CHAPTER 9

Conclusions

The merger situations

368. We have first to determine, in respect of each of the three matters referred to us, whether a merger situation qualifying for investigation (as defined in section 64(8) of the Fair Trading Act 1973) has been created. We consider first whether such a merger situation as between Eurocanadian Shipholdings Ltd (ECS) and Furness, Withy & Co, Ltd (FW) had been created in the six months ending 28 November 1975 when this matter was referred to us; secondly, whether arrangements are in progress or contemplation which if carried into effect will create such a merger situation as between ECS and FW, which matter was referred to us on 23 December 1975; thirdly, whether arrangements are in progress or contemplation which, if carried into effect, will create such a merger situation as between ECS and Manchester Liners Ltd (ML), which matter was referred to us on 28 November 1975.

369. In all three cases we are required to exclude from consideration section 64(1)(a) of the Act, but the condition of section 64(1)(b) is satisfied because, as is evident from their published accounts, both the value of the assets of FW and the value of the assets of ML exceed £5 million. In relation to each of the second and third of these merger situations, we are required under section 75(2) of the Act in effect to proceed as if the proposed merger had taken place immediately before the date of the reference.

I. The existing merger situation between ECS and FW

370. During the six months ending 28 November 1975, ECS and its associates increased their shareholding in FW from less than 10 per cent to 20·6 per cent of the FW equity. This was achieved largely by ECS's purchase from (or through) Hambros Bank of 2,926,076 ordinary shares on 29 August 1975. In addition, ECS acquired from Hambros on 29 August 1975 an interest in a further 2,193,368 ordinary shares (8·2 per cent of the FW equity). The nature of the transaction of which these 2,193,368 shares were the subject is described in paragraph 165. Its legal character has been a matter of dispute between ECS and FW (see paragraphs 194 to 196 and 214). In our judgement the transaction did not constitute a sale of the shares to ECS, but a grant to ECS of an option to purchase the shares on 9 December 1975 (or such later date as might be agreed) for 260p per share, together with certain interim rights. The features of the transaction which appear to us to point to this conclusion are the following:

(i) Until 9 December the shares were to be held by nominees for Hambros' account.

(ii) ECS was under no obligation to pay for the shares on 9 December (or later date agreed), but was bound only to use its best endeavours to do so.

(iii) Any dividend or other distribution declared or made between 29 August and 9 December was to be received by ECS, but was to be reimbursed to Hambros if ECS did not pay for the shares on 9 December (or later date agreed); and there was a similar arrangement governing any rights issue made by FW between 29 August and 9 December.

(iv) Until 9 December the voting rights attached to the shares belonged to Hambros. It is true that Hambros agreed to exercise these voting rights until 9 December as ECS might direct; but the fact that the rights were actually to be exercised by Hambros (or those holding as nominees for them) indicates that neither the rights nor the shares had in law become the property of ECS on 29 August.

371. The conditional nature of the purchase of the block of 2,193,368 FW shares was not conveyed to the FW board either by Hambros (though Hambros is represented on the FW board) or by ECS (see paragraph 170). On 10 September, ECS formally notified the FW board that ECS had acquired a 'beneficial interest' in 4,627,472 FW shares on 29 August and that a further number had been acquired by its associates. We are told by FW that, as a consequence, it believed that ECS and its associates held 28·8 per cent of the FW equity unconditionally.

372. In its evidence, FW has said that at that time the FW board could reasonably have expected in this situation, the support of 15·5 per cent of the FW shareholders, 11·3 per cent being shareholders subject to the influence of Rea Brothers and 4·2 per cent being 'traditional' supporters of the board (see paragraph 200). In a confrontation with ECS, it would probably have been able to obtain support also from shareholders who did not normally sign proxy forms for voting at general meetings of the company, but it was difficult for the board to make direct approaches to many of the FW shareholders because their holdings were in the names of nominees, and any support which it might have obtained from the general body of FW shareholders would not have been likely to be sustainable if a confrontation continued for any length of time. FW's adviser, Rea Brothers, took the view (see paragraph 167) that ECS had become able to establish *de facto* control of FW and Sir James Steel, acting on his own initiative, instructed Rea Brothers to try to find a solution. This instruction led to the proposed share exchange under which, in effect, all or most of ECS's FW shares were to be extinguished in exchange for FW's shareholding in ML together with two bulk carriers belonging to FW (see paragraphs 175 and 176).

373. We do not know what course events would have taken if FW had known the true position, that is to say that ECS's right to control the votes attached to 8·2 per cent of the shares would expire on 9 December unless it either paid for the shares or reached some new agreement with Hambros. However, we have to form a judgement, independently of what FW believed the situation to be, on the question whether a merger situation was created as a result of the shareholding interests which ECS had actually acquired in the six months ending 28 November.

374. We disagree with the submission of ECS (see paragraph 214) that, in view of the provisions of section 66(5) of the Act[1], the 8·2 per cent should be left out of account altogether. ECS's right to the shares was, in our view, an option, and that option had not been satisfied on 28 November, when the merger situation was referred to us. No account, therefore, may be taken of the option to buy the shares; but the transaction of 29 August conferred upon ECS other rights in addition to the option. It gave ECS the right to control the votes attached to the shares, and this right, though temporary, became effective immediately and was neither optional nor conditional. The position was that on 29 August, ECS acquired unconditionally the voting rights in 8·2 per cent of the equity from 29 August up to 9 December. On 28 November, these voting rights still had 11 days to run. Section 66(5) does not oblige us to leave these voting rights out of account. Indeed, to the extent that they increased the power of ECS to influence or to control the policy of FW, it is our duty to take them into account. In our judgement, however, voting rights as temporary as were those of ECS in respect of the 8·2 per cent shareholding would contribute only in a small degree to the power of their holder over the policy of the company. If the temporary nature of these voting rights had been known to FW, the additional power over the policy of FW which possession of them would have given to ECS would have been slight.

375. If the 20·6 per cent of the shares which ECS held unconditionally are alone taken into account, the position as between ECS and the FW board would have been fairly evenly balanced. We accept that the support which the FW board might be able to obtain from shareholders who do not normally sign proxy forms would be likely to diminish over time, but we think it reasonable to assume that the board could have obtained sufficient support to prevent control of the company passing to ECS. We are of opinion that ECS did not become able to control the policy of FW by virtue of its shareholding of 20·6 per cent plus its temporary voting rights in a further 8·2 per cent.

376. In view of the provisions of section 65 of the Act, it is incumbent upon us to determine also whether in the six months preceding 28 November, ECS became able materially to influence the policy of FW. FW contends that ECS did become so able because it was in its power to frustrate special resolutions requiring a three quarters majority of the votes cast at a general meeting of the company, and it might well have been able to defeat ordinary resolutions, particularly if the FW board had not taken special steps in advance to enlist shareholder support. ECS contends (see paragraph 224) that material influence could only be exercised if either it had obtained representation on the FW board

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[1]Subsections (4) and (5) of section 66 read as follows:

(4) Subject to the preceding provisions of this section, the time at which any two enterprises cease to be distinct enterprises, where they do so under or in consequence of any arrangements or transaction not having immediate effect, or having immediate effect in part only, shall be taken to be the time when the parties to the arrangements or transaction become bound to such extent as will result, on effect being given to their obligations, in the enterprises ceasing to be distinct enterprises.

(5) In accordance with subsection (4) of this section (but without prejudice to the generality of that subsection) for the purpose of determining the time at which any two enterprises cease to be distinct enterprises no account shall be taken of any option or other conditional right until the option is exercised or the condition is satisfied.

or its level of shareholding was such as might be thought to confer a reasonable prospect of its securing board representation either with the consent of the board or by the exercise of votes at an annual general meeting. Without deciding whether it is right that material influence can be achieved only in these circumstances, we are content for the purposes of this case to accept the condition put forward by ECS. We accept also that ECS will not obtain representation on the FW board with the consent of the present board. In our judgement, however, as a result of the events in the six months preceding 28 November, ECS would have had a reasonable prospect of obtaining representation on the board by decision of the company at a general meeting. With a 20·6 per cent shareholding it may be that ECS would not have achieved representation at a first attempt; but we believe that it would eventually have attracted the support of enough other shareholders at a general meeting to have obtained the election to the board of a representative irrespective of its voting rights in the 8·2 per cent. Backed by its shareholding of 20·6 per cent it could therefore exercise material influence on FW's policy. Moreover, even without representation, or the prospect of representation, on the board ECS might be able materially to influence the policy of FW by exercising its voting power at general meetings of the company or by letting the board know how its voting power would be exercised. We conclude that in the six months ending on 28 November 1975, ECS became able materially to influence the policy of FW, and a merger situation qualifying for investigation was thus created.

II. The prospective merger situation between ECS and FW

377. ECS states that it intends, in the absence of an agreement on the lines of the proposed share exchange described in paragraphs 175 and 176, to increase its shareholding in FW up to 29·9 per cent with the object of obtaining representation on the FW board, and since the references to us it has increased its holding of FW shares to 24·9 per cent (see paragraph 178). It states that it does not seek a controlling interest in FW, nor does it seek to control FW's policy.

378. We have expressed the view (see paragraph 376) that ECS would have had a reasonable prospect, on the basis of the shareholding it had acquired in the six months up to 28 November 1975, of obtaining the election of a representative on the FW board. However, ECS seeks board representation on a scale related to its shareholding percentage. In the discussions with FW which followed its notification on 10 September of its acquisition of FW shares, it sought to nominate five directors on the FW board out of a total of 15 (see paragraph 172). We think that the influence which it could exert on FW's policy as a result of such representation would be substantially greater than the minimum degree of influence that would qualify as 'material'.

379. We have already noted (see paragraph 372) that Rea Brothers took the view that ECS could establish *de facto* control of FW with 28·8 per cent of the ordinary shares. This view was formed on the assumption that the support of all the Hambros shares was lost to the FW board. This may not now be the case since the 8·2 per cent, formerly held by Hambros, has been sold to Rea Brothers, and Rea Brothers has placed these shares with purchasers, some of whom may be subject in some degree to Rea Brothers influence (see paragraph

202). Against the 29·9 per cent of the FW equity which ECS says it may acquire, the FW board might therefore in future expect to obtain the support of about 24 per cent of the shareholders, made up as follows:

	Per cent
Shares managed, controlled or influenced by Rea Brothers together with traditional supporters	15·5
Shares previously owned by Hambros and now placed by Rea Brothers with clients and institutions	8·2
Total	23·7

There cannot be certainty in the future either about the number of shares managed, controlled or influenced by Rea Brothers or the effectiveness of its control. The eventual degree of support on which the FW board could rely might well, therefore, be less than 23·7 per cent.

380. In view of this situation, the absence of other large holdings of FW shares and the large proportion of these shares held by nominees, we consider that a holding of just under 30 per cent would enable ECS to get a sufficient number of its representatives elected to the board to control the policy of FW. A further merger situation qualifying for investigation is thus created.

III. The prospective merger situation between ECS and ML

381. At present FW holds 61·6 per cent, ECS 37·6 per cent, and other shareholders 0·8 per cent, of ML's ordinary shares (see paragraph 163). Under the share exchange proposals (see paragraph 176) ECS would have acquired FW's shares and therefore a controlling interest in ML. ECS had told us that it would seek to resume negotiations on that basis if permitted to do so. These proposals were under consideration immediately before the reference to us. ECS has also stated that its principal object in seeking representation on the FW board is to bring about a merger of the North Atlantic container operations of ML and Cast. It is, therefore, obvious that arrangements were in progress or in contemplation on 28 November 1975 which, if carried into effect, would give to ECS a controlling interest in ML. A merger situation qualifying for investigation was thus created.

The public interest

382. Having determined, as we are required to do under the provisions of section 69(1)(a) of the Act, what are the merger situations qualifying for investigation, we have investigated, as we are required to do under section 69(1)(b), whether the creation of those merger situations operate or may be expected to operate against the public interest.

383. Control of ML has been ECS's primary objective in the creation of all three merger situations. It follows that our conclusions on whether the proposed merger between ECS and ML operates or may be expected to operate against the public interest will affect our conclusions on the merger situations as between ECS and FW. It is convenient, therefore, to report first on the merger situation as between ECS and ML.

A. The proposed merger between ECS and ML

384. The issues for the public interest to which this proposed merger gives rise include its probable effects on competition and on the service available to British exporters and shippers generally; on ML's effectiveness as a company and on costs; on the balance of payments; on the Port of Manchester; and on employment.

1. *Competition and service to British shippers*

385. We accept the view of the British Shippers' Council (see paragraph 320), that it is advantageous for the British shipper to have available the services of a ship-operating company which is both owned and controlled in the United Kingdom. We think that such a company, with its roots in the United Kingdom and its experience of business in the United Kingdom, is likely to have close knowledge of the requirements of British exporters and importers and to pay particular regard to their interests. Its United Kingdom services are often the main and most important part of its operations which it would be very reluctant to withdraw. In the negotiation of rates and the making of other arrangements inside shipping conferences, the interests of British shippers are more likely to be supported effectively by a British than by a foreign ship-operator. Such considerations can increase materially the competitiveness of the British exporter.

386. We have received no single criticism from ML's customers of the way in which it conducts its business and much positive testimony to the quality of the service which it provides. This testimony shows that the potential advantages described in paragraph 385 are in fact enjoyed by British industry as a result of ML's operations. Witnesses spoke of the prompt, safe and reliable service provided by ML; of ML's readiness to co-operate in new projects and to produce special containers for customers' special needs; of the accessibility of ML's management; and of the ability of ML to influence the policy of shipping conferences where British interests were affected. The chairman of the North Atlantic Shippers' Association went so far as to say that ML was as good a shipping line, both as an operator and as conference member, as one could realistically hope to find (see paragraph 322).

387. We fear that the merger would put these advantages seriously at risk. While it is the intention of ECS that ML should continue to operate as a British company, ML would become owned and controlled from abroad. It would try, no doubt, to continue to offer a competitive service to its customers, but we do not think it would promote the interests of British exporters and importers as effectively as it does now. Cast's central management (Intercast SA) is situated on the Continent of Europe, and it is on the Continent that much of its business is carried on. According to the intentions of ECS, some, at least, of ML's ships on the North Atlantic would call in the United Kingdom on their way from Antwerp to Montreal instead of plying simply between the United Kingdom and Canada. It is therefore likely that as a result of the merger British interests would be less heeded than they are now. Moreover, the effect which we apprehend upon the effectiveness of ML (see paragraph 394) would be bound to impair the quality of the service which ML now provides.

388. ECS's proposed substitution of Liverpool for Manchester as the United Kingdom port for ML's North Atlantic route would reduce the facilities available to British shippers to and from Canada. A withdrawal of ML's calls at Greenock would reduce the quality of the service there.

389. At present the British shipper to and from Canada has the choice of using either a conference or a non-conference service because Cast operates outside the conferences. Although the volume of traffic carried by Cast via its feeder service from Harwich, amounting to 5,000 to 6,000 container journeys, constitutes a relatively small part of the total traffic carried between the United Kingdom and Canada, Cast provides effective competition in terms of price, and the importance of this service to British shippers is therefore disproportionate to the amount of cargo carried because of its effects on rates generally (see paragraphs 252 and 334). This situation would be unlikely to survive the proposed merger. This is because under ECS's proposals (see paragraph 184) Cast Containers Ltd would become the contractual carrier for ML's present traffic, and we think it unlikely that Cast Containers Ltd would be a member of the United Kingdom/Canada conferences for a part of its United Kingdom trade only.

390. The effect of the merger on the Atlantic conferences is also of interest to British shippers. In this field, ECS proposes that ML should remain inside the United Kingdom/Canada conferences while Cast remains outside (see paragraph 187). We have already pointed out that this proposal would probably be incompatible with the continuance of Cast's present United Kingdom service outside these conferences (see paragraph 389). The merger could have other implications for the existing conference arrangements, particularly in view of ECS's intention that neither Cast nor ML should join the Continent/Canada conferences. If ECS's proposal that Cast Containers Ltd should become the contractual carrier for ML's traffic were put into effect there would have to be negotiations on whether, and if so on what terms, ML could remain, or Cast Containers Ltd could become, a member of the United Kingdom/Canada conferences. ML considers that such negotiations would be undertaken in very disadvantageous circumstances. Even if Cast were prepared to discontinue its non-conference service via Harwich, it might be refused membership (or ML's membership might be terminated) on the grounds given in paragraphs 255 and 337. We are not in a position to forecast the attitudes of the various parties if they were actually faced with the problem, but we think that there is a real possibility that an approach by Cast to join the United Kingdom/Canada conferences in respect of its United Kingdom trade would not be negotiable on terms that would be acceptable to all the parties and that as a consequence the conferences would break up.

391. We have not thought it appropriate within the terms of the present references to conduct a general inquiry into the desirability of the system of shipping conferences. It is unnecessary to do so, because, in our view, there is no likelihood that the merger situations would lead to the disappearance of conferences from the United Kingdom/Canada trade. The evidence on the point all suggested that, if the existing United Kingdom/Canada conferences were to break up, the consequence would be a period of rate warfare, possibly fatal to

some carriers now in the trade, followed by the formation of new conferences. We have been given no reason to believe that such a process would lead to any improvement in the service available to shippers generally or that it would lead to more effective competition as between conference and non-conference trade.

392. In paragraphs 398 to 402, we examine certain claims by ECS that a merger of its North Atlantic container operation with that of ML would reduce costs. Such savings would increase the Cast group's profits but they could also be of benefit to British shippers to the extent that the improved competitive position of the merged group led to lower freight rates. It is impossible to be sure whether, and if so to what extent, the merged operation would have this effect.

393. In all, therefore, we are of opinion that the merger would be likely to have an adverse effect on the interests of British exporters and importers.

2. *The effectiveness of ML*

394. We consider that ML is an effective company. In particular, it has an impressive record of enterprise and successful innovation (see paragraphs 128 to 135). We think that Cast also has an impressive record (see paragraphs 63, 79 and 81). However, ML put it to us that its character could hardly be more dissimilar from that of Cast and that the merger of the two enterprises would therefore be damaging (see paragraphs 245 to 248). ECS disagrees with the validity of some of these points and the significance of others (see paragraphs 256 and 257). We consider that the following differences in the characteristics of the two businesses are relevant:

(i) ML is an old established company with a long tradition of owning and operating ships, whereas Cast has been in existence for only a few years, and its experience is limited to the operation of chartered ships.

(ii) It has been ML's long-term policy to provide a comprehensive scheduled liner service allied to a conference tariff, whereas Cast is selective in the business which it seeks, and it operates outside the conferences.

(iii) ML's wide range of business uses a fairly elaborate commodity tariff and employs many container types, whereas Cast operates a simple container rating system and employs only one type of container.

(iv) While both Cast and ML seek to be competitive, ML places emphasis on quality of service, Cast on price.

(v) ML is a public company managed by a board of directors whereas Cast is controlled in effect by a single individual, Mr Narby, who is accountable only to himself and his two Canadian partners. The two holding companies, ECS and Intercast SA based respectively in Bermuda and Switzerland, are private companies and are not required either to publish or file their accounts.

395. We think that these differences in the characteristics of the two businesses in their cumulative effect would militate against a successful merger of the two groups unless it were the policy of Cast to allow ML to operate within the Cast organisation with as wide a degree of latitude as it is able to operate at

present, and with full encouragement to exercise its management talents in the development of new activities and services. ECS's proposals would not, in our view, have this result. All ML's ship-operating activities would be closely integrated with those of Cast and its organisation would be re-moulded so as to fit into the existing Cast organisation; ML's ship-operating activities would be allocated to two new ML companies, a company which would own and manage ships which it would charter to Cast Shipping Ltd in Bermuda, and a container service company responsible for United Kingdom inland transport and marketing which would lease its containers to Cast Containers Ltd. These new ML companies would be risk-bearing only in a very limited sense. The nature of the re-organisation proposed suggests that ML would be bound to adapt itself to Cast procedures and would be largely deprived of its present degree of management independence and responsibility. We consider that the implementation of these proposals would be disruptive and damaging to the effectiveness of ML and be likely to lead to serious loss of morale on the part of its staff and management.

396. ECS put it to us that ML without the merger would not survive competition from larger operators on the North Atlantic. It submitted to us information (see paragraph 228) purporting to show that ML was already losing custom on its North Atlantic route. We obtained from ML detailed information on all the individual cases submitted to us by ECS (see paragraph 239) and we do not think they support its argument that ML is losing custom to its competitors. There is indeed no reason to expect that ML would lose custom by virtue of higher costs, at any rate to the extent that its charges are determined by conference rates. If ML's costs are higher than those of its competitors (which ML does not concede), this would tend to show itself in terms of falling profits rather than falling turnover. It is, however, the case that the volume of the traffic handled by ML on the North Atlantic route has fallen since 1974 (see paragraph 239) and that its profitability also has fallen (see paragraph 152). ML attributes this to the general recession in trade together with, in 1975, the effects of strikes both in Montreal and in Manchester. It considers that it has recovered the custom which it lost to its competitors in 1975 as a result of these strikes and says that it continues to win new business.

397. We have been unable to discover whether ML is losing or gaining ground on the North Atlantic *vis-a-vis* its competitors in terms of either turnover or profits, because the size of its market cannot be estimated accurately and most of its competitors do not publish separately the profitability of their North Atlantic container operations. However, bearing in mind the long period in which ML has survived in a changing market and its current policy of reducing its dependence on the North Atlantic by extending its business in other directions, we do not doubt ML's continuing ability to survive in this trade. Still less do we regard its survival as a company, within the FW group, as being seriously at risk.

3. *Cost savings claimed for the merger*

398. We have considered the prospects that cost reductions would be obtained, which prospects constitute an important part of ECS's case for the merger. There are two principal areas in which such reductions are foreseen by ECS:

the use of larger ships, and the rationalisation of the Canadian 'land-leg' part of the container operations of ML and Cast. As ML operates its Atlantic container service from the United Kingdom and Cast operates its services mainly from the Continent (with a feeder service only from the United Kingdom), the scope for economies in the United Kingdom and on the Continent is clearly small.

399. As regards the use of larger container ships, ECS estimated that the cost of carrying a container across the North Atlantic in a small ship was 27 per cent higher than the cost of carrying it in a larger ship when both ships were full[1] (see paragraph 230). ML was not shown this study (see footnote 1 to paragraph 230) but was asked to provide us with its own estimates of certain costs. ML's figures suggest that ECS may have overestimated some of the savings to be obtained from the use of larger ships, but even when allowances are made for this and for the cost of the containers themselves, we estimate that, on the assumptions made, the cost per container of the small ship would still be about 16 per cent higher than that of the larger ship. An independent study of the North Atlantic route by the Marine Transport Centre at Liverpool University estimated, after taking account of some ECS comments, that the cost per container of the small ship would be 15 per cent higher than those of the larger ship when both ships were full[2] (see Appendix 19). Although this study makes operating assumptions rather different from those made by ECS, in effect it broadly confirms the modified results of the ECS study, which we think it reasonable to accept.

400. ML has argued that the cost savings theoretically obtainable from the use of larger ships are outweighed by important disadvantages in practice. In particular, it is an essential condition for savings to be obtained that the volume of traffic suffices to provide economic loads for the larger ships without sacrifice of regularity and frequency of service. ML's current Atlantic traffic, carried by four 527 TEU container ships, provides sailings every 5 to 7 days. The present volume of business handled by ML does not justify the use of substantially larger ships. However, ECS suggests that the use of larger ships would be feasible if ML's and Cast's trades were combined. This would necessitate the larger ships calling at Antwerp on the return voyage from Canada. Use of a larger ship on a triangular route would add about 5 per cent to the unit costs, as compared with their use on the straight journey across the North Atlantic assumed in the two studies referred to in paragraph 399. In addition, the larger ships would have to berth at Liverpool instead of Manchester because they would be too large to use the Manchester ship canal. ML claims that it is cheaper overall for it to use Manchester rather than Liverpool, and it has the advantage of choice at present which with larger ships it would forego.

401. ML has also argued that its policy of operating small ships gives it flexibility of operation in the face of cyclical fluctuations in its North Atlantic

[1]ECS later re-worked some of the figures to show that the economies of the larger ship could be presented even more favourably (see Appendix 19). These appeared to us not to modify the real orders of magnitude.

[2]Broadly, the cost comparisons continue to apply when the two ships are not full, provided that they are loaded up to an equal percentage of their capacity (see paragraph 6 of Appendix 19).

trade in that it can charter out ships surplus to its requirements in times of recession without reducing to an unacceptable extent the frequency of its service. It claims that this flexibility has given it better load factors than its conference competitors, as a result of which it is operating more profitably on the North Atlantic than they are. We have been unable to establish whether this is so (see paragraph 397). However, while we accept ML's argument that it is able to operate flexibly with its small ships, we think that, if the existing ML and Cast trades were combined and a triangular route with somewhat larger ships as envisaged were operated, the merged group could operate with a similar degree of flexibility, because the volume of the traffic carried would bear a similar relationship to the size of ship used. We therefore think that in applying the technical studies to the actual situation, the main adjustment necessary arises from the additional costs of a triangular service. We conclude, therefore, that substantial operating economies, worth up to about 10 per cent of the shipping costs, or somewhat less in terms of operating costs, might be obtainable by merging the ECS and ML container operation on the North Atlantic.

402. As regards the Canadian 'land-leg', ECS proposes that Cast's terminal at Montreal should be amalgamated with ML's terminal there leading to economies which it estimates at £1 million annually (see paragraph 233). In addition, ECS considers that economies in administration and inland transport of about £1·3 million and £1 million respectively could be achieved (see paragraph 234). We estimate that such economies if eventually achieved would have the effect of cutting the merged group's total operating costs on the North Atlantic route by about 8 per cent. These estimated cost savings were contained in a detailed technical study carried out by ECS. ECS did not wish us to show this to ML and we do not know what ML would have said about it.

403. ML expressed scepticism about the benefits of a joint terminal in Montreal and the practicability of achieving other savings in Canada. For example, it considered that the merged group's market share would fall and that staff economies would not be facilitated by the need to market the group's service partly on a conference and partly on a non-conference tariff. Its own staffing was geared to a high level of service to the customer and its terminal was not designed to handle Cast's ships and would be expensive to adapt. In its view no further rail savings would be obtainable (see paragraph 243). In all the circumstances we do not feel able to base any conclusion on the cost advantages claimed in respect of either a joint terminal in Montreal or other services in Canada.

404. We are not in doubt that substantial economies might be obtained from a merger of the ML and Cast container operations on the North Atlantic; though these economies could not be fully obtained, under ECS's proposals, until all ML's ships were replaced in four to five years' time. The benefit of these savings which would accrue mainly, if not wholly, to the new owners of ML, would be attended by certain disadvantages to British interests. We have already noted that there would be a shift in the centre of control abroad which would be likely to affect adversely the interests of the British shippers (see paragraph 387). The proposed triangular route for ML's ships would remove the advantages of a direct service and we do not think the British shipper could rely on a reduction

in freight rates as a consequence of Cast's reduced costs (see paragraph 392). Moreover, as we have pointed out in paragraph 395, the integration of ML with the Cast organisation which would be necessary to obtain these operating economies, would be damaging and disruptive to ML in other ways. Any advantages to the Cast group would not, therefore, be matched by advantages to the United Kingdom.

405. Should it become apparent to ML that its present North Atlantic operation had ceased to be viable, we do not think that ML would lack the flexibility to seek and find a solution either on its own or in conjunction with a partner. Nor should it be overlooked that ML already enjoys some rationalisation benefits from its existing co-operation agreement with Canadian Pacific Steamships Ltd, benefits which would almost certainly be lost if the merger were to take place (see paragraph 249).

406. We conclude that the Cast group could obtain substantial economies if its North Atlantic container trade were merged with that of ML. However, we think that ML would be rendered less effective as a company and that some of its business would be lost; and that the service to British shippers might be poorer.

4. *The balance of payments*

407. In assessing the likely balance of payments effects of a merger involving the acquisition by a non-resident company of a resident company, distinction can usefully be drawn between the effects of the merger transaction itself and effects which would be likely to arise as a result of changes in the conduct of the business acquired consequent on the change of control.

408. As regards the merger transaction itself, we can proceed on the basis, commonly adopted, that such a transaction may be regarded as unobjectionable in balance of payments terms provided that the price paid for the acquisition of the British company is freely negotiated on an arm's length basis and acceptable to the parties concerned. In the present instance the relevant transaction is the proposed share exchange which was under discussion between Rea Brothers and ECS immediately before the reference to us. ECS has told us that it would seek to resume negotiation, on the basis of these proposals, if allowed to do so. On the other hand, the share exchange proposals never reached even the stage of being submitted to the board of FW, and Sir James Steel has told us that he would not be in favour of accepting them. It would therefore be unsafe to assume that, if FW and ECS were free to resume their discussions, they would reach agreement on the terms of the proposed share exchange. Nevertheless, this proposal and the circumstances from which it arose contain important indications of what would be likely to happen.

409. Sir James Steel instructed Rea Brothers to approach ECS because in Rea Brothers' view ECS was already in a position to gain control of FW (see paragraph 204). The fact that this was the origin of the negotiations indicates the constraint under which Sir James was acting. FW was not a willing seller of its shares in ML. On the contrary, we were told that the FW board was concerned to maintain FW's effective control of ML. If the FW board were to negotiate

with ECS on the basis of the share exchange proposals, it would do so not as a willing seller, but as a forced seller driven to contemplate parting with something which it would prefer to keep (control of ML) in order to avoid something which it considered still more undesirable (control of FW passing to ECS). Such negotiations might result in a bargain, but it would not be a bargain freely struck. The price agreed for FW's shares in ML would be a price agreed between a willing buyer and a forced or weak seller. In our judgement, therefore, there is a risk that the result would be disadvantageous to the balance of payments.

410. As regards changes in the conduct of the business consequent on the change of control, the single most important effect would be likely to be in the sphere of investment policy, particularly in relation to ships. ML at present has, we understand, made no firm decisions on orders for new ships to follow those for the two new container ships which are due to be delivered next year, although a British yard is carrying out certain design studies. ECS states that the joint resources of ML and Cast would be used to build six new bulk carriers which would be owned and operated by ML primarily on Cast routes. No doubt its decisions on whether to place orders for new ships or to charter at any particular time would depend on its assessment of the market prospects for bulk carriers at that time. The effect on the balance of payments of decisions to build ships would depend on where they were built. There is some reason to suppose that orders for new ships placed by ML would be more likely to be with a British yard than orders placed by ECS. In forming this view we take account of the presumably satisfactory relationship which ML has had with Smith's Dock Company in recent years and the fact that since 1969 ML has placed all its orders for new ships, save two small container ships, with British yards. ML's reason for preferring British yards are recorded in paragraphs 307 and 308.

411. Examples of other areas of group policy which might have balance of payments consequences are the following:

(i) *Containers:*

ML says that 69 per cent of its expenditure on containers has been in the United Kingdom. We understand from ECS that its containers have been purchased in France. The establishment of a common group policy could have an adverse effect in this field.

(ii) *Ship and container repair facilities:*

Ship and container repair work might well be centralised in the ECS group outside the United Kingdom, particularly as, in ML's view, ML's own ship and container repair facilities in Manchester might cease to be viable if Liverpool became the base port for its North Atlantic operations (see paragraph 248). In this connection, ECS said that it did not envisage any change in the location of container repair facilities (see paragraph 260).

(iii) *Ships stores, provisions and fuel:*

A foreign group operating from an overseas base might well tend to centralise purchases of this kind outside the United Kingdom.

412. The ECS proposal to put British crews on its new bulk carriers could have a beneficial effect on the balance of payments, but it would be small.

413. Changes of policy in these areas could work to the advantage as well as to the disadvantage of the balance of payments, but on balance we think the latter more likely because of the shift in the centre of control abroad.

414. We give it as our view in paragraph 395 that ECS's policies would reduce the effectiveness of ML in the development of new activities and services. Such adverse effect of the merger would be likely to have an adverse effect on the balance of payments.

415. FW and ML have argued that under ECS's merger proposals the rates at which ML's ships and containers were respectively chartered and leased to Cast Shipping Ltd and Cast Containers Ltd in Bermuda would not be determined at arm's length and they could therefore be fixed so that the profits from ML's operations appeared mainly in Bermuda rather than in the United Kingdom. Assuming the rates could be fixed in this way, which we think they might well be in spite of the relevant provisions of the Income Tax Act 1970 (see paragraphs 362 to 364), the new ECS group's liability to United Kingdom taxation whether immediate or deferred would be reduced compared with what it would have been if the profits had appeared as ML profits and then remitted. There would then be an additional balance of payments loss equivalent to any tax loss.

416. The current 'free depreciation' provisions make it possible for British shipowners to defer payment of Corporation Tax (though not Advance Corporation Tax payable in respect of distributed profits), provided they invest in new ships or make other fixed investment at a rate and to a value sufficient to match the flow of taxable profits. The main advantage to ECS of arranging transfer prices within the group in such a manner that ML's profits would tend to arise in Bermuda rather than in the United Kingdom would be that its investment policy would be freed from tax considerations to the extent that profits were transferred in this way. Such arrangement would of course be of no benefit to ECS—at least for some time—if ECS were to undertake through ML the large investment in bulk carriers to which we refer in paragraph 410.

417. ECS states that it would be contrary to its interests to arrange transfer prices in this way because of its need to ensure that the earnings (primarily foreign exchange) of the ML shipowning company could be at a level which would give it the commercial and financial stability to enable it to obtain finance for the intended shipbuilding programme (see paragraph 303). We are not, however, persuaded by this argument, partly because finance could presumably be raised at least to some extent on the security of the ships themselves, but more importantly because ECS itself could be the borrower or guarantor and therefore provide adequate earnings cover for the borrowing.

418. We think that the overall effect upon the balance of payments is more likely to be unfavourable than favourable.

5. *Use of the Port of Manchester*

419. Mr Redford, chairman of the Manchester Ship Canal Company (MSCC), told us that the Manchester ship canal was constructed because of dissatisfaction at the time with Liverpool as a port. A large number of substantial enterprises

now bordered the canal (see Appendix 8) which was an important artery for the whole of the North West region. There had been a long history of close co-operation between ML and MSCC and about 12 per cent of MSCC's total revenue in 1975 derived from ML's operations. It was MSCC's view that ML should be free to continue to develop its business in Manchester with the enterprise and innovation which it had shown previously if both it and MSCC were to remain profitable (see paragraph 331).

420. ML does not regard itself as tied to the Port of Manchester and it says it decided in favour of Manchester Docks in 1968 as the base for its container operations because the studies which it made at the time showed that this was the best and most economical solution (see paragraph 129). Both ML and the British Shippers' Council say that Manchester remains more economical than Liverpool and fewer delays are experienced at Manchester than at Liverpool. ECS's plans to bring into service on the North Atlantic ML's two new ships and in four to five years time to replace ML's other ships with larger ships (see paragraph 186(iv)) would necessitate the substitution of Liverpool for Manchester because the new ships would be too large to pass through the ship canal. We do not know whether ML would always prefer to base its operations on Manchester rather than on Liverpool, but ECS's merger proposals would be likely at least to accelerate any substitution of Liverpool for Manchester. We think that this would be harmful to an important regional interest and, to that extent, harmful to the national interest also.

6. *Employment*

421. The merger might affect employment in the United Kingdom either directly through its effect on ML or indirectly through its effect on the procurement of goods and services in the United Kingdom.

422. Representatives of the trades unions expressed fears that the merger might lead to development abroad instead of in the United Kingdom and that British ships might be transferred to flags of convenience. We are satisfied that ECS's proposals of themselves would not lead to any significant change in ML's labour force either afloat or in the United Kingdom. Indeed, ECS claimed that its bulk carrier programme would add to the employment of seafarers. On the other hand, if our fears that ML's effectiveness as a company would be impaired by the merger were realised, this would be likely to have adverse effects on employment. The indirect effects of the merger on employment, which could be more material, would arise from the considerations referred to in paragraphs 410 to 413.

423. We judge that the effects of the merger on employment in the United Kingdom would be likely to be small, but that the overall effect is more likely to be unfavourable than favourable.

7. *Summary*

424. ML gives a first class service to British exporters and shippers generally. Transfer of control to ECS would be likely to impair this service. It might well deprive the British shipper of his present choice between a conference and non-conference service. ML's operations would become closely integrated with those

of the Cast group and, because of the widely differing nature and objectives of the two groups as they are at present, ML would suffer substantial disruption and damage. The economies that might be obtained by the Cast group from a merged North Atlantic container operation would compensate neither for this nor for the shift in the centre of control abroad. The effects of the merger on the balance of payments and on employment would be more likely to be unfavourable than favourable. ECS's proposals to use larger container ships would be likely at least to accelerate any substitution of Liverpool for Manchester as the base port for ML's North Atlantic operations and we think this would be harmful to regional interests.

8. *Conclusion*

425. We conclude that the proposed merger may be expected to operate against the public interest. The particular effects, adverse to the public interest, which in our opinion it may be expected to have, are those given in paragraph 424.

B. The merger situation between ECS and FW which has already been created

426. ECS is not at present represented on the FW board but we take the view that it would have had a reasonable prospect of obtaining such representation in the situation as it was before 28 November 1975 irrespective of its temporary voting rights in the 8·2 per cent of the FW shares which were the subject of a conditional purchase from Hambros Bank (see paragraph 376). Since 28 November 1975 ECS relinquished these temporary rights because it did not complete the purchase of the shares, but it has purchased further FW ordinary shares during the course of our inquiry (see paragraph 178).

427. There is conflict between the parties about the desirability of ECS representation on the FW board (see paragraphs 282, 292 and 293). The main objection raised by FW is that FW and Cast are competitors. FW suggests that ECS representation on its board would give Cast access to commercial information about FW which would be improper for a competitor to have, and it would create conflict of interest for the ECS representative between his duty to FW shareholders and his duty to Cast. ECS agrees that it would be undesirable for a competitor to be represented on the FW board, but disagrees that Cast is a competitor save in one or two marginal respects.

428. We are of opinion that Cast is in competition with ML both in the United Kingdom and in Canada and that there is potential competition between Cast and FW in other parts of the world. We consider that such competition constitutes an objection to ECS representation on the FW board.

429. FW suggests also that an ECS presence on the FW board would be disruptive in view of the conflicting interests, attitudes and policies of the two groups. It points out that the merger is opposed. Cast's own performance so far has been successful within its particular field, but we think it unlikely that an ECS representative would make a useful contribution on the FW board because of the conflicting interests to which we refer in paragraph 428. We note in particular that ECS, if represented on the FW board, would seek Cast control

of ML's North Atlantic container operations (see paragraph 188). We think that this would be an undesirable objective and be likely to create discord within the FW board.

Conclusion

430. We conclude that the merger situation operates and may be expected to operate against the public interest. The particular effects adverse to the public interest which in our opinion it has or may be expected to have are those given in paragraphs 427 to 429.

C. The proposed merger between ECS and FW

431. ECS states that it is not its intention to exercise control of FW's policy and it has not put forward any arguments in favour of a merger arising from its becoming able to control that policy. Indeed, it states that control of FW by ECS would be undesirable (see paragraph 209).

432. If ECS were to become able to control the policy of FW, it would become able to control the policy of ML also because of FW's controlling interest in that company. We have already concluded that the acquisition by ECS of FW's controlling interest in ML would be likely to operate against the public interest. The objections which we consider would apply to the acquisition by ECS of a controlling interest in ML would, in our view, apply also to a situation in which it became able to control ML because it had become able to control FW.

433. The disadvantages which we think arise from ECS's ability to influence the policy of FW (see paragraphs 428 and 429) would, in our view, apply *a fortiori* if it were able to control FW's policy. In particular, ECS would experience acute conflict between its own interests and the legal duty of the FW board to other shareholders.

Conclusion

434. We conclude that the proposed merger may be expected to operate against the public interest. The particular effects adverse to the public interest which in our opinion it may be expected to have are those given in paragraphs 432 and 433.

Recommendations

435. We are unable to recommend any actions which would prevent the adverse effects which we consider would be likely to arise from the proposed merger between ECS and ML (see paragraph 425), and we therefore recommend that the merger should not be permitted.

436. We are unable to recommend any action which would prevent the adverse effects which we consider would be likely to arise from the proposed merger between ECS and FW (see paragraph 434), and we therefore recommend that the merger should not be permitted.

437. We are unable to recommend any action which would remedy or prevent the adverse effects which we think will result from the merger situation

between ECS and FW which has already been created (see paragraph 430). We therefore recommend that ECS should be required over a reasonable period, say two years, to reduce its holding of FW ordinary shares to not more than 10 per cent of FW's issued ordinary share capital, and that meanwhile it should not be permitted to exercise voting rights in respect of shares representing more than 10 per cent of the issued ordinary share capital of FW.

J G LE QUESNE (*Chairman*)
T BARNA
F E JONES
CAROLINE MILES
S A ROBINSON
J S SADLER

Y LOVAT WILLIAMS (*Secretary*)

6 July 1976