

CHAPTER 5

Conclusions

(a) The merger situation

111. Under the terms of the reference and the provisions of sections 69(1) and 75(2) and (4) of the Fair Trading Act 1973, we are required to investigate and report on the questions:

- (i) whether a merger situation has been created; and
- (ii) whether arrangements are in progress or in contemplation which if carried into effect will result in the creation of a merger situation.

112. The preliminary condition set out in section 64(1)(b) is satisfied by the fact that the value of Morris's assets exceeds £5 million. We are required to exclude from consideration the alternative condition under section 64(1)(a) that the merger would create or extend a monopoly situation.

Has a merger situation been created?

113. The Fair Trading Act 1973 provides that a merger situation exists if two or more enterprises have ceased to be distinct enterprises at a time or in circumstances outlined in section 64(4) of the Act. Two or more enterprises are regarded as having ceased to be distinct enterprises if they are brought under common ownership or common control. A person (which includes a body corporate) is regarded as having control of another body corporate or enterprise if he either:

- (i) has a controlling interest in it; or
- (ii) is able to control the policy of the person carrying on the enterprise;
or
- (iii) is able materially to influence that policy.

Movement from the situation described in (iii) to that described in (ii) or (i) or from (ii) to (i) is to be regarded as bringing the enterprise under common control.

114. The Commission in a recent case indicated that in their opinion a person has a controlling interest in a company if, and only if, his shareholding is such that he can at a general meeting of the company out-vote the aggregate of all other shareholders. His shareholding must therefore exceed 50 per cent. In the present case, we are dealing with the two lesser degrees of control.

115. As indicated in Chapter 2, AI have built up their shareholding in Morris, as opportunity afforded. In considering this holding, one must have regard to the acquisition of shares in Morris by Bryanston which is clearly an associated person within the meaning of section 77 and also small holdings by Mr A T Smith and Mr P C Hegard. The position at the beginning of November 1975 was that AI and associates held 33.44 per cent of the Morris issued ordinary share capital. There was a number of Morris family holdings which, with holdings of directors not associated with AI, amounted to 25.56 per cent. AI does not dispute that at this time it was able materially to influence the policy of Morris. On 3 November

1975, AI bought 150,000 shares from B S G International being 4.52 per cent of Morris's issued share capital, bringing the total holding of the AI group to 37.96 per cent.

116. We have considered the position of the 85,000 shares which had been acquired in April 1975 by Rowe Rudd for discretionary clients. We accept that, in the ordinary way, Rowe Rudd would not exercise voting rights on behalf of a discretionary client since this could lay a stockbroker open to pressure from interested parties to use voting rights in ways that might not be acceptable to the discretionary client. In this case, however, the transaction had been financed by Seton Trust which is largely owned by Mr Hegard and under his control. Rowe Rudd were also acting as advisers to AI in connection with the proposed mandatory bid for the remaining shares in Morris and were undertaking to place a substantial proportion of shares offered under the bid. Rowe Rudd believed that it was desirable that AI should secure control of Morris and there was therefore no obvious clash of interest between the interest of the discretionary clients as seen by Rowe Rudd and voting the shares in support of AI. In these circumstances, we consider that, between the date of the acquisition of these 85,000 shares and the date of the reference, the probability is that, if occasion had arisen, proxies relating to these shares would have supported any motion brought by AI before a general or extraordinary meeting of shareholders. If so, this would have brought the shares likely to support AI to 40.52 per cent. We have, however, looked at the matter from the angle that AI had the assured support of at least 37.96 per cent of the voting rights.

117. At the time of the reference and at present, AI has not been exercising *de facto* control over Morris. The question, however, to which we have had to address our minds is whether AI is able to exercise control over Morris if it decides to use its voting power. AI argued that the purchase of the 150,000 shares in November 1975 did not give it control of policy since it continued to have only two directors on the board and that, while it might be able at a shareholders' meeting to prevent the re-election of a director, it had not the voting strength to secure a radical change in the composition of the board. The chairman of Morris believed, on the other hand, that, when AI decided to exert its strength, it would be able to replace members of the board of Morris by nominees of its own and so exercise effective control of the policy of the company. It may be that the Morris family votes would be used against any such move. We do not think there can be any certainty how the institutions would act. Some of them might consider a settled position would be better than the instability inherent in a constant threat by the largest shareholder to remove members of a board if that board were acting in ways of which the largest shareholder disapproved.

118. The percentage of shareholding which gives ability to control a company must depend *inter alia* on the disposition of the remaining shares. In general, the wider the dispersion of the shares, the smaller the percentage needed to control the company. Section 7 of the Insurance Companies Act 1974 regards one third or more of the voting power as giving control of an insurance company. The City Take-over Panel at one time regarded 30 per cent as in practice giving effective control if the shares were acquired from the directors of a company, though the figure, if shares were bought in the market, was 40 per cent. Since

July 1974, the City Code has adopted a uniform figure of 30 per cent. These precedents suggest that there are circumstances in which a holding of less than 40 per cent gives ability to control.

119. In considering the possible balance of forces in a shareholders' meeting, we believe the shareholders other than AI and associates, the family, the directors and the institutions would play little part. Many would not vote. It does not seem possible to predict how the rest would react to competing claims for their support.

120. Before the purchase of the 150,000 shares from B S G International in November 1975, AI and associates had 33.44 per cent of the Morris issued share capital. If the family holdings and the holdings of directors other than Mr Smith and Mr Hegard (25.56 per cent) can be regarded as a block likely to oppose AI, it would have been necessary for that opposition to get only a further 7.88 per cent from the institutions to have a block that would equal that of AI. With AI at 37.96 per cent, those opposing them would have to get 12.40 per cent from the institutions—which represents 95 per cent of the institutions' holdings of 13.10 per cent. This seems to us a quite unrealistically high figure. It is certainly more than the 70 to 80 per cent of the shares held by the institutions which the chairman of Morris thought were likely to side with the majority of his board in supporting the present policies of the company.

121. We have reached the conclusion that AI is able to control Morris and that a merger situation was created by the purchase of 150,000 shares on 3 November 1975.

Is a merger situation also in progress or in contemplation?

122. Our reference also requires us to investigate and report on whether a merger situation qualifying for investigation will be created if arrangements in progress or in contemplation take place. By reason of Rule 34 of the City Code, AI is obliged to make a bid at 60p for the shares which they do not hold in Morris. The bid is in abeyance pending the result of the reference to the Commission. AI argued that the proposed bid was at a price which made it most improbable that it would succeed and that consequently a contemplated merger situation qualifying for investigation could not be said to exist. We do not accept that the likelihood or otherwise that a bid will succeed is relevant to the issue. Under section 75(2) we are required, in effect, to proceed in relation to the proposed merger as we could proceed if it had taken place immediately before the date of the reference. We are satisfied that arrangements are in contemplation which, after they were successful, would result in AI and Morris ceasing to be distinct enterprises. We conclude, therefore, that a merger situation will be created if the arrangements in contemplation are carried into effect.

(b) Public interest

123. On the basis that a merger situation exists and that a further merger situation is contemplated, we have examined whether this is against the public interest.

124. The crane industry in this country and the much smaller hoist industry have sales of the order of £125 million a year. These are not large industries but, within the field which they cover, there can be substantial imports if the UK producers are not as efficient as overseas suppliers and substantial exports if the UK producers are efficient. Morris is a major UK producer of cranes and hoists. In recent years Morris has much improved its performance by means of product and plant rationalisation, marketing improvements and selective diversification. The company is now proposing to embark on a major programme of capital investment. This programme is the work of the present management team which has been engaged in a major reappraisal of all aspects of the company's operations. Industrial relations are good.

125. While Morris has already achieved a significant improvement in efficiency and performance (as measured by turnover, exports and profits), it still has some way to go before it is effectively equipped to match the strong international competition which has developed in recent years. The company seems to be well organised to make the further effort that is required. This is recognised by the Department of Industry which regards the future of Morris as important to the UK crane industry and to the many basic industries that use its products.

126. AI told us that they regarded Morris as undervalued because the underlying asset value of the business was much greater than its Stock Exchange valuation and because the efficient use of these assets was improving and could be further improved. They therefore regarded shares in Morris as a good investment. They believed that they had a contribution to make to the further improvement in the management of Morris and that they could bring financial expertise to bear on Morris's financial problems. AI did not claim that they had any contribution to make to Morris's technical problems nor that there was any substantial advantage to be gained by a closer working relationship between Morris and the existing subsidiaries of AI. In our view the main reason for the greatly improved performance of Morris is the management team recruited by the present chairman and managing director. Much, if not all, of this improvement would have happened without any contribution from AI.

127. AI explained that it was an industrial holding company which seeks to invest its resources in successful or potentially successful trading companies offering prospects of growth and that it applied its expertise to the building up of the trading subsidiaries in the group. AI said that it accorded a high degree of autonomy to the trading units that are its subsidiaries, subject to the close monitoring by AI of progress against agreed budgets and to close financial supervision. We find it difficult to relate this description to the past record of AI which appears to have bought and sold subsidiaries with regard mainly to the immediate financial interests of the group. It may be that AI intends now to settle down to a long term supervision of Derritron Ltd, Morris and the smaller subsidiaries; but past experience is not re-assuring.

128. We are reporting before the inspectors appointed by the Department of Trade to investigate the affairs of Bryanston have reported. We did not think that it fell to us to investigate specific complaints about the conduct of affairs in

Bryanston and AI. It is not, however, possible to ignore the widespread distrust of Mr A T Smith and Mr P C Hegard which stems from an impression that in their business activities they are interested primarily in making quick financial gains. The complex series of transfers and cross transfers of shares did nothing to re-assure Mr Smith's and Mr Hegard's colleagues on the board of Morris.

129. The chairman and managing director of Morris considered that control of Morris by AI would prejudice the progress of the company. The trade unions representing the work people in Morris feared that AI would fail to maintain the standard of efficiency and management and the good labour relations which the present management had achieved. They were also fearful that parts of Morris would be sold off for financial gain and the enterprise as a whole would suffer from this. They were not placated by general statements such as those contained in the draft offer document. We formed the impression that Morris would not have such ready access to funds from banks and finance houses if AI were in charge. We were told that important customers of Morris had expressed unease but doubtless this was partly due to a dislike of any change which might interfere with the flow of production and the attainment of delivery dates.

130. Our conclusion is that the merger of Morris and AI is contrary to the public interest. This applies both to the existing merger situation we have described above and the further merger situation which might be created if the mandatory bid were proceeded with.

131. Where we find that the creation of a merger situation operates against the public interest, section 72(2) of the Fair Trading Act 1973 requires us to specify the particular effects, adverse to the public interest, which the creation of that situation has or may be expected to have. In our view there is a serious risk that either merger situation will interfere adversely with the progress of Morris, including its contribution to the balance of payments, will cause serious friction in the relations with trade unions and employees and will make it more difficult for Morris to raise funds from banks and finance houses. We can see no countervailing advantages.

132. We are unable to recommend any action which would remedy or prevent these adverse effects. We, therefore, recommend that the contemplated merger should not be permitted, and that the existing merger should not be allowed to continue.

133. In order to implement this recommendation, we further recommend that AI (taken with its associates) should be required in the first instance not to exercise voting rights in respect of shares representing more than 10 per cent of the issued ordinary share capital of Morris. We considered whether it would be sufficient to bring the voting rights below those of the Morris family, say to 20 per cent, but the ultimate size of the Morris family holding must be a matter of some doubt and if AI were able to exercise voting rights amounting to 20 per cent, this, possibly with other shares in related hands, would constitute a formidable block. We further recommend that AI should divest itself of shares so as to bring the holdings of AI and its associates down to 10 per cent of the issued ordinary shares of Morris. Provided that the voting rights have been restricted, this divestment can take place over a period and in an orderly manner.

134. If the shares of which AI should divest itself were to be put on the market or if AI decided to dispose of all their shares, a fresh merger situation might be in the making since the shares might be bought by another group seeking to control Morris. Obviously the merits of any such situation would be a matter for separate consideration. At this juncture, however, further uncertainty would be undesirable. We therefore recommend that the divestment should be supervised by the Director General of Fair Trading. It may be that shares disposed of by AI could be placed with financial institutions, insurance companies, unit trusts and pension funds. If the price of Morris shares remains at present levels, divestment is unlikely to involve AI or its associates in an appreciable financial loss.

ALEXANDER JOHNSTON (*Chairman*)

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5 April 1976