers which are not pre-notified remain liable for reference to the MMC for a period of up to five years, so the incentive to comply is great.

(ii) Statutory undertakings - legislation will permit statutory enforcement of undertakings given by the parties to the DGFT and the Secretary of State, in order to avoid references to the MMC. This greatly enhances the role of the DGFT and should cut the number of references to the MMC.

(iii) Speeding up procedures - a package of measures to speed up the reference procedure, following a consultancy report by Ernst and Whinney. Aim is to reduce whole OFT and MMC procedure to about 4 to 5 months (from around 8). Also proposed to alter without delay (by statutory instrument) the minimum number of MMC commissioners on a case from five to three.

7. Charging - you will be aware that Treasury officials have been pursuing actively with DTI the inclusion of a paragraph in the text suggesting that bidding companies should be charged for the cost of OFT and MMC investigations (Mr Waller's minute of 19 February to the Chief Secretary refers).

separate folder, enclosed

8. Public interest issues other than competition - are dealt with in chapter 2. On **highly-leveraged bids** (paras 2.24 to 2.25), the Secretary of State will not normally regard high leveraging on its own as a ground for reference, but he will continue to consider referring such bids when he believes that a high degree of leveraging, combined with other features of the bid, may pose dangers to the public interest. Similarly on **foreign takeovers** and **reciprocity**, the language in para 2.26 is a helpful clarification of present policy.

9. On newspaper mergers (paras 5.14 to 5.18) the paper is primarily concerned with speeding up the process.

10. On the EC angle the draft paper says little and does nothing to prejudge the OD(E) discussion of the proposed EC Mergers Regulation this Thursday (para 1.10).

RTP

11. This Green Paper marks a radical departure from previous policy and practice. DTI envisage allowing six months for comments. Since they believe some proposals will then need further work they have not currently bid for legislative space for 1988/89.

12. Principles and Practice - the review concluded that the present law is less effective than it should be in tackling seriously-damaging cartels and that the DGFT has ineffective powers to investigate and fine. The proposal is to move away from a legal, **form** based approach, to a new law prohibiting agreements with anti-competitive **effects**. In practice, this will mean a general prohibition (para 4.2), perhaps with "hard-core" anti-competitive agreements and practices identified (para 4.13). **Exemptions** would be allowed for agreements which were on balance beneficial, including provision for both individual and "block" exemptions. The **Competition Authority** would be based on the OFT, although there may need to be changes to its structure and operations - eg the possibility of having a collegiate group at its head is floated (paras 6.18). **Appeals** would be allowed to the RTP Court, though this should fall short of a full rehearsing.

13. Means of enforcement, involving both stronger powers of entry and search, plus the use of fines (up to a maximum of 10 per cent of total turnover), may well receive publicity. Again, appeals will be possible to the RTP Court, which will be able to increase penalties as well as reduce them.

14. Compatibility with EC law is emphasized, but not in such a way as to pre-judge this Thursday's OD(E) discussion on mergers. Article 85 of the Treaty is clearly largely about RTP and the Commission has an established, accepted role and a body of case law. Nothing in this paper suggests an extension of the Commission's powers.

15. Professional Exemption - you might note that para 5.18 and Annex D could cause a considerable splash, by suggesting that the many sectoral and professional exemptions, listed in Annex D, will not automatically be carried across into new legislation, without the merits of each exemption having been established afresh. Relevant Treasury divisions have been alerted to Annex D. The Treasury will have a keen interest in the review of many current exemptions, not least in the financial area. FIM have also warned the Bank of England. You might, for instance, note Nos 19, 27 and 46 in Annex D, which, at first sight, FIM and MG have indicated we may want to preserve. For now, you might simply want to ask Lord Young to

ensure that defensive press briefing makes it clear that the RTP review does not mean that the present systems, under which financial institutions and markets are regulated and the authorities control monetary operations, are to be overturned.

16. There are several small points that might still usefully be changed:

(i) Para 3.12 - presumably "for this task" should be inserted after "lack of resources".

(ii) Para 6.3 - it is not clear why formal, written declarations from the authority will not be published. We see no reason for them not to be.

(iii) Annex E6 - this paragraph should imply that other legislation on the control of restrictive practices will be kept under review in the light of developments.

CONCLUSIONS

17. You might aim to write tomorrow, thereby meeting the deadline on both papers in one letter. You can welcome the broad thrust of both papers. On Mergers you might note that the Chief Secretary is writing on charging. On RTP, you could note that the compatibility with Europe in no way prejudges any decisions on EC Mergers; record the Treasury and Bank of England's interest in the review of many current exemptions; suggest that defensive press briefing makes it clear that financial sector regulation and monetary operations are not facing major changes; and note the small points listed above. You might end by stating that we would expect any additional resource requirements on the OFT or MMC as a result of this review to be found either from the budgets of those bodies, or from the DTI envelope, within which Lord Young now has freedom to manage his resources.

Philip Wynn Owen.

P WYNN OWEN

CONFIDENTIAL

DRAFT LETTER FROM THE CHANCELLOR TO:

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-15 Victoria Street

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY

Many thanks for copying to me your draft papers on Mergers and Restrictive Trade Practices.

2. I welcome the broad thrust of both documents. As the RTP paper rightly says, the promotion of competition is at the root of our economic philosophy. It is therefore absolutely correct not only to improve the speed and efficiency of the mergers review process, but also to act on the RTP front to suppress anti-competitive agreements.

3. On mergers I welcome the discussions currently underway between our departments on charging bidding companies for the cost of OFT and MMC investigations. This seems to me absolutely right. John Major is writing and you will presumably wish to write round to clear this with E(A) colleagues.

4. On RTP, I welcome the move to an effects based system. I note this will bring some further degree of compatibility with EC practice, but that the text has been drafted so as in no way to prejudge our OD(E) discussion of the proposed EC Mergers Regulation this Thursday. I fully support the stronger powers, both of search and fines, envisaged for the DGFT.

5. I would also expect the pro-competitive tenor of paragraph 5.18, with its threat to the numerous professional exemptions listed in Annex D, to arouse considerable interest. It must be right to review this absurdly long list. But

you will need to give further thought to how to conduct the review and in particular how you and sponsor departments will handle the professional lobbying which we must anticipate on this. As you know, the Treasury will have a significant interest in the review of many of these exemptions, not least in the financial area (where the Bank of England will also need to be involved). I will not ask for a specific caveat to be inserted in the Green Paper, as this could lead to accusations of favouritism towards the financial sector. But, we need to make it clear, if asked, that the RTP review does not mean we are proposing major changes in financial sector regulation and the way the authorities conduct monetary operations.

6. I had the following minor points:

(i) Para 3.12 - surely "for this task" should be inserted after "lack of resources". We do not wish generally to enhance the Commission's bureaucracy.

(ii) Para 6.3 - it is not clear to me why formal written declarations should not also be published.

(iii) Annex E6 - we should not rule out amending other relevant legislation. So insert "at this stage" after "intend" in line 1 and add at the end of the para "The legislation will be kept under review in the light of developments".

7. Ongoing discussions about mergers apart (about which John Major is writing separately), these papers contain measures that may create the need for more resources in future years, particularly on RTP work. My presumption, which Treasury officials have already made clear to yours, is that the necessary resources will either have to be found from within the relevant OFT and MMC budgets, or from within your programmes.

8. I am copying this letter to the Prime Minister, E(A) colleagues, the Lord Chancellor, the Secretaries of State for Foreign and Commonwealth Affairs, the Home Department, Health and Social Security, and Education and Science; and to Sir Robin Butler.

[N L]

RJ4.45

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 23 February 1988

MR WYNN OWEN

cc PS/Chief Secretary
Sir P Middleton
Mr Burgner

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY

The Chancellor was grateful for your minute of 22 February. He has written to Lord Young on the lines of the draft.

2. The Chancellor has noted that the DTI envelope, within which Lord Young now has freedom to manage his resources, permits him (inter alia) to spend vast sums on TV advertising!

J M G TAYLOR

CONFIDENTIAL

From: P WYNN OWEN
Date: 2 March 1988

MR R I G ALLEN

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
PS/Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Burgner
Mr Culpin
Mrs Lomax
Mr Moore
Mr Odling-Smee
Mr Peretz
Mr Turnbull
Mrs Brown
Mr MacAuslan
Mr Waller
Mr Call

MERGERS - DEPARTMENTAL POLICY PAPER

You should be aware that DTI will be publishing the attached Departmental Policy Paper on Mergers tomorrow afternoon.

2. A summary of its key provisions was given in my minute to the Chancellor of 22 February (copy attached - top copy only).

3. If you receive any queries, you might say that the Treasury welcomes this paper and was represented on the Steering Group which prepared it. Refer all other questions to DTI.

4. I will circulate the final version of the separate Green Paper on RTP, which is due to be published next Tuesday or Wednesday, as soon as we have it. Again, this is likely to be on the eve of publication.

Philip Wynn Owen.

P WYNN OWEN

Reference.....

CONFIDENTIAL
EMBARGO : 3.30 PM THURSDAY 3 MARCH

TO: Steering Group
Working Group (Mergers)

FROM: CECILY MORGAN
GP4
Room 635
1 Victoria Street
215 5091

2 March 1988

cc PS/Secretary of State
PS/Chancellor of the Duchy.
PS/Mr Maude
PS/Sir Brian Hayes
Mr Hobday IT/1
Mr Lunn CM/2
Miss Stoddart EEP3
Mr Loughead IEP1
Mr Muir I
Mrs Brown C
Mr Willott FS
Mr Cooke OT2
Mr Catto IFA3
Miss Woodbridge Sols
Mr Startup GP4
Mr Bridge VM

REVIEW OF MERGERS POLICY

I enclose an advance copy for each of you and for copy recipients of the mergers policy paper which is to be published on Thursday, 3 March at 3.30 pm. Please note that the contents are confidential until then.

Cecily Morgan

CECILY MORGAN

SLDAAM

CODE 18-77

DRAFT DRAFT DRAFT

88/210

01-215 xxxx

3 March 1988

GOVERNMENT TO CHARGE FOR MERGER CONTROL SAYS FRANCIS MAUDE

Francis Maude, Corporate Affairs Minister, today (3 March) announced the publication of a policy document on merger control.

He said:

"The Government plans to introduce a number of significant changes to procedures at OFT and the MMC which will improve the speed and quality of the mergers control process. And, for the first time the companies involved in takeovers will have to bear the costs of the services provided."

In answer to a Parliamentary Question from

Mr Maude said:

"This paper sets out three major legislative changes aimed at improving the procedures: a new formal, but voluntary, procedure for pre-notifying mergers; a new provision for legally binding undertakings to be given in certain cases without a MMC reference, and a new statutory charge to cover the costs of the improved merger control process.

Pre-notification

"Those who choose to pre-notify a proposed merger will need to submit answers to a standard questionnaire about the transaction and businesses involved. In simple cases, this information will allow a proposed merger to be automatically cleared within four weeks provided it has been publicly announced. In more complex cases, the OFT will need more detailed information and in those cases the parties will be informed tha the right to automatic clearance has lapsed. I would expect companies to see considerable advantages in using this pre-notification system. If a merger is not pre-notified, it will generally take longer than four weeks to decide whether or not a reference to the MMC should be made. Moreover, mergers which are not pre-notified will remain liable to reference to the MMC for a period of up to 5 years firms therefore have much to gain in certainty and speed under the new procedure.

MORE/...

Statutory Undertakings

"Some mergers pose a threat to competition which is obvious even from a cursory examination, but which may nevertheless be capable of being removed by some modification of the merger arrangements. The parties to such mergers are often willing to promise such modifications. At present, however, there is no means by which such undertakings can be given statutory force except by invoking a full MMC investigation.

"Therefore, we propose to introduce new provisions for statutory undertakings to be given to the Secretary of State by the parties, as a possible alternative to a full MMC investigation. These undertakings may cover such possibilities as divestment of some of the assets of the merging enterprises or the post-merger behaviour of the new group. This new provisions will give the Director General of Fair Trading an enhanced role in negotiating modifications to a merger proposal and will provide a quicker and more flexible mechanism for dealing with competition problems in certain cases. The paper goes into the proposal in more detail.

Charging

"All these improvements in speed and quality will involve resource costs at the OFT and MMC. The Government propose to introduce a statutory charge to cover the costs of the merger control process. Details remain to be settled: one possibility is a charge payable by the acquiring company and leviable on mergers where a controlling interest is acquired and where the assets test is satisfied. The charging structure will be kept as simple as possible.

"Apart from these three major changes, the paper suggests a number of other changes in procedure aimed at speeding up and improving the present process such as closer integration between the OFT and MMC. It is the Government's aim that MMC investigations should in most cases last no more than three months.

Newspapers

"Cmnd 278 in January announced that legislation will be introduced to enable the Secretary of State to specify the period within which MMC investigations into newspaper mergers should be completed. The MMC have said that they will complete future enquiries into the general run of newspaper mergers within two months.

MORE/...

"The DTI has also examined its own procedures for handling cases and will issue a guidance note giving details of the procedures and specifying the information required by the Department in considering all applications for consent to a newspaper transfer. Early contact between the Department and parties to transfers will be encouraged and the streamlining of procedures within the MMC and Department will make it more difficult for companies to argue that an MMC inquiry is ruled out by financial urgency."

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the department for Enterprise

MERGERS POLICY

A Department of Trade and Industry Paper on the policy and procedures of merger control

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CONTENTS

CHAPTER I:
INTRODUCTION AND BACKGROUND

1.1 In June 1986 the Government launched a review of certain aspects of UK competition law and policy, including mergers policy and the merger control provisions of the 1973 Fair Trading Act.

1.2 The review has been conducted by an interdepartmental group under the Chairmanship of Mr Hans Liesner, Deputy Secretary and Chief Economic Adviser in the Department of Trade and Industry. The Group drew its membership from senior officials from the Department of Trade and Industry, the Treasury, the Ministry of Agriculture, Fisheries and Food and the Cabinet Office. The Group maintained close liaison with the Office of Fair Trading and the Monopolies and Mergers Commission and consulted other Government Departments as appropriate. It also drew on additional advice and support from outside consultants and experts both in this country and abroad. Submissions were invited from interested organisations and individuals, and were received from those listed at Annex A.

1.3 In October 1987 the Secretary of State announced interim conclusions of the review, covering the main general issues (text at Annex B); and in the White Paper " DTI—the department for Enterprise " (Cm 278), published in January this year, the review's remaining conclusions were announced, including specific proposals for legislative change (the text of the relevant passage is reproduced at Annex C). The purpose of the present paper is to set out more fully the reasoning behind the conclusions already announced on mergers policy and to explain the details of the proposed legislative changes. The Government will shortly be publishing a separate Green Paper on restrictive trade practices policy, the other subject of the review.

BACKGROUND

Recent merger activity

1.4 The period from the beginning of 1984 up to the launch of the review in June 1986 was one of high acquisition and merger activity. The numbers of acquisitions and mergers were not exceptionally high, but there were a few very large acquisitions, and total expenditure by UK industrial and commercial companies in 1986 reached £14·9 billion (see table). In constant price terms this exceeded the peaks of the previous acquisition and merger booms of 1968 and 1972. One other feature of the 1984 to 1986 period was the concentration of acquisition activity in the food, drink and tobacco and distribution industries: expenditure by companies classified to these two sectors accounted for 49 per cent of the total in 1984 and 1985 and 42 per cent in 1986.

1.5 Since the middle of 1986 the acquisition and merger boom has continued but its characteristics have changed. The number of acquisitions has increased sharply to 1,125 in 1987, so that although there were no transactions of over £1 billion, total expenditure amounted to £15·4 billion, slightly higher than

in 1986. In addition, acquisition activity became more widespread in the industrial and commercial company sector, notably in the engineering and paper, printing and publishing industries.

Acquisitions and mergers by industrial and commercial companies within the UK 1964–87

Year	*Number of Companies Acquired*	*Expenditure*	
		Current Prices £*m*	*Constant(1986) Prices** £*bn*
1964	940	505	3·5
1965	1,000	517	3·4
1966	807	500	3·2
1967	763	822	5·1
1968	946	1,946	11·5
1969†	907	935	5·3
1969†	846	1,069	6·1
1970	793	1,122	5·9
1971	884	911	4·4
1972	1,210	2,532	11·4
1973	1,205	1,304	5·4
1974	504	508	1·7
1975	315	291	0·8
1976	353	448	1·1
1977	481	824	1·7
1978	567	1,140	2·2
1979	534	1,656	2·8
1980	469	1,475	2·1
1981	452	1,144	1·5
1982	463	2,206	2·6
1983	447	2,343	2·7
1984	568	5,474	5·9
1985	474	7,090	7·2
1986	696	14,935	14·9
1987	1,125	15,363	14·8

Source: Business Monitor MQ7

As the table heading implies, the data relate to expenditure incurred on acquisitions etc. The completion of such acquisitions often lags well behind the announcements of bids and deals in the financial press. This affects the time profile of the statistics.

*Consideration in current prices deflated by the TFE deflator.

†Based on company accounts up to 1969, and on the financial press and other sources since 1969.

1.6 A notable characteristic of the recent boom is that high expenditure on acquisitions has now been sustained for four years, whereas the 1968 and 1972 booms were much more short-lived. Furthermore, high acquisitions activity has also been experienced in West Germany, Canada, and in particular in the USA.

1.7 In the past, concern has been expressed about the rapid and continuing rise of concentration in UK manufacturing during the post-war period, coupled with the fact that mergers were an important source of increased concentration. The most commonly used measure of concentration is for the individual market or industry. This shows the percentage share of the industry's output accounted for by, say, the five largest enterprises in that industry. Earlier evidence available showed sharp increases in industry

concentration in the 1950s and 1960s. Updating those statistics to 1984, the latest year for which figures are available, shows a remarkable degree of stability in industry concentration since that time (for details see Annex D). Slight increases were evident in the early 1970s, but since the mid-1970s, the tendency has been for industry concentration to decline a little. However, these figures do not allow for the increasing importance of competition from foreign trade. When—admittedly imperfect—adjustments are made to take account of foreign trade, the results point to a steady decline of concentration over the last 15 years. Since statistics are only available to 1984, it is not possible to say what effect, if any, the recent mergers boom has had on levels of industry concentration.

1.8 The high level of merger activity in 1985 and early 1986, and in particular one or two prominent cases, aroused considerable controversy. The Government took the view that, while on the whole mergers policy appeared to be working reasonably effectively, it was right to take note of the criticisms that were being expressed and to carry out a thorough review of the policy. It was also decided to examine the procedures involved in statutory merger controls, in particular to see whether there was scope for shortening the time taken to investigate and reach decisions on individual cases.

The existing legislation

1.9 The key features of the merger control provisions in the Fair Trading Act 1973 are as follows:

(i) Merger control applies to mergers widely defined: not just to public bids for shares but also to transfers of subsidiaries and other enterprises between companies, mergers between private companies, and acquisitions of substantial shareholdings.

(ii) Actual or proposed mergers (including partial shareholdings) qualify for consideration under the Act if they create or enhance a 25 per cent market share or if the value of the assets taken over exceeds £30 million (variable by statutory instrument).

(iii) There is no obligation to notify qualifying mergers to the authorities; but the Director General of Fair Trading (the Director General) has a duty to keep himself informed about mergers which may qualify for investigation, and to advise the Secretary of State on the exercise of his powers under the Act, notably whether to make a reference.

(iv) The decision whether or not to refer a qualifying merger to the Monopolies and Mergers Commission (MMC) for investigation is the Secretary of State's, and the law gives him very wide discretion in the exercise of his power.

(v) When a merger is referred, the MMC are required to investigate and report whether the merger operates or may be expected to operate against the public interest. The MMC are required to take into account "all matters which appear to them in the particular circumstances to be relevant". But the law also specifies a number of matters which the MMC must consider eg the desirability of promoting competition.

(vi) The MMC are *not* asked to consider whether the merger would be positively in the public interest, and there is no obligation on the parties to demonstrate that positive benefits arise from the merger (although in practice the parties often seek to do so).

(vii) Unless the MMC conclude that the merger operates or may be expected to operate against the public interest, there are no powers under the Act to prevent the merger or to impose conditions.

(viii) If the MMC conclude that the merger may be expected to operate against the public interest, the Secretary of State may prohibit the merger, or allow it to proceed subject to conditions. He may also allow the merger to proceed unconditionally despite an adverse MMC finding. But, with one exception, the Secretary of State has always accepted an adverse finding by the MMC.

1.10 Mergers involving coal and steel products covered by the Treaty of Paris are subject to special controls exercised by the European Commission. Moreover, certain other mergers falling within UK legislation may in some circumstances also be subject to challenge by the Commission under Article 86 (abuse of dominant position) or Article 85 (restrictive agreements) of the Treaty of Rome. In addition, a long-standing draft EC Regulation is under discussion, which would provide for a system of Community-level prior control over mergers. The subject of the review reported here has been UK mergers control, operated by the UK national authorities, and has not included the future of EC merger control.

Present policy towards mergers

1.11 Given the law as it stands, the main policy issue is the set of criteria which the Secretary of State should use in deciding whether or not to refer a merger to the MMC. For many years, the policy has been to give prominence to competition as a criterion for reference, though other public interest issues have also featured as grounds for referral. In a statement in July 1984, reaffirmed by subsequent Ministers, the then Secretary of State Mr Tebbit in effect shifted the emphasis somewhat further towards competition. He said that references would be made "primarily", though not exclusively, "on competition grounds". The statement was intended to increase the predictability of reference decisions, by making it clear that reference on grounds other than competition would be less likely than before. The statement also explained that in evaluating the competitive situation, regard would be given to the international context: to the extent of competition in the home market from non-UK sources and to the competitive position of UK companies in overseas markets.

1.12 The scope of the present law is deliberately wide, in order to minimise the risk that mergers raising public interest issues will slip through the net. As a reflection of this, only a small proportion of qualifying mergers, well under 5 per cent on average, get referred to the MMC: in recent years, there have generally been between five and ten references per year, out of an annual total of 200–400 or more qualifying mergers. The overall impact of the present policy is of course greater than this statistic might suggest, because the prospect of being referred, and ultimately blocked, probably deters parties in many cases from proposing mergers which may raise competition issues.

CHAPTER II: MAJOR POLICY ISSUES

Concerns expressed about present policy

2.1 Concern has been expressed about present policy, both before the review began and in evidence submitted to the review, from a number of different, and sometimes mutually opposed, viewpoints.

2.2 Some observers see the recent high level of merger and takeover activity as damaging in itself, primarily on the grounds that it encourages short-term thinking and distracts incumbent managements from their real job of running their companies. Some of those who take this view argue for stricter and more wide-ranging government supervision of mergers, aimed not only at mergers which may threaten competition but at merger activity generally. It has been suggested that the burden of proof should be reversed, so that all mergers—or at least all mergers over a certain size—would have to be shown to be positively in the public interest before they could proceed.

2.3 A related, though less far-reaching, concern about the present approach is that the emphasis on competition as a criterion in merger control operates in favour of diversifying or conglomerate mergers at the expense of horizontal mergers. It has been argued that this inherent "bias" has affected the development of industrial structure in an undesirable manner. The policy conclusion from this line of argument might be that the authorities should be less inclined to block horizontal mergers (which are those most likely to affect competition) and more inclined to block diversifying or conglomerate mergers (which typically do not affect competition).

2.4 The opposite point of view has also been forcefully expressed in evidence to the review, that there is no place for government intervention in the merger process except where competition is threatened. Some of those who take this view have suggested that the law should be amended so that mergers can be prevented only on competition grounds and not on other public interest grounds.

2.5 There have also been criticisms of the way in which existing policy is operated. Many industrialists and industrial organisations have argued that there is too parochial an approach to the assessment of the likely effects of a merger on competition. It is claimed that not enough weight is given to competition from imports or to the possible benefits which may arise from a merger in the form of increased efficiency and hence increased ability on the part of UK firms to compete in overseas markets. It is sometimes suggested that where UK firms need to plan their operations and compete on a global basis, the UK competition authorities, too, should take the global market as the basis for their assessments of the competitive effects of mergers. The policy conclusion of this line of thinking is that more horizontal mergers should be allowed to proceed without an MMC reference.

2.6 Another source of criticism has been the alleged lack of clarity and predictability in reference decisions. Although the commitment to make references mainly on competition grounds gives some guidance, some observers argue that it is difficult to tell how cases are assessed against the competition criterion, and press for published guidelines—possibly along the

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lines of those published by the US Department of Justice—setting out in quantified form a set of rules explaining in what circumstances a merger is likely to be challenged on competition grounds.

2.7 There has also been criticism of current merger control procedures. Particularly before the review began, the long delay faced by proposed mergers which were referred to the MMC was a source of concern. During the course of the review, the MMC have made good progress in cutting the length of time taken in merger investigations. Nevertheless, it can still be argued that in fast-changing markets the delay occasioned by an MMC reference can often be fatal to a proposed merger, even though the MMC may in the end clear it. It is argued that delay can be particularly serious and unfair in cases in which there are rival bids for the same target company, of which one is cleared to proceed without a reference while the other is referred and temporarily blocked.

The rationale for the present policy

2.8 The answer to the main criticisms of present policy lies chiefly in the Government's underlying approach. This is that intervention by public authorities in lawful commercial transactions should be kept to a minimum, since broadly speaking the free commercial decisions of private decision-makers in competitive markets result in the most desirable outcomes for the economy as a whole. Competition in free markets leads to an efficient, productive and flexible economy, which both delivers to consumers the goods and services they require at the lowest possible prices, and forms the only lasting basis for secure employment. In short, competition is good for wealth creation.

2.9 This broad principle applies as much to transactions involving the sale and purchase of productive assets (and shares representing them) as to other commercial transactions. Government should not normally intervene in the market's decisions about the use to which assets should be put, since private decision-makers will usually seek (and usually be best placed to achieve) the most profitable employment for their assets, and in competitive markets this will generally lead to the most efficient use of those assets, for the benefit of both their owners and the economy as a whole.

2.10 It does not follow that the market's decisions are correct in every case. Mistakes can be made in the private as much as in the public sector. The bulk of the evidence (summarised in Annex E) is that the commercial performance of enterprises post-merger has, more often than not, failed to live up to the claims of the acquiring firm at the time of merger. However, it is for investors to assess this evidence and to act on it as they see fit. For its part, the Government believe that the people best placed to make a judgement of commercial prospects are those whose money is at stake; it is not the role of Government or statutory agencies to second-guess commercial judgements. Indeed, they are more likely than private sector decision-makers to make mistaken commercial judgements.

2.11 A particular advantage of avoiding government intervention as much as possible in the market for productive assets is that, as some of the evidence in Annex E suggests, the threat of takeover has a salutary effect on the incumbent managements of public companies. They should be under the discipline of having to demonstrate to their shareholders that they are running the company as efficiently as possible. Any government action which places obstacles in the way of takeovers weakens this discipline. There needs to be a strong case for government intervention to prevent a takeover if this advantage of non-intervention is to be set aside.

2.12 Nonetheless, such cases can arise, typically where there are grounds for believing that the interests of private decision-makers run counter to the public interest. The classic example of this divergence is where a merger confers excessive market power on the new enterprise, so that it offers the prospect of profits to the owners but threatens to damage the public interest, for example, by leading to distortion of the market, reduction in efficiency, and exploitation of the customer. In these circumstances there is a strong case for the public authorities to intervene. This is the rationale for the Government's current policy under which the potential effect on competition is the main consideration in deciding whether to refer a merger to the MMC.

2.13 It would be entirely inconsistent with the Government's general approach described above to intervene more generally against mergers, for example because of worries about alleged "short-termism", regardless of whether they raised specific competition or other public interest issues. It would be still more inconsistent to reverse the burden of proof and to require those proposing a merger to demonstrate that their proposal would be positively in the public interest. This would make takeovers much harder to carry out, and would have a damaging effect on efficiency by weakening the discipline of the market over incumbent company managements. The Government are fully committed to preventing that small number of mergers which are genuinely anticompetitive; but this goal can be, and is, achieved effectively with the existing presumption, and there is no need to reverse it. The vast majority of mergers raise no competition or other objections, and are rightly left free to be decided by the market, without the Government's putting up obstacles in their way.

How is the potential effect on competition assessed?

2.14 Under the Fair Trading Act, there is a two-stage assessment process: first, a preliminary assessment by the Director General of Fair Trading as to whether a merger raises issues which merit a full examination; and second, in cases referred to them, a full examination by the MMC. Many commentators have called for greater clarity in the criteria used in the preliminary assessment, in order to make reference decisions more predictable.

2.15 It is not possible to set out rules of thumb which can be straightforwardly or mechanically applied to all cases: there is an irreducible element of judgement involved in assessing the likely effects of a merger on competition, which cannot be captured in formulae or statistics, and flexibility is essential in dealing with the unique circumstances of each case. However, it is possible to say something in qualitative terms about the assessment.

2.16 The first point to note is that the Government and the UK competition authorities are, naturally, concerned about the effects of a merger on competition in the UK market. It is the exploitation through market power of *UK* customers—whether other UK industries or the final UK consumer—that is the appropriate touchstone for UK merger policy.

2.17 As for the suggestion that the competition authorities are too parochial in their approach and should take a wider European, or indeed global, view of markets, the Government believe the criticism to be based on a misunderstanding. It is not parochial for the UK authorities to be concerned about UK markets as long as, in assessing the UK market situation, full account is taken of competition from imports. (The separate question of UK companies' ability to compete in overseas markets is discussed in para 2.19 below.) The Director General does indeed give full weight to competition from imports, both actual and potential, from EC sources and from elsewhere.

[illegible]

In many markets, particularly for manufactured goods which can be traded easily across national frontiers, a merger may create a single UK supplier with a very high share of the UK market, and yet not pose a serious threat to competition because of the potential for competition from imports. The increased openness of the UK to competition from imports is a major reason why relatively few references to the MMC are necessary.

2.18 In the typical case, the underlying question is whether the merger is likely to confer market power which the new enterprise may be able to exploit at the expense of UK customers. Relevant factors, which will be taken into account in appropriate cases by the Director General in giving his advice and by the Secretary of State in reaching his decision, include:

(i) the market share of the new enterprises created by the merger (but a high market share does *not* necessarily lead to a reference);

(ii) the market shares and competitive strengths of competitors (both domestic and overseas);

(iii) the ease with which new suppliers (domestic or overseas) can enter the market;

(iv) advantages that the new enterprise may have over competitors, eg intellectual property rights, control over the supply of inputs, influence at the distribution/retailing level;

(v) the scope for collusion between the remaining suppliers in the market;

(vi) the availability of substitute products and the extent of competition in the supply of those substitutes;

(vii) the market position of buyers or suppliers in the relevant market, and their likely ability to restrain any attempt by the newly merged enterprise to exert monopoly power.

Some of these factors are clearly unquantifiable and their relative importance will vary from case to case according to the circumstances; but the underlying objective will be to try to determine whether there is a real risk that the new enterprise will acquire a lasting position of excessive market power in the UK as a result of the merger. In cases where a reference is made, the MMC take a similar approach to the assessment of competition issues.

The assessment of offsetting benefits

2.19 Some critics have argued that greater weight should be given to prospective benefits from a merger in deciding whether to make a reference. This is often expressed in terms of giving greater weight to international competitiveness. Arguments about the prospective gains to efficiency, and to international competitiveness, from a merger are certainly considered in appropriate cases. However, in view of the past record of post-merger performance (Annex E), it would not be right for the authorities simply to take on trust the confident claims often put forward by the proposers that benefits will flow from the transaction. For mergers which do appear to pose a significant threat to competition in the UK market, the Government believe it is right that there should be a strong presumption in favour of referral to the MMC. It is then for the MMC to conduct a full examination, to assess both the likely damage to competition and any likely benefits to efficiency, and to reach a balanced overall verdict.

Public interest issues other than competition

2.20 Many of those submitting views to the review have mentioned a range of issues, other than those concerning competition, which they believe would justify intervention by the Government. Some of the issues most commonly

mentioned are the effects on *employment*, on *regional* economic development, and on *research and development* spending by companies; the consequences of *highly leveraged bids;* and *foreign* takeovers (including reciprocity).

2.21 The Government's view is that none of the matters mentioned above is one where the public interest typically diverges from the interests of private sector decision-makers, although it is recognised that in exceptional cases it may do so. Normally, therefore, the decision should be left to the market. It is of course true that the business decisions of private firms may have specific and immediate adverse effects. This applies not only to merger decisions but also to a whole range of business decisions, including investment or closure decisions or decisions on individual major contracts. Where it is necessary, the Government have in place policies to influence private sector decision-making—for example in the choice of business location, or in research and development. However, the Government see no case for intervening on a regular basis directly to prevent private firms from carrying through their business decisions, on the grounds that those plans may have adverse immediate implications for such matters as employment or research and development.

2.22 For example, taking the issue of regional or local employment, mergers may frequently have immediate, and in the short-term adverse, effects on local employment if part of the plan behind the merger is to rationalise or integrate previously independent centres of production. But in a dynamic economy, patterns of production are inevitably subject to constant change, and to seize upon the immediate adverse effects on business decisions—whether related to mergers or more generally—as a reason for preventing them from being carried out would drastically reduce the economy's flexibility and adaptability to change, which is an essential precondition for economic success in a world of rapidly changing markets.

2.23 On the issue of research and development, it is sometimes claimed that a particular target company will maintain a high level of R&D spending if it retains its independence; but if it is taken over, the acquiring company management will cut R&D spending in the interest of short-term profitability, and will neglect the longer-term future both of the company that it has acquired and of the economy as a whole. The possibility cannot be ruled out that the acquiring company management will indeed fail to make a longer-term success of its acquisition. But there is, equally, the possibility that the existing management will make bad decisions, whether on R&D or on other investments. Either way, it is not normally for Government to adjudicate between the R&D plans of rival managements: that is a matter for the shareholders.

2.24 The consequences of highly-leveraged bids have been a source of concern to some commentators, primarily on the grounds that such bids are often mounted on the basis of plans to break up the target company if the bid is successful. In the typical highly-leveraged case, the bidder will usually need to sell off parts of the company he has acquired in order to meet the debt obligations he has incurred in financing the bid. Some observers see such post-merger divestment as inherently destructive, and apply the pejorative label "asset-stripping" to it. On the other hand, others have pointed to the possible benefits of leveraging in subjecting the incumbent managements of even the largest company to the possible threat of takeover and to its associated healthy disciplines, from which they might in practice have been immune without the growth of leveraged financing techniques.

2.25 The Government's view is one of scepticism as to whether there is normally a divergence between the interests of private decision-makers and the public interest where leveraged bids are concerned. Some highly leveraged bids are rejected by shareholders: the market can and does make sensible judgements in rejecting bids where the risks of a high degree of leveraging seem too great. However, where there are profitable opportunities arising from leveraged takeovers followed by break up of the target company, the presumption must be that the profit arises from the assets concerned being put to more efficient and more profitable use than in the original target company, and that this is to the benefit of the economy as a whole. Therefore the Secretary of State will not normally regard high leveraging on its own as a ground for reference. However, he will continue to consider referring such bids when he believes that a high degree of leveraging, combined with other features of the bid, may pose dangers to the public interest.

2.26 As for foreign takeovers of UK companies, the Government's general attitude towards inward investment by foreigners in the UK economy is to welcome it, and broadly speaking this applies to inward investment by way of acquisition of existing UK companies as much as to direct inward investment. UK companies engage in a considerable quantity of overseas investment, including acquisitions of foreign companies, and it is in the interests of the UK economy that there should be as little official interference as possible in this two-way flow. Nevertheless, there are instances in which foreign ownership of a UK company may raise particular concerns, and in such cases the power to make a reference to the MMC is available for use. One consideration that may be relevant in some cases is the extent to which UK companies have reciprocal freedom to acquire companies based in the home country of the prospective acquirer.

2.27 As the preceding paragraphs indicate, the Government recognise that a very small number of exceptional cases may raise a variety of public interest issues, other than competition, which it would be wrong to leave entirely in private hands. It is therefore intended to retain the open-ended public interest criterion in the legislation, and with it the option of making references to the MMC on grounds other than a threat to competition. But this option will continue to be used sparingly: as stated earlier, the Government believe that the threat of takeover is a powerful spur towards efficiency in the management of UK companies. Similarly the MMC, in their assessment of mergers referred to them will continue to make an overall public interest judgement. In practice, in assessing the public interest, it is likely that the main consideration for the MMC will continue to be the likely effect of the merger on competition, as it has been in most past cases.

2.28 An issue of some concern has been how to handle cases where there were rival bids for a single target company, of which one raised competition issues and hence merited reference to the MMC while the other did not. Reference of one rival, combined with non-reference of the other, has been widely seen as both unfair and a distortion of the market process. The Government have considered whether action would be justified to deal with the problem, but have concluded that it would not. Annex F sets out the main issues. Any remedy involves blocking, at least temporarily, a transaction which in itself may be entirely innocuous, and this solution would thus itself be unfair and distorting—as well as creating unwelcome scope for those involved in contested takeovers to exploit any new rules for their own purposes. The Government therefore propose no change in this area. The faster merger control procedures discussed in Chapter V may ease the problem in some cases, though they do not remove it altogether.

Disclosure of information

2.29 Under the Government's policy of leaving most merger decisions to the market, it is important that adequate information should be publicly available as a basis for the market's assessments and decision.

2.30 In the course of the review, concern has been expressed that there may be too much flexibility in the accounting treatment of mergers and acquisitions, and that disclosure is in some cases inadequate to allow the outsider to assess the effects. The Government therefore welcome the decision of the Accounting Standards Committee to carry out a thorough review of the relevant accounting standards. DTI has also recently put forward for consultation complementary proposals for legislative changes as part of the implementation of the EC Seventh Company Law Directive. These focus on the need for disclosure to enable the reader of accounts to understand the impact of a merger or acquisition on a company's accounts. The proposals also raise the issue of the conditions under which merger accounting and merger relief should be available and of the relationship between the accounting treatment of an acquisition in a parent company's individual accounts and its consolidated accounts.

2.31 It is also important that adequate information about the ownership of companies is available. The Companies Act, 1985, contains provisions requiring the disclosure of interests in shares in all public companies. Most types of interests in shares (including beneficial ownership, control of voting rights and control of disposal rights) must be disclosed within five days by any person, or persons acting in concert, holding interests of 5 per cent or more of the voting capital of a public company. In addition, the Act gives companies the power to inquire into interests in their shares whatever the size of holding. The Rules Governing Substantial Acquisitions of Shares, which are administered by the Takeover Panel, restrict the speed at which shares may be purchased once a holding exceeds 15 per cent. They also require accelerated disclosure, within one business day, of holdings over 15 per cent. During formal offers, the City Code on Takeovers and Mergers requires accelerated disclosure of dealings by those holding 1 per cent or more of the shares of the offeree or offeror companies and of dealings by the parties of the offer or those acting in agreement with them. Following the review of the operations of the Takeover Panel early last year, the Government intend to publish soon a consultative document inviting comments on whether the provisions of the Companies Act might be improved in any way.

CHAPTER III: PRENOTIFICATION

3.1 Whilst the Government consider that the broad thrust of current merger policy should remain unchanged, there is room for improvement in the procedures of statutory merger control. A major consideration is the length of time taken by the procedures; but the Government are also concerned to ensure more generally that the system operates flexibly and efficiently. The Government propose two major legislative changes directed towards this objective: a new formal—though voluntary—merger prenotification procedure, explained in this chapter; and a new provision for statutory undertakings to be given in some cases without an MMC reference (Chapter IV). Chapter V discusses other procedural issues, and in particular the scope for further reductions in the time taken by merger control procedures in cases where a reference to the MMC is made.

Mandatory prenotification systems

3.2 Many other countries have mandatory prenotification systems, at least for the more important mergers. The main reason for a prenotification requirement is that it is difficult to unscramble a merger if it is completed before it has been fully considered by the authorities. In these countries, the law therefore usually lays down a short waiting period during which the proposed merger may not proceed. During the waiting period, the authorities have an opportunity to carry out an initial investigation; and if this reveals that there may be grounds for stopping a merger, the period can be extended.

3.3 The requirement to prenotify is generally combined with a requirement to supply information to the authorities about the transaction, about the businesses and markets involved and about the possible effects of the merger. This initial supply of information gives the authorities material for their preliminary investigation; but it is not unusual for the authorities to require further information, particularly in cases in which there is a significant chance of the authorities challenging the merger.

3.4 The two main possible advantages of a prenotification requirement are, therefore, that it can be used to prevent mergers being completed before the authorities have had an opportunity to investigate; and that it can be linked to a requirement to supply relevant information.

3.5 The main disadvantage of requiring prenotification is that it creates an additional burden both for the authorities and for businesses. If the prenotification requirement is to be effective in its main aim, it needs to be drawn in such a way as to cover a wide range of transactions; and it will inevitably catch a large number which turn out to be of no interest to the competition authorities. Nonetheless, the requirement itself needs to be policed, even against those mergers which are most unlikely to be serious candidates for substantive action by the authorities. Experience in other countries suggests that this enforcement task is not always a fruitful use of the authorities' limited resources.

The present UK position

3.6 As it stands at present, the law in the UK makes no explicit provision for mergers to be notified to the Office of Fair Trading (OFT). Nevertheless,

parties often choose to inform the OFT of their proposals either in confidence before they are made public or about the time a proposal is announced. A major motive for doing so is to obtain clearance before completing the transaction, and so to avoid running the risk of having the merger referred to the MMC after the event, and possibly being required in the end to unscramble the merger. In the case of bids for public companies the rules of the City Code on Takeovers and Mergers are relevant: an offer must be conditional on non-reference to the MMC and will lapse if the proposal is referred. In 1986 about one-third of all cases considered by the OFT (other than requests for confidential guidance) were full bids for public companies subject to the City Code.

3.7 Nevertheless a sizeable number of potentially qualifying mergers, particularly smaller ones, are not brought to the OFT's notice by the parties. The OFT finds out about many cases from the financial press and follows them up on its own initiative. In the event many prove not to qualify under the criteria laid down in the Fair Trading Act; and of those that do the great majority are found to be straightforward cases with no grounds for reference to the MMC. For most of the period in which mergers control has been in operation in the UK, it has been comparatively rare for completed mergers to raise issues which justify reference, although there have been a number of references of completed mergers in the recent past.

3.8 Against this background, the case for introducing mandatory prenotification in the UK is weak. Although completed mergers can present a problem, they do so comparatively rarely. Moreover, in order to be sure of catching the few which may present a significant problem, it would be necessary to set low thresholds defining the transactions to be notified, and many transactions of no real interest to the authorities would be subject to the requirement. Compliance with the requirement would need to be monitored and enforced, even against those mergers of no interest to the authorities.

A non-mandatory prenotification system

3.9 The Government believes that there is, nevertheless, a case for a *non-mandatory* prenotification arrangement. The vast majority of merger cases considered by the OFT—well over 95 per cent—are cleared without reference to the MMC, and the aim of the proposed procedure is to facilitate the more rapid and efficient handling of those cases where it can be established at an early stage that there is no serious ground for contemplating a reference.

3.10 The proposed procedure can be outlined as follows. Those who choose to prenotify their proposed merger to the OFT will be required to submit, with their prenotification, answers to a standard questionnaire setting out basic information about the transaction and about the businesses involved. In simple cases, the information supplied in this way will be sufficient for the Director General to advise the Secretary of State, without further inquiry, that there is no ground for a reference. In such a case, provided that the proposed merger has been publicly announced so that third parties have an opportunity to register any objections, the parties will be entitled to automatic clearance of their proposal if they hear nothing from the OFT within a period to be specified by statutory instrument: the present intention is that it should be four weeks. In more complicated cases, the OFT will need more detailed information before the Director General is in a position to advise, and in those cases the parties will have to be informed that the right to automatic clearance has lapsed—though naturally the Secretary of State will still aim to reach his decision as quickly as possible. Mergers which are not prenotified will remain liable to reference to the MMC for a period of up to five years.

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3.11 The advantage to the parties of prenotifying is therefore that they have a prospect of obtaining quick clearance. The intention will be to allow clearance within the four week period in as high a proportion of cases as possible. However, it must be recognised that there will be cases that cannot be dealt with within that period, for example because more information is required either from the parties to the merger or from third parties or because, in a complicated case, further time is needed for analysis or deliberation. In such circumstances, the OFT will have discretion to "stop the clock", simply by informing the parties that in the case in question they cannot assume automatic clearance after four weeks. Similarly, the clock may be stopped if, in the Director General's view, the prenotification is not valid. Appropriate disciplines will be put in place to ensure that, when the clock is stopped, the case is nevertheless handled as quickly as possible.

3.12 It is for the party proposing the merger to make the prenotification if he wishes to obtain the benefits of doing so. Where both parties to the proposed transaction are agreed on the proposal, they will be expected to submit a joint prenotification, pooling the information available to each in completing the questionnaire. In the case of a public bid for a company opposed by the incumbent management, it may be necessary for the bidder to complete the questionnaire unilaterally. If the information provided is not, in the Director General's view, sufficient to enable him to advise clearance without further enquiry, he may notify the bidder, as he is entitled to do in all cases, that automatic clearance within four weeks cannot be assumed. But this will not necessarily happen in every resisted takeover; each case will be handled on its merits. Whatever the position, the target company management will of course be free, as at present, to make their own submission to the OFT arguing the case for a reference to the MMC.

3.13 The exact content of the questionnaire will need careful consideration. Major items of information likely to be required include:

(i) names of companies, all subsidiaries and associated companies;

(ii) details of the proposed transaction (or shareholding) and its financing;

(iii) the latest annual accounts of the companies concerned;

(iv) brief statement of the reasons for the proposal and any expected changes in the businesses involved as a direct result of the merger;

(v) main products (goods and services) of the companies, with identification of those which compete in the same UK market and of those which are inputs for or bought by the other company;

(vi) main competitors in overlapping product markets;

(vii) main customers in overlapping product markets;

(viii) estimates of UK market shares for overlapping products or of products that are inputs for, or bought by, the other company, including the share of imports;

(ix) any other information the parties may wish to offer on the competition effects (if any) of the merger.

3.14 To set the four-week period in motion, the parties will need not only to complete the standard questionnaire but also to put their proposal in the public domain. In cases involving public offers for shares, this will generally be by an announcement of the bid or of the intention to bid, or by an announcement that an offer is being considered. In other cases there will be an obligation to make a similar public announcement, so that the proposal comes to the

attention of those having an interest, who can make representations to the OFT if they wish. The law will not prescribe the manner in which a proposal should be publicised, since appropriate arrangements will vary from case to case. But prenotifiers will have to inform the OFT what arrangements for publication have been made. If the OFT is not satisfied that those with an interest are likely to have heard of the proposal, it may need to take the initiative to identify interested parties and invite their views. That process will take time, and this is a further possible reason for stopping the clock.

3.15 Firms will continue to be able to seek confidential guidance about a possible proposal, as at present. They may often find it sensible to use the standard prenotification questionnaire in applying for confidential guidance. However, confidential notification of a proposal will not constitute formal prenotification. If the parties wish to proceed with a case which has been the subject of confidential guidance, and wish to obtain the benefits of prenotification, they must prenotify in the ordinary way and publish their proposal.

3.16 Although prenotification will be voluntary, there will be incentives to prenotify. If a merger comes to the attention of the competition authorities other than by prenotification, it will generally take longer than four weeks for the Secretary of State to decide whether or not it should be referred to the MMC: this is because the OFT will need to gather the information it needs, instead of receiving it by way of prenotification. If a merger is not prenotified, or if the information in the prenotification turns out to be materially incomplete or incorrect, it will remain possible for the Secretary of State to refer it to the MMC for a period of five years after it has taken place—although of course he will normally make a decision for or against reference as soon as possible after the merger has come to his attention.

3.17 It will be for the parties to judge whether a transaction appears to give rise to a "qualifying merger situation" within the terms of the Fair Trading Act, and hence whether prenotification is desirable. The extended liability to MMC reference applies to any unnotified qualifying merger situation.

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CHAPTER IV: STATUTORY UNDERTAKINGS IN PLACE OF AN MMC REFERENCE

4.1 Some mergers pose a threat to competition which is obvious even from a cursory examination, but which may nevertheless be capable of being removed by some modification of the merger arrangements. The parties to such mergers are often willing to promise such modifications. At present, however, there is no means by which such undertakings can be given statutory force except by invoking a full MMC investigation. Accordingly the Government propose to introduce new provisions for statutory undertakings to be given to the Secretary of State by the merging parties, as a possible alternative to a full MMC investigation. The aim is to make available a quicker and more flexible mechanism for dealing with competition problems in certain cases.

The current position

4.2 Under the law as it stands, there is nothing to prevent the parties to a proposed merger from approaching the OFT with possible variants on the proposal, involving the possible divestment of some of the assets of either the acquiror or the acquiree businesses. The Director General has a statutory duty to advise the Secretary of State on any definite proposal put to him. There have been a few cases in which the Director General has advised, and the Secretary of State decided, against reference explicitly on the understanding (backed by legally binding agreements between the parties) that certain of the assets or activities involved would be divested.

4.3 However, the present law is not well geared for this purpose. It makes no explicit provision for the Director General to discuss divestments with the parties as an alternative to an MMC reference. Moreover, there is no provision for binding undertakings to be given that the planned divestments will be carried out. If divestments are promised but not performed it is likely that the Secretary of State's only effective sanction is to withdraw his earlier clearance of the merger, and make a reference after all. This has happened in one case, but in the circumstances it is a cumbersome procedure. It is always better to remove the objectionable features of a merger from the start than to unscramble the merger after the event because it is unacceptable.

The proposal

4.4 Under the Government's proposal, the Director General will in appropriate cases discuss with the parties possible variants on their proposal, with a view to obtaining suitable legally binding undertakings in order to remove competition objections. A typical case would be one in which the proposed merger was between two diversified companies, whose product ranges overlapped to a limited but nevertheless important extent. In such a case, the Director General would be able, if he was so minded, to let the parties know that he was inclined to advise in favour of a reference of the proposal as it stood; but he would be prepared to consider advising against a reference if the parties were able to offer divestments which would remove the competition problem. (In some cases, the divestments could themselves give rise to qualifying mergers which would need to be considered in the ordinary way.) The final decision would rest, as at present, with the Secretary of State.

4.5 In all cases the parties will be required to take arrangements for divestment as far as possible before clearance can be given, for example by agreeing sale contracts with the prospective purchasers, for completion within a specified period after completion of the merger. In addition, whenever it is feasible to do so, the parties will be required to complete *all* the stages of the divestment process before the merger takes place. But the parties will often be understandably reluctant to move that far until they know for sure that they will then obtain clearance for the merger. To meet this, it will be necessary to provide for clearance to be given conditionally upon completion of the agreed divestments before the merger goes ahead. Until the divestments have been effected, the parties will be required to give interim undertakings not to proceed with the merger, analogous to the interim undertakings currently obtained to block a merger while it is under investigation by the MMC.

4.6 However, there may sometimes be reasons why it is not feasible for the divestments to be completed until after the merger itself has taken place. For example, in a contested takeover, in which the bidder plans to divest some of the assets of the target company in order to remove a competition problem, the divestment clearly cannot take place until the merger itself has been completed. In such a case, consideration could be given to granting clearance conditional not on prior completion of the divestments but on undertakings to complete them within a specified period, combined with interim undertakings to keep the operations of the two merging enterprises separate until the agreed divestments have been effected. If the divestment undertakings were not honoured, the Secretary of State would have powers, without an MMC investigation, by order to require divestment of some or all of the assets or activities acquired in the merger.

4.7 In the same way, the Director General would also be able to propose conditions other than on divestment, eg about the post-merger conduct of the merged companies, if he was satisfied that these conditions were necessary to prevent any anti-competitive effects.

4.8 In view of the price-sensitivity of information about merger control decisions and the scope for abuse of insider information, the Government favour as much openness as possible about any discussions on the above lines. Although the detail of discussions between the parties and the OFT would usually be confidential, it would be important to reduce as far as possible the disparity of information between those privy to them and the general body of investors, and for this reason the fact that discussions were taking place would be publicly announced. Moreover the Director General may wish, in order to assess the value of undertakings offered by the parties, to consult interested third parties. He would not normally do this unless authorised by the parties; but if they withheld such authority he might remain unable to recommend acceptance of their undertakings.

4.9 These proposals would also be applicable in the context of the existing confidential guidance system. Where the parties apply for confidential guidance and are told that their proposal is likely to be referred, they may well wish to know, still in confidence, whether there is scope for avoiding reference by amending their plans. In some cases it might be possible to formulate suitable undertakings which could be provisionally accepted at the confidential stage. But, as always with confidential guidance, the Secretary of State's position would be reserved and could change in the light of comments and information received once the proposal was in the public domain. In other cases it might be necessary, before giving any view, to wait until the proposal was in the public domain so that interested parties had the opportunity to comment.

4.10 These proposals for undertakings, both on divestment and on post-merger conduct, give a much enhanced role to the Director General in finding solutions, in co-operation with the parties, where it is mutually accepted that a merger raises competition issues. The proposals will be most useful in cases where, even in advance of a full investigation by the MMC, it is apparent both that a merger would have anti-competitive effects and that a remedy for these effects is readily available. One possible result may be to reduce somewhat the number of mergers which it is necessary to refer to the MMC. However the power to refer will remain the centrepiece of merger control, and will remain available for use whenever a merger raises competition issues which cannot be readily dealt with by undertakings, whenever the parties are unable or unwilling to offer them, and when wider issues arise. Even if, as a result of these proposals, there is a fall in the number of mergers referred to the MMC, they should not be seen as a weakening of merger control, but as the addition of an extra, more flexible, method available to the competition authorities to pre-empt the more obvious and more easily remediable anti-competitive effects.

CHAPTER V:
OTHER CHANGES IN PROCEDURES

Introduction

5.1 The Government's two major proposals for legislative change, to provide for prenotification and for undertakings, are designed to increase efficiency and flexibility in handling those cases in which the objectives of merger control can be met without an MMC investigation. However, since reference to the MMC remains the centre-piece of merger control procedures, it is important to ensure that those cases which run the full course of the procedure, including an MMC investigation, are dealt with as speedily and efficiently as possible.

5.2 The largest element in the full procedure is the MMC investigation itself. But it is important to view the procedure as a whole, starting from the time at which a merger proposal comes to the notice of the OFT, right through to the time an MMC report on it is published and the Secretary of State's decision is announced. The Government attach great importance to maintaining the thoroughness and fairness of the procedures on which merger control decisions are based: a decision to prevent a merger entails a considerable limitation of property owners' ordinary right to sell their assets as they choose, and should not be taken lightly. Subject to this overriding requirement, however, the Government aim to keep the overall period of time to the minimum, in order to remove uncertainty in the market and in particular to ensure that any merger which is referred but found on investigation by the MMC not to be against the public interest can be allowed to proceed with the least possible delay.

5.3 Over the past few years, the average time taken by the full procedure, from a merger's becoming known to the OFT to the publication of the MMC's report and the Secretary of State's decision, has been approximately eight months. However, good progress has recently been made by the MMC in cutting the length of their investigations, from an average of about six months over the past few years to about four months in 1987, and three months in some recent cases. This has brought the time taken by the whole procedure in 1987 down to an average of between five and six months.

5.4 Following a management consultancy study of current procedures and working methods within the DTI, the OFT and the MMC, the Government expect that it will be possible to make further progress in cutting the overall time taken without reducing the quality of the MMC's investigations. The Government's aim is that in the general run of cases referred to the MMC the whole procedure should be completed in about four to five months, though this may not be possible in particularly difficult cases.

Interaction between OFT and MMC

5.5 One main element in this planned time-saving is a closer integration of the merger work of the OFT and the MMC. The Government attach considerable importance to retaining the two institutions as independent organisations with separate identities and distinct functions; but it is right that there should be the closest possible practical collaboration between them.

The aim should be to ensure in particular that there is no unnecessary duplication of work, and that when a merger is referred the MMC have the full benefit of the OFT's work on the case and are in position to focus straight away on the issues.

5.6 It has sometimes appeared to outside observers, including those whose proposed mergers have been referred, that the MMC start from a clean sheet and fail to capitalise at all on the earlier work done at the OFT stage. This is not in fact the case; under current procedures, the MMC are aware, at the outset of an enquiry, of the main issues identified by the Director General. However, it is proposed that in future they will in addition have ready access to the detailed papers the OFT holds on a case at an earlier stage than is possible under the current law. This will help ensure that the head-start given to the MMC by the OFT's analysis, together with supporting documents, is exploited as fully as possible so that the MMC are in a position to collect additional relevant information on the issues from the beginning of their enquiry.

5.7 Another aspect of collaboration between the OFT and the MMC concerns staffing arrangements. Consideration has been given to the idea of the two bodies drawing on a common pool of professional staff, so that for example the same economist advising on a case at the OFT stage might stay with the case during investigation by the MMC. Though this proposal offers advantages, it has been rejected on the grounds that it might prejudice the independence of the two institutions. However, the Government do see advantage in more regular interchange of staff between the OFT and MMC, in order to develop closer links between them and a fuller appreciation in each of the merger control process as a whole.

The MMC's procedures

5.8 The Government's aim is that once a merger has been referred the MMC's investigation should in most cases last no more than three months. It is recognised that this will not be feasible in every case: there are likely to be a few cases in which the issues are so intrinsically complex that a somewhat longer period is inevitable. At the same time, it should be possible to deal with simpler cases in less than three months.

5.9 A major factor behind recent progress towards quicker investigations has been that the MMC have set firm timetables for the submission of evidence from the parties. This practice will continue, and will be operated stringently. In order to achieve the required speed, it will be essential for the Commission to seek and get full co-operation from all parties concerned. This will require strict adherence to deadlines imposed by the Commission according to the circumstances of each enquiry, and failure to meet deadlines will normally be assumed to mean that no comment is to be expected. The same procedure will apply to monopoly enquiries. The Government fully support this approach. In appropriate cases the MMC will also consider a number of other changes in procedures which the Government expect will contribute to further progress in reducing the length of investigations. These include:

- a more pro-active investigative approach by MMC staff and Commissioners, with greater emphasis on gathering the facts in day-to-day working contact with the parties, and correspondingly less emphasis on formal submissions and formal hearings (though these would remain important elements in the procedure);
- greater recourse to informal factual presentations by the parties, which may have the effect of reducing the number of more formal hearings and meetings, without prejudicing the ability of the parties to present their case;

— a change in the style of the MMC's report to a terser document, concentrating on the issues relevant to the MMC's conclusion, and with no more background factual material than necessary for a proper understanding of the issues and the conclusion.

5.10 At present, the MMC's investigations are usually conducted by groups of six Commissioners, each of whom (except the Chairman and Deputy Chairmen) is engaged to spend 1½ days a week on MMC work. It may be possible to conduct investigations more quickly if they are carried out by a somewhat smaller group of Commissioners, and it is proposed that this should be tried on an experimental basis. The current statutory requirement is that the MMC group responsible for an investigation should include at least five Commissioners; and since the law lays down that a two-thirds majority in the group is required for an effective adverse finding, it has been found sensible in practice normally to have groups of six. This number also provides a suitable balance of breadth and experience. In order to provide the MMC with greater flexibility, the Government propose without delay to alter the statutory requirement to a minimum of three. This will enable the MMC to experiment with smaller, yet still well-balanced, groups. This change can be made by statutory instrument.

5.11 More generally, the Government are considering whether to increase the total number of Commissioners available so that some of them can devote their time to a single enquiry at a time rather than working on several simultaneously. In addition, whilst the Government continue to favour the concept of part-time Commissioners, who can bring their current experience of the outside world to bear on their MMC work, they see advantage in more flexible arrangements than the current standard 1½ days a week engagement. In future it will be the intention to vary the commitment required of individual Commissioners to meet the MMC's need for speed and flexibility; this can be done under existing law.

Delay between the submission of the MMC's report and its publication

5.12 Under current practice, it is usual for about three weeks to elapse between the MMC's submitting a merger report to the Secretary of State and publication of the report. During this period the Secretary of State considers not only what action to take in the light of the MMC's conclusions and the Director General's advice on them, but also whether to make excisions from the published version of the MMC report. This latter issue is frequently a particular source of delay, since decisions cannot be reached until the parties have put in their requests, and since questions about excisions can become contentious, with protracted discussion between the Department and the parties. In order to save time, it is proposed that the MMC will in future pass on to the Secretary of State the parties' requests for excisions from the factual material in advance of submitting to him the full report.

5.13 A further small time-saving measure is that the MMC will take on the practical arrangements for getting the report printed and published, although the Secretary of State will remain formally responsible for publication.

Charging

5.14 These proposals should improve the speed and quality of the merger control process. The process involves resource costs at OFT and MMC; and to meet these costs the Government propose to introduce a statutory charge. Details remain to be settled: one possibility is a charge payable by the acquiring company, leviable on mergers where a controlling interest is acquired and where the assets test is satisfied. In any event the charging structure will be kept as simple as possible.

Newspaper mergers

5.15 Cm 278 announced that legislation would be introduced to enable the Secretary of State to specify the period within which the MMC should report on a newspaper merger referred to them. At present the law provides for a fixed period of three months, although, as Cm 278 indicated, for the general run of newspaper mergers the MMC say they will complete their enquiries within two months. The change in the law will provide the Secretary of State with the maximum degree of flexibility to set a period which is appropriate to the particular circumstances.

5.16 This new approach should mean that there will be fewer cases where a merger may be allowed to proceed without a reference to the MMC on grounds of financial urgency. But when such cases arise it will clearly be important for the Department's administrative arrangements to be at their most effective. The Department has therefore examined its administrative procedures for handling both urgent and non-urgent merger cases.

5.17 The prime consideration in handling cases is that the Department should be given as much notice as possible and should be provided with adequate information. To assist in this process the Department will shortly issue a guidance note which will give details of the procedures and which will specify the information normally required. The note will give particular advice on applications made under the discretionary provisions—Sections 58(3) and 58(4)—of the Fair Trading Act 1973. The note will be circulated widely to newspaper owners and their advisers and will provide a basis for early contact between the Department and parties to a transfer so that proposals can be properly presented and, particularly in cases of financial urgency, preliminary work begun in advance of a formal application being received.

5.18 When cases of financial urgency arise the Department will generally look to the auditors of the concerns in question to provide such verification as may be appropriate. There may however be circumstances in which the Department will wish to engage an independent firm of accountants to assist in this task.

5.19 The Government believe that the MMC's intentions as to timescale, the legislative change proposed, and the administrative approach indicated above, should enable all newspaper merger applications to be dealt with efficiently and expeditiously.

List of contributors

In addition to a small number of private individuals, submissions on mergers policy were received from the following organisations:

Associated British Foods plc
Association of Consulting Engineers
Association of Independent Businesses
Birmingham Chamber of Industry and Commerce
Biscuit, Cake, Chocolate and Confectionery Alliance
British Footwear Manufacturers' Federation
British Institute of Management
British Radio and Electronic Equipment Manufacturers' Association
British Telecommunications plc
Campaign for Real Ale Limited
Chartered Association of Certified Accountants
Chemical Industries Association Limited
Confederation of British Industry
Cumbernauld and Kilsyth District Council
Ellerman Holdings Ltd
English China Clays plc
Food and Drink Federation
Food and Drink Manufacturing Industry Economic Development Committee
General, Municipal, Boilermakers and Allied Trades Union
Glasgow Chamber of Commerce
Glasgow District Council
Graham Bannock and Partners Limited
GKN plc
Hanson Trust plc
Horizon Travel plc
Inbucon Management Consultants Limited
Industrial Policy Association
Institute of Directors
John Sacher Industrial Group
Law Societies' Joint Working Party on Competition Law
London Chamber of Commerce
Lovell, White and King
Motor Agents Association
National Consumer Council
National Economic Development Office
Pilkington Brothers plc
Rhuddlan Borough Council
Scottish Council Development and Industry
Scottish Development Agency
Scottish and Newcastle Breweries plc
Trades Union Congress
Transport and General Workers Union
Union of Independent Companies
Wider Share Ownership Council

Extract from a speech given by the Secretary of State on 8 October 1987

Healthy competition within our economy has long been accepted as a key ingredient of an efficient economy, and the Government is committed to a strong competition policy. Since last year, some aspects of competition policy have been under review. This review is continuing, but I can now announce some interim conclusions.

On mergers policy, I consider that the law should continue to give me discretion to refer mergers to the Monopolies and Mergers Commission on public interest grounds. But the Review has also confirmed my view that in determining whether mergers should be referred, the main, though not exclusive, consideration should be their potential effect on competition. In an open economy like ours, this of course involves taking full account of international competition both from European and from other sources.

I shall therefore maintain the policy that my predecessors consistently followed since July 1984 of taking reference decisions against this background. The policy has stood up well to the test of time. It ensures that the interests of other industries and of the final consumer are adequately protected; it makes for the greatest practicable degree of certainty; and it leaves to the market decisions on which the market will generally be a better arbiter than Government. Government should, I believe, intervene only where the interests of the decision makers in the market are likely to diverge from the public interest.

However, there has been widespread criticism of the procedures of statutory mergers control, which are time-consuming and inflexible. Good progress has recently been made in cutting the length of MMC investigations; but work is continuing to see if further improvements are possible, including legislative change if necessary.

I am also considering possible improvements in the special provisions of the Fair Trading Act for the control of newspaper mergers. After discussions with me the MMC have said that they will complete future enquiries into the general run of newspaper mergers within two months, rather than the three months which the law gives them. This improvement will make it more difficult for the parties to newspaper mergers to argue that an MMC enquiry is ruled out by financial urgency.

The accounting treatment of mergers and acquisitions has been a topic of public debate. It has been argued for example, that current accounting rules do not result in adequate disclosure of the true financial implications of mergers. With my encouragement the Accounting Standards Committee is reviewing the relevant accounting standards, and I look forward to seeing the results of this work shortly.

Extract from White Paper " DTI—the department for Enterprise " (Cm 278)

Mergers

2.8 On mergers policy, the main, though not exclusive, consideration in determining whether mergers should be referred to the Monopolies and Mergers Commission (MMC) will be their potential effect on competition. But the Government believe that the law should continue to give the Secretary of State for Trade and Industry discretion to refer mergers on other public interest grounds.

2.9 This policy enables the great majority of proposed mergers and acquisitions which do not pose a threat to competition to be decided by the market, without intervention from official agencies. The Government believe that there are considerable benefits from allowing freedom for change in corporate ownership and control through mergers and acquisitions. Generally, the market will be a better arbiter than Government of the prospects for the proposed transactions, and will ensure better use of assets, for the benefit of their owners and the economy as a whole.

2.10 Government should intervene only where the interests of the decision makers in the market are likely to run counter to the public interest. The classic example of this is where a merger threatens to give the newly-formed enterprise a position of market power which it will be able to exploit at the expense of its customers. Mergers may, also, occasionally raise other issues which affect the public interest, and that is why the discretion to refer on public interest grounds is to be retained. Similarly, the MMC, in their assessment of mergers referred to them, will continue to make an overall public interest judgement. In practice, in assessing the public interest, it is likely that the main consideration for the MMC will continue to be the likely effect of the merger on competition, as it has been in most past cases.

2.11 In assessing the threat to competition and deciding whether to refer a merger to the MMC, the Secretary of State, and the Director General of Fair Trading (DGFT) who advises him, will continue to take full account of competition from within Europe and from other international sources. In addition, opportunities to exploit market power are often in practice limited by the threat that new competitors will enter the market; the assessment therefore takes into account the potential for competition from new suppliers, whether from domestic, European Community or other overseas sources.

2.12 In most cases, competition is likely to be the most effective means of promoting efficiency. There may sometimes be cases in which a merger appears both to threaten competition and to offer the prospect of efficiency gains. In such cases, arguments about the gains to efficiency (and thus to international competitiveness) which may flow from a merger will be considered. But the paramount consideration is to maintain competitive market conditions. Mergers which may significantly threaten competition will therefore normally be referred to the MMC for a full examination. It is for the MMC to assess both the potential damage from a merger and its potential benefits, and to reach a balanced overall judgement.

2.13 There has been widespread criticism that current merger control procedures are time-consuming and inflexible. Within current procedures, good progress has recently been made by the MMC in cutting the length of their investigations; the average time taken by the MMC over merger enquiries has come down from about six months, over the past few years, to about four months in 1987. Similar improvements are now in prospect in the handling of monopoly investigations by the MMC. Following a management consultancy study of current procedures and working methods within DTI, the Office of Fair Trading (OFT) and the MMC, the Government expect that it will be possible to make further progress in cutting the overall time taken, measured from when a merger becomes known to the OFT to the time when an MMC report on it is published and the Secretary of State's decision is announced. Some of the proposed improvements in working methods and internal procedures will require minor legislative change.

2.14 In addition, two major legislative changes will be sought which are designed to enable the merger control process to operate more efficiently and flexibly: a formal, though non-mandatory, prenotification procedure; and a new function for the DGFT to obtain undertakings from the parties in cases where it is possible in this way to remove a potential threat to competition without the need for an MMC investigation.

2.15 A number of major industrialised countries have mandatory pre-notification procedures for mergers above a certain size. These are designed primarily to prevent mergers taking place before the competition authorities can take action to prevent them. In practice this is rarely a problem in the UK, and the Government do not believe that a mandatory prenotification requirement would bring sufficient advantages to justify the additional regulatory burden on businesses But a non-mandatory system will bring real benefits. The vast majority of merger cases are cleared without a reference to the MMC, and the aim of the proposed procedure is to handle more rapidly and efficiently those cases where it can be established, at an early stage, that there is no serious ground for contemplating a reference.

2.16 Those who choose to prenotify their proposed merger to the OFT will be required to submit, with their prenotification, answers to a standard questionnaire setting out basic information about the transaction and about the businesses involved. In simple cases, the information supplied in this way will be sufficient for the DGFT to advise, without further inquiry, that there is no ground for a reference. In such a case, provided that the proposed merger has been publicly announced so that third parties have an opportunity to register any objections, the parties will be entitled to automatic clearance of their proposal if they hear nothing from the OFT within a defined period of four weeks. In more complicated cases, the OFT will need more detailed information before the DGFT is in a position to advise. In such cases the parties will have to be informed that the right to automatic clearance has lapsed; though naturally the Secretary of State will still aim to reach his decision as quickly as possible. Mergers which are not prenotified will remain liable to reference to the MMC for a period of up to five years.

2.17 The second major legislative proposal is designed to provide a quicker and more flexible mechanism than a full MMC reference for dealing with some of the competition problems which may arise. The DGFT will be enabled to discuss with the parties possible modifications to their merger proposal, usually involving the divestment of some of the assets of the merging businesses. If the parties are able to offer divestments which remove the competition problem, the DGFT may be prepared to advise the Secretary of State against reference

on that basis. Whenever it is feasible, the parties will be required to complete the divestments before the main transaction is given clearance. Where it is not possible, then the parties may be given clearance to complete their transaction first, but only subject to legally binding undertakings to make the agreed divestments within a specified period afterwards. The parties would also be required to give legally binding undertakings to keep the operations of the two merging businesses separate until the agreed divestments had been completed. If the divestment undertakings were not honoured, the Secretary of State would have powers, without an MMC investigation, to require divestment of some or all of the assets acquired.

2.18 In addition to discussing possible divestments, the DGFT will also be enabled to propose undertakings, which the parties may give to the Secretary of State about the post-merger behaviour of the new group, designed to prevent the anti-competitive effects which might otherwise flow from the merger. Any such undertakings would be legally binding.

2.19 The law contains special provisions for the control of newspaper mergers. As with other mergers it is desirable that the examination process should be completed as speedily as possible. The MMC have said that they will complete future enquiries into the general run of newspaper mergers within two months rather than the three which the law now gives them. Against this background, the Government propose to amend the law to give the Secretary of State the flexibility, as with merger enquiries generally, to specify the period within which the MMC should report. The statutory arrangements under which a newspaper merger may be allowed to proceed without a reference to the MMC in cases of financial urgency will be maintained, but consideration will be given to ways of tightening their administration. These measures will make it more difficult for the parties to newspaper mergers to argue that an MMC enquiry is ruled out by financial urgency.

2.20 DTI will shortly publish a further paper setting out more fully the background to these decisions on merger control and the details of the proposed legislative changes.

Recent trends in UK concentration

I. INTRODUCTION

1. One important indication of a market's structure is seller concentration. Seller concentration, or more simply, concentration, refers to the number and size distribution of firms producing in a particular market, group of markets or economy. In general, the fewer the number of firms and/or the narrower the distribution of market shares, the greater the degree of concentration in that market.

2. The most commonly used measure of concentration is the concentration ratio. This shows the percentage share of total economic activity in a market or economy accounted for by the largest concerns in that market or economy. There are a number of benefits in using concentration ratios, not least their simplicity and minimal data requirements. However, there are a number of drawbacks to remember in any interpretation of such statistics:

— They are a discreet statistic and suppress information not directly used in their calculation. For example, they are silent on the individual size of the largest firms relative to the remainder of firms.

— They are somewhat arbitrary, depending on a largely subjective assessment of what constitutes the "largest" firms.

— It is possible that though, over a period of time, considerable changes in industry structure occur, this is not reflected in the values of concentration ratios. For example, though concentration ratios remain unchanged, the *identity* of the owners of the largest firms over time can be subject to considerable fluctuation.

— Concentration ratios reflect only formal aspects of an industry structure. There may well be significant intangible informal linkages facilitating inter-firm collusion.

3. The most commonly used concentration ratios are those which indicate aggregate concentration and those which indicate industry concentration. The former show the share of the largest concerns in economic activity across a number of markets, sectors or across the economy as a whole and generally give some indication of the extent to which large corporations dominate economic activity. In contrast, industry concentration ratios are typically concerned with the structure of a single industry or market.

II. AGGREGATE CONCENTRATION

4. In the past, the availability of data has restricted aggregate concentration studies to the manufacturing sector. Since non-manufacturing activity in the UK typically accounts for around 75 per cent of GDP, one cannot easily draw conclusions about activity in the economy as a whole from such studies. Nevertheless, an examination of aggregate concentration in the manufacturing sector does provide a convenient point of departure.

5. The most commonly used aggregate concentration ratio is given by C100. This is usually defined as the percentage share of net output accounted for by the one hundred largest private sector enterprises in manufacturing; Table 1 gives C100 ratios for the period 1970–84.

TABLE 1 **Percentage share of the 100 Largest Enterprises in Manufacturing Net Output 1970–84**

Year	*1970*	*1972*	*1974*	*1976*	*1978*	*1980*	*1982*	*1984*
C100	39·3	41·0	42·1	41·8	41·1	40·5*	41·1*	38·7*

Source: Business Monitor PA 1002

* Figures after 1978 are not strictly comparable with those coming before; in 1980 there was a definitional change in the Standard Industrial Classification

6. The years immediately after 1945 were ones witnessing significant increases in C100. The pre-war figure of around 25 per cent rose to around 40 per cent by the late 1960s, with most of the increase coming in the late 1950s and early 1960s. Table 1 strongly suggests that the years subsequent to 1970 have been ones of relative stability.

7. As noted earlier, merely examining aggregate concentration in the manufacturing sector does not necessarily give a good guide to activity across the whole economy; an important study by A Hughes and M S Kumar[1] attempts to remedy this defect. The authors principally use company accounts data and conclude that during the early 1970s, aggregate concentration *across the whole economy* increased, but then declined in the latter half of the decade.

8. The evidence suggests that in the manufacturing sector, aggregate concentration has remained largely stable since 1970. The Hughes and Kumar results mean that in the remainder of the economy aggregate concentration may well have increased in the early 1970s and then declined. Most importantly, the 1970s and early 1980s did not witness the sharp increases in aggregate concentration evident in the 1960s.

III. INDUSTRY CONCENTRATION

9. In the context of competition policy, the most commonly used concentration ratio is that which gives some indication of the competitive environment of a single market or industry. This usually takes the form of the percentage share of (typically) the five largest enterprises in total economic activity—defined in terms of output or employment—in a given industry; this ratio is denoted by "C5", that is:

$$C5 = \frac{Q5}{Q} \times 100$$

where Q5 is the total output of the five largest firms in the industry and Q is the total industry output

The more highly concentrated an industry, the closer C5 comes to 100 per cent. In terms of the interests of competition policy, the more highly concentrated an industry, the greater is the potential threat to competition.

[1] Hughes, A and Kumar, M S (1984) "Recent Trends in Aggregate Concentration in the United Kingdom Economy" Cambridge Journal of Economics, Vol. 8, September.

10. Most C5 figures relate to manufacturing activity since this is the basis of the Census of Production, the most reliable and consistent data source. However, there are a number of important drawbacks inherent in the use of Census-based C5 figures, particularly when one attempts some sort of long term inter-temporal comparison The main problems are:

— The definitions and scope of the Census have been subject to considerable change. The Standard Industrial Classification (SIC) was revised in 1958, 1968 and again in 1980. These revisions alter the nature, extent and character of "industries" as defined by the Census of Production and make it extremely difficult to determine the nature of industry concentration across periods during which the classification and definition of data has changed.

— The Census of Production is limited to manufacturing activity which, in accounting for only around 25 per cent of total UK GDP, limits the scope of analysis and therefore does not necessarily give a good guide to the economy-wide situation.

— Census data on C5 is usually given at an "industry" level. For the purposes of competition policy, such data would ideally be given at a level of aggregation closer to the economist's notion of a market; this would inevitably give a somewhat better indication of the competitive environment of a particular product. Under a market level of aggregation, rivals are defined in terms of their ability to produce a similar product, and not the ability to operate in a given industry. In being constrained by the availability of data, one risks too broad a definition of the scope of potential competition for a product when using the industry level of aggregation.

— Foreign trade is omitted from published C5 figures. In recent years, this has become an increasingly important omission given the growth in world trade. Ideally, an analysis of concentration ratios would be based on the share of the largest sellers in the UK economy whatever their nationality or location. Imports, for example, provide a growing source of competition to rival the domestic UK producer's home market. This important shortcoming of Census statistics is considered in detail below (see Section IV).

Industry Concentration 1970–79

11. Table 2 gives gross output equally-weighted and output-weighted mean C5 figures for the three years 1970, 1975 and 1979, for a sample of 93 comparable industries representing some 51 per cent of total Manufacturing and Mining Output in 1970.

TABLE 2 **Equally-Weighted and Gross Output-Weighted Mean C5 1970, 1975 and 1979***

per cent

	1970	*1975*	*1979*	*Change 1970–79*
Equal Weights	46·2	47·9	46·8	+0·6
Output Weights	46·6	48·1	47·1	+0·5

Source: Business Monitor PA 1002.

*Sample of 93 comparable industries.

12. Table 2 suggests that industry concentration remained fairly constant during the 1970s; the C5 figures imply only a slight increase over this period. Furthermore, it appears that the greater part of this increase occurred during the early 1970s; since the mid-1970s, industry concentration, as shown by Table 2, declined. Table 3 shows a more detailed picture by industry of the trends over this period.

TABLE 3 **Industry Concentration by UK Manufacturing Sector, 1970, 1975 and 1979**

SIC Order	Description	No. of Industries	Constant (1970) Weighted Mean C5 (Gross Output) per cent 1970	1975	1979	Change 1970–79
III	Food, drink and tobacco	11	51·9	53·4	51·5	−0.4
IV	Coal, petroleum products	1	45·1	47·4	35·2	−9·9
V	Chemicals, allied industries	14	54·7	54·9	54·7	0·0
VI	Metal manufactures	4	57·7	59·4	52·0	−5·7
VII	Mechanical engineering	9	38·3	42·4	40·1	1·8
VIII	Instrument engineering	2	30·8	30·6	29·8	−1·0
IX	Electrical engineering	6	61·7	59·0	55·8	−6·0
X	Shipbuilding	1	48·5	48·1	72·3	23·8
XI	Vehicles	3	81·3	78·0	80·3	−1.0
XII	Metal goods nes	6	37·8	38·0	37·8	0·0
XIII	Textiles	10	33·5	38·3	37·8	4·3
XIV	Leather, leather goods, fur	2	18·9	22·1	24·9	6·0
XV	Clothing and footwear	5	24·5	27·4	25·7	1·1
XVI	Bricks, pottery, glass etc	4	36·7	41·5	41·5	4·8
XVII	Timber, furniture etc	4	12·1	13·3	13·7	1·5
XVIII	Paper, publishing etc	4	43·1	40·8	40·8	−2·3
XIX	Other manufacturing goods	7	35·4	35·0	36·3	0·9
	TOTAL	93				

Source: As Table 2.

Industry Concentration 1979–84

13. Due to the definitional change in the SIC in 1980, it becomes necessary to base the analysis of industry concentration for the period 1979–84 on a different sample of industries from that used for the 1970s; at the time of this analysis, data beyond 1984 is unavailable. However, the concentration ratios in Table 4 are again defined in terms of gross output and to some extent this facilitates a comparison with the previous decade.

TABLE 4 **Equally-Weighted and Gross Output-Weighted Mean C5 1979, 1981 and 1984***

	per cent 1979	1981	1984	Change 1979–84
Equal Weights	52·1	51·5	49·9	−2·2
Output Weights	54·2	54·9	52·6	−1·6

Source: BSO data.

*Sample of 199 comparable industries.

14. It is apparent from Table 4 that industry concentration fell during the early 1980s. Though exact comparisons with the previous decade are impossible due to the differing samples used, it is nevertheless reasonable to conclude that since 1975 industry concentration has been declining; the early 1980s may well have seen an acceleration in this downward trend.

15. The figures in Table 4 are based on a sample of 199 SIC Industries accounting for 83 per cent of the gross output of Divisions 1–4 in 1981. The most striking feature of Table 4 is the fall in industry concentration as shown by both equally- and output-weighted mean C5; the equally-weighted mean C5 figure fell by 2·2 percentage points to 49·9 in 1984.

16. Table 5 gives output-weighted mean C5 for the 199 industries at the more disaggregated two-digit, SIC Class. As a whole, Table 5 would suggest that industry concentration across the majority of industry sectors declined during the period 1979–84; this result is supported by the conclusions on concentration emerging from the more aggregate mean C5 figures.

TABLE 5 **Industry Concentration by UK Manufacturing Sector, 1979, 1981 and 1984**

SIC Class (2-digit)	*Description*	*No. of Industries*	*Constant (1979) Weighted Mean C5 (Gross Output) per cent* 1979	1981	1984	*Change 1979–84*
12/4/5	Fuels, mineral and nuclear	4	76·0	81·5	72·4	−3·6
21/2/3	Extraction, metal manufacture	8	64·0	61·9	61·4	−2·6
24	Non-metallic mineral products	12	54·2	53·5	54·4	0·2
25/6	Chemicals	21	64·8	64·0	63·5	−1·3
31	Metal goods	14	31·6	31·1	30·0	−1·6
32/3	Mechanical engineering	28	43·9	42·3	42·0	−1·9
34	Electrical/electronic engineering	15	60·7	61·0	54·4	−6·3
35/6	Vehicles, transport, equipment	9	73·8	74·9	70·5	−3·3
37	Instrument engineering	6	42·4	42·3	41·4	−1·0
41/2	Food, drink, tobacco	19	64·0	63·4	60·9	−3·1
43	Textiles	15	39·6	40·3	36·8	−2·8
44/5	Leather, footwear, clothing	16	27·9	29·8	29·0	1·1
46	Timber, wooden furniture	9	19·1	18·2	20·4	1·3
47	Paper, printing	11	36·6	34·3	31·6	−5·0
48/9	Other	12	30·6	30·6	26·7	−3·9
	Total No. of Industries	199				

Source: As Table 4.

IV. CONCENTRATION AND FOREIGN TRADE

17. The analysis of concentration so far has taken no account of the influence of foreign trade on UK domestic market structure. This is an important shortcoming; imports, for example, provide an increasing source of competition to rival domestic production, and the recent growth in world trade would suggest this influence is growing.

18. Ideally, to take account of both imports and exports, a foreign trade *adjusted* industry concentration ratio would be given by:

$$A5 = \frac{(Q5 - X5)}{(Q - X + M)} \times 100 \qquad \text{(i)}$$

where A5 is the foreign trade adjusted concentration ratio; Q5 the output of the five largest domestic UK located producers; X5 the exports of the five largest UK located producers; Q the total industry output; X the industry exports and M industry imports.

19. Unfortunately, the lack of data necessitates the use of a more simplified foreign trade adjusted C5 figure. There is no data available on the precise exports of the five largest UK located producers; ie X5. This forces one to assume that the largest five domestic producers are responsible for the same share of industry exports as they are for domestic production; the so-called "neutral export" assumption. The foreign trade adjusted C5 figure now becomes:

$$A5^{-} = \frac{Q5}{Q + \frac{(M.Q)}{(Q - X)}}. \times 100 \qquad \text{(ii)}$$

20. The foreign trade adjusted concentration ratio given by equation (ii) is somewhat naive and suggests the possibility of certain biases which may arise given that:

- the statistic takes no account of the fact that the leading domestic producers may themselves control a substantial percentage of imports;
- it assumes that the five largest producers are domestically located;
- where import controls or quotas exist, the ratio may overstate the competitive influence of importing firms;
- it assumes perfect substitutability between imports and domestically produced goods.

Concentration and Foreign Trade 1970–79

21. Using a sample of 91 comparable industries accounting for some 71 per cent of domestic manufacturing output in 1970, it has been possible to assess the impact of foreign trade on concentration during the 1970s. Table 6 presents average output concentration ratios for the sample both unadjusted and adjusted for foreign trade.

TABLE 6 **Average C5 1970–79, Unadjusted and Adjusted for Foreign Trade***

per cent

Concentration	*1970*	*1973*	*1977*	*1979*	*Change 1970–79*
Unadjusted	49·0	50·9	48·9	48·5	−0·5
Adjusted	41·3	40·9	38·1	36·5	−4·8

Source: Business Monitors PA100s, M10, MQ10 and C154.

*93 comparable industries.

22. The *unadjusted* concentration ratios in Table 6 suggest a similar trend to that highlighted earlier; namely that unadjusted concentration increased slightly during the early 1970s and then subsequently declined. However, after accounting for foreign trade, *adjusted* concentration declined continually during the decade and at an increasing rate. In 1970, the downward adjustment for foreign trade was 7·7 percentage points compared to 12·0 percentage points in 1979.

Concentration and Foreign Trade 1979–84

23. The above analysis can be extended to 1984. Again, unadjusted and adjusted concentration ratios are used, however, because of the definitional change in the SIC in 1980, a differing data base is used. Though exact

comparisons with the figures for the period 1970–79 are consequently impossible, broad trends can be compared, given the similar coverage of the two samples. Table 7 gives both unadjusted and adjusted mean C5 figures for 1979–84:

TABLE 7 **Average C5, 1979,1981 and 1984, Unadjusted and Adjusted for Foreign Trade***

per cent

Concentration	*1979*	*1981*	*1984*	*Change 1979–84*
Unadjusted	51·4	50·9	49·1	−2·3
Adjusted	39·3	37·6	33·8	−5·5

Source : BSO Data, Business Monitors PA100s, MQ10.

*Sample of 195 comparable industries.

24. Table 7 suggests that the increasingly important influence of foreign trade on concentration implied by the 1970s data has persisted and indeed grown during the early 1980s. The downward adjustment for foreign trade increased from 12·1 percentage points in 1979 to 15·3 percentage points in 1984. Given the relatively short length of the period, one can only conclude that the impact of foreign trade on UK market structure has further increased for many manufacturing industries.

25. There still remain a number of industries which even after the foreign trade adjustment were highly concentrated during the period 1979–84; ie with *adjusted* C5 figures above 70 per cent. There were 20 such industries, as shown by Table 8. Of these 20 industries, 11 were persistently highly concentrated, ie had an adjusted C5 figure greater than 70 per cent in all three years. The 11 persistently highly concentrated industries accounted for some 6 per cent of the output of the total sample of 199 industries in both 1979 and 1984. It is worth noting that the distribution of the 20 industries in Table 8 is fairly even across the four main Division headings of the Standard Industrial Classification.

TABLE 8 **Highly Concentrated Private Sector Manufacturing Industries, After Accounting for Foreign Trade**

Adjusted C5 *per cent*

SIC Class (4-digit)	*Description*	*1979*	*1981*	*1984*
1200	Coke Ovens	94	99	56
2420	Cement, Lime and Plaster	85	83	84
2440	Asbestos Goods	85	84	76
2478	Glass Containers	78	78	75
2513	Fertilisers	75	79	76
2565	Explosives	78	75	73
2569	Adhesive Film, Cloth and Foil	73	64	58
2581	Soap and Detergents	76	75	74
3290	Ordnance and Ammunition	80	75	76
3410	Insulated Wires and Cables	81	77	64
3432	Batteries	80	73	51
3434	Electrical Equipment for Vehicles	72	69	60
3441	Telegraph and Telephone Equipment	77	78	69
3620	Locomotives and Parts	85	87	81
4115	Margarine	87	86	83
4197	Biscuits and Crispbread	81	78	79
4213	Ice Cream	69	83	57
4290	Tobacco	98	97	98
4721	Wall Coverings	74	71	66
4722	Personal Hygiene Paper Products	71	66	61

Source: As Table 7.

V. CONCLUSIONS

26. There are a number of conclusions to emerge from this survey of recent trends in UK concentration:

— Concentration gives an important indication of levels and changes in the structure of markets but it needs to be examined along with other characteristics of markets before drawing any conclusions on firms' conduct and on policy.

— Aggregate concentration in the Manufacturing Sector has remained broadly stable since 1970. However, evidence on economic activity as a whole suggests aggregate concentration increased during the early 1970s, but then subsequently declined.

— Industry concentration increased only slightly during the early 1970s. Since the mid-1970s, however, industry concentration has shown a gradual decline, a trend which has continued into the 1980s.

— Foreign trade at the industry level of aggregation has had an increasingly important influence on UK market structure in recent years. This has meant that after adjustment for foreign trade, concentration has shown a steady decline since the early 1970s.

— There remains a small but still appreciable number of persistently highly concentrated domestic industries even after an adjustment for foreign trade is made.

— Since the available data only extends to 1984, it is not yet possible to say what effect the recent mergers boom has had on industry concentration, and the trends outlined above.

Post-merger performance: the evidence

I. Introduction

1. The 1978 Green Paper (Cmnd 7198) considered several studies that attempted to evaluate the benefits of mergers by looking at post-merger profitability in comparison with profitability before the mergers took place. These studies produced the finding that in roughly half the cases examined, the merger had resulted in an unfavourable or neutral effect on the profitability of the companies concerned. The failure of the evidence to show improved profitability following mergers was interpreted as strong evidence that mergers were failing to generate economic benefits.

2. It was recognised that there were a number of limitations to these studies of post-merger performance. In particular, there were difficulties in estimating how the firms concerned would have performed in the absence of the merger and thus in attributing any change in profitability to the merger itself. The force of this criticism was reduced by the fact that other studies adopting quite different approaches had arrived at results similarly showing disappointing post-merger performance. A further problem with the studies is that they measure performance by profitability, a weak test of efficiency gains because mergers may produce higher profits through the exploitation of increased market power. Thus this limitation serves, if anything, to reinforce the findings of poor post-merger performance.

II. Subsequent evidence

3. Since Cmnd 7198 was prepared, a number of empirical studies of merger performance have been conducted using several different approaches. These include detailed case studies, accounting studies of pre- and post-merger performance and stock market studies that assess whether mergers create value for shareholders. The findings of a number of these studies are summarised below:

(a) *Cowling (1980).* Using an in-depth case study approach of nine mergers that occurred between 1965 and 1970, this attempts to assess the overall contribution of mergers to economic efficiency of firms, thus avoiding the shortcomings associated with profit performance. Efficiency was measured using the unit factor requirement index that estimates total input requirements per unit of output. The results showed no general efficiency gains forthcoming. However, there were one or two instances of efficiency gains, notably when superior management gained control of more resources, but these were not sufficient to suggest that efficiency gains typically apply.

(b) *Mueller et al (1980).* This major empirical investigation was designed as an international comparison covering seven countries—UK, USA, Germany, France, Belgium, Holland and Sweden. One of the objectives of the research was to ascertain whether mergers increased the efficiency of the companies concerned. This also recognised the inadequacy of the profit test and measured performance using growth and share prices as well as profitability. The results using after-tax profits were mixed, with four countries, including the UK, showing

slightly improved performance and the other three showing declines. The tests on growth were uniformly negative. Returns to shareholders in four countries including the UK, improved in the immediate post-merger period, but this difference disappeared after three years. The results of this comprehensive investigation tended to reinforce the doubts felt about mergers as generators of improved company performance.

(c) *Hughes et al (1986).* This study focused on the relationship between financial institutions' holdings and companies' economic performance. Data was used on institutional holdings for a sample of 300 UK industrial companies over the period 1971-80. Overall the results showed a decline in profitability following merger. However, it was small in magnitude and only statistically significant in one year. The results for acquirers with large institutional holdings were different, showing some improvement in profitability, though again the results were not significant.

(d) *Kumar (1984).* This study investigated issues relating to the growth of firms over the period 1960 to 1976, using data for 2,000 UK quoted companies. As part of this wider examination, some analysis of post-merger performance, examining the impact on investment as well as profitability was conducted. The results were rather mixed, showing some tendency towards a worsening in profitability performance and an improvement in investment post-merger. However, there was a significant minority of mergers showing a worsening of investment performance and an improvement in profit. Disaggregating the sample, Kumar's results showed that non-horizontal (ie vertical and conglomerate mergers) led to a clear improvement in performance while the results of horizontal mergers were more mixed with no pronounced trend.

(e) *Holl and Pickering (1986).* The aim of this study was to discover the determinants of successful and unsuccessful takeover bids. Performance was measured using profitability and growth and the data consisted of a matched sample of 50 abandoned and 50 consummated UK mergers. Overall, the results showed that mergers appeared to have an adverse effect on profits and medium-term growth. Of particular interest is the result that both bidding and target companies in abandoned mergers performed better than the matched sample of successful bidders. The conclusion of the study was twofold:

(i) that the threat of takeover was an effective spur to efficiency and

(ii) that consummated mergers do not, on balance, lead to efficiency gains.

(f) *Ravenscraft and Scherer (1986).* The aim of this study was to assess whether acquired companies showed superior post-merger profit performance relative to control groups and their pre-merger performance. The study covered the mid-1970s and used US data. The results showed that in just over half the sample, profits improved compared with the pre-merger period. In those cases where profits declined, the counter-factual question of whether this would have happened if the merger had not taken place was addressed. It was found that the profits of merged companies fell more rapidly than those of the control group. One interesting conclusion is that in contrast to Kumar's findings, conglomerate mergers performed less well than horizontal mergers.

(g) *Sturgess and Wheale (1984).* This study used annual shareholders' rates of return as a measure of post-merger performance. 52 UK firms were assessed over the period 1961-70, including 26 firms that had grown through acquisition and 26 through internal growth. The results were inconclusive with neither the merger intensive group nor the internally growing group consistently out-performing the other.

(h) *Firth (1980).* The approach used in this study was similar to that of Sturgess and Wheale, involving an assessment of gains and losses to stockholders. A sample of 224 successful UK takeover bids over the period 1972–74 was used. On average, the stock market took a slightly pessimistic view of these mergers, with gains and losses fairly evenly balanced. The author concluded that mergers were not value creating and were more likely to be motivated by maximisation of management utility reasons than by maximisation of shareholder wealth.

(i) *Franks and Harris (1986).* This again examined shareholder wealth effects of corporate takeovers, using data on almost 2,000 acquisitions over the period 1955 to 1985. The results showed large returns to acquiree shareholders in the form of large acquiree bid premiums, which were even higher in the case of contested bids. Post-merger performance of acquirors over the two years following the merger, showed returns comparable to general stock market prices, but insufficient to keep pace with the acquiror's own pre-merger performance.

III. Conclusions

4. Evidence on post-merger performance that has emerged since the Green Paper supports the earlier findings of disappointing or inconclusive performance. Indeed, the consistency of the results of the various studies and the wide range of approaches used tends to reduce the force of the methodological limitations and to increase the robustness of the findings.

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Rival bids

1. The classic case of the rival bids problem arises when two bids are made more or less simultaneously for a target company, one of which merits reference to the MMC while the other does not. It is widely seen as unfair—and it can also be seen as economically inefficient—that a contest between rival bidders for a company should be in effect decided by the decision on whether to refer to the MMC. The problem has arisen only rarely so far, and in some cases has been resolved by the referred bidder adjusting his proposals so as to remove the need for a reference. But this may not always be possible.

2. Faster merger control procedures may alleviate the difficulty to some extent. For example, a second bid for a company may emerge after an earlier bid has been referred to the MMC but before the MMC's investigation is completed; the faster MMC investigations are, the less likely that situation will give rise to the rival bids problem. But shorter MMC investigations cannot be relied upon to provide a solution in every case. Where rival bids are more or less simultaneous, there is no prospect of accelerating MMC investigations to such an extent that the enquiry can be completed, and the Secretary of State's decision reached, within the City timetable for the conduct of bids.

3. One option for dealing with the problem would be to abandon the current practice of ensuring, either by obtaining undertakings or by making orders, that proposed mergers referred to the MMC are not allowed to proceed while the investigation is in progress. The suggestion would be that mergers should be allowed to proceed despite a reference, on the understanding that, in the event of an adverse finding by the MMC, divestment of some or all of the assets concerned might be required. A change of this kind would also require an alteration to the City Code on Takeovers and Mergers, under which bids lapse on reference.

4. However, the Government have rejected this option. It is not a real solution to the problem in any case, since any fight between rival bidders, where one was not referred to the MMC and the other was referred and was consequently under threat of divestment, would be very far from evenhanded. Indeed, it is doubtful whether there would be many cases in which a bidder would wish to proceed on this basis. Moreover, unscrambling a completed merger can give rise to difficulties.

5. The other option for dealing with the problem would be to find a way, through fresh legislation if necessary, to block all bids for a target company so long as one bid is under investigation by the MMC. The arguments for and against this option are more finely balanced.

6. One line of argument lays stress on the problem of the unfairness to the referred bidder, whose opportunity to complete his proposed merger (if cleared by the MMC) is removed if a rival bid is successful in the meantime. In addition, it can be argued that the blocking of one bid but not the other leads in practice to a severe distortion of the market for the control of the target company. Of course, any active merger control policy creates distortion in the

takeover market. Even in the absence of rival bids, the mere act of reference creates distortions, for example in giving the target company time to organise its defences, and often results in the abandonment of a merger even without an adverse public interest finding from the MMC. But, it can be argued, the distortion is particularly acute in the case where control of the target company is settled by the success of one bid while the other is delayed by a reference. The danger is that the target company's assets will be managed not by those best able to do so, but, less effectively, by those who might have been only the market's second choice.

7. There is therefore at least an argument for saying that it would be desirable to block rival bids while an MMC investigation is in progress. But there would be some considerable disadvantages. Such a course would involve the temporary suspension of the market for control in the target company, and its shareholders would find their rights even more seriously diminished than before. It could lead to both bids failing for other reasons, because circumstances might change while the bids were blocked. It would create scope for artificial defensive tactics by target company managements: faced with an unwelcome bid, they would have a clear incentive to seek out a white knight whose bid would merit reference, in order to block at least temporarily the unwelcome bid.

8. Moreover, it can be argued that, notwithstanding concerns about fairness, there is no real problem under the current arrangements. In appropriate circumstances it is quite right that a bid should be blocked by being referred to the MMC, usually because of the competition concerns that it raises, while a rival bid for the same target should be free to proceed if it raises no public interest issues. Use of statutory merger controls always involves some diminution of shareholders' rights to dispose freely of their assets, and some distortion of capital market decisions; and this is no different in rival bids cases from other cases. The blocking of rival bids, in an attempt to remove the unfairness and distortion created by the original reference decision, would create further distortion and unfairness, not least to the bidder who finds his bid blocked although it is in itself unobjectionable. Moreover, if the concern is about fairness to the shareholders of the target company, then any action which prevents an otherwise unobjectionable rival bid from proceeding can hardly be a solution, since it limits the target shareholders' rights still further. There is, therefore, a strong case for making no change to policy to deal with rival bids.

Conclusion

9. While there are persuasive arguments on both sides, the Government's view is that on balance it would not be right to block rival bids for a target company while one bid is under investigation by the MMC.

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