Takeovers – will they ever be the same again?

by Philip Goldenberg


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With the Company Law Review and the Human Rights Act, Philip Goldenberg, a senior corporate finance partner at City solicitors S J Berwin & Co, asks whether takeovers will ever be the same again. The answer, he says, is 'no'...

The Takeover Panel (the panel) is a remarkable institution. A voluntary unincorporated association exercising public functions, and indeed creating a system of quasi-law in competition with the general framework of company law. A body which originally claimed not to be amenable to judicial review, and in whose affairs the Courts, while rejecting this claim, have nevertheless hitherto been reluctant to interfere. An organisation which, given its voluntary nature, would be exposed to attack under art. 86 of the Treaty of Rome if it were to abuse its dominant position as a regulator; and yet, which, given the public functions it exercises, is subject to the obligations that arise in relation to public authorities under the *Human Rights Act* 1998 (HRA 1998).

None of this, of course, is to decry the merits of the panel. Its rules are sensible, and indeed form the basis of the current draft EU Takeover Directive. Its operations are speedy and flexible; and its officials are helpful and courteous. But the House of Commons was on the side of historical inevitability when, in considering the Financial Services and Markets Bill, it allocated the ultimate control of market abuse in a takeover context not to the Panel, but to the statutory Financial Services Authority.

HUMAN RIGHTS

The HRA 1998 is relevant to the operations of the panel in two ways: the first general, the second specific.

The general issue arises under art. 6(1) of the 'convention rights', which provides that, in the determination of their civil rights and obligations, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. It is probable (but not certain) that the panel (for this purpose including its internal appeals procedure) would be regarded as pronouncing a determinative judgment; but it is certain that the Panel is not 'established by law'. Further, while it may well be 'impartial', it is difficult, given its composition, to argue that it is 'independent'.

This leads to the point of specificity. The traditional rigid distinction between 'public' and 'private' equity (companies whose shares are publicly traded and those whose shares are not) is now unsustainable, as the multitude of 'public to private' transactions shows; and the composition of the panel is very much on the public equity side. How can it therefore be seen to be an 'independent tribunal' in terms of art. 6?

A CHANGE IN ETHOS

Of great importance to the future of takeovers is a change in ethos which may be brought about by the Company Law Review. The process started in March 1998, with the publication by the Department of Trade and Industry (DTI) of a consultative document called 'Modern Company Law for a Competitive Economy'. This established a review process which, while managed by the DTI, is nevertheless independent and self-standing.

There is a further relevant convention right as regards takeovers. Article 1 of the First Protocol to the European Convention on Human Rights gives all natural or legal persons the entitlement to the peaceful enjoyment of their possessions except in the public interest and subject to the conditions provided for by law and the general principles of international law. There is a specific exception to this right (which might be better viewed as more specific wording in terms of the 'public interest exception') in relation to the State's right to control the use of property in accordance with the general interest.

This exception would presumably cover a compulsory purchase order (CPO) made in accordance with and for a purpose provided in statute law (although the Courts would clearly be open to argument that a particular CPO was inappropriate in terms of the applicable convention right). But the exception would not seem to apply to an expropriation of property other than for a public or general interest purpose. As is well-known, under the takeover provisions of the *Companies Act* 1985, an offeror obtaining more than 90 per cent of an offeree's shares may then expropriate the minority, subject only to the right of a dissenter to apply to the Court. There have not been many such applications, and the general wisdom has hitherto been that the Court would be reluctant to intervene (simply on the basis that, if over 90 per cent of shareholders have found an offer acceptable, why shouldn't everybody else). The application of art. 1 to the First Protocol, however, opens up the argument that dissenter minority shareholders could simply say that they wished to retain their shareholdings, and there was no public or general (as opposed to private) interest in favour of such shareholdings being expropriated. What view the Court would take, in terms of the balance between the dissenter's convention rights and a 'general interest' argument in favour of the traditional application of the present law, has yet to be ascertained. There is no doubt, though, that the balance has been tilted by the HRA 1998.

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A year later, the steering group of the review process published a strategic framework consultative document setting out the key issues as it perceived them, particularly the general framework of corporate governance. Various technical consultation papers followed.

In March 2000, the steering group published a much lengthier document called 'Developing the Framework'. While this was still in some senses consultative, it was nevertheless firmer on those issues already aired a year previously. So heavy (in all senses) is the document that it is known to cynical professionals as the 'Green Brick'!

One of the key proposals of 'Developing the Framework' is that listed companies should be obliged to publish annually an Operating and Financial Review (OFR), which would go beyond the traditional form of historic financial reporting to a much more broadly-based set of indicators.

An OFR would include:

- a developmental review of a company's business, including market changes, new products and services, and changes in market positioning;
- a company's purpose, strategy and principal drivers of performance;
- its key relationships with employees, customers, suppliers and others on which its success depends;
- a review of its corporate governance;
- the dynamics of a company's business, including a full SWOT analysis, which would go beyond the financial to market conditions, technological change, health and safety, environmental exposure, tangible and intellectual capital, brand development, research and development, and training;
- environmental policies and performance; and
- policies and performance on community, social and ethical issues and reputation.

It may be argued that any competent management would do all this anyway; but the effect of this change will be to compel less good management to improve their standards, and also to introduce a real measure of transparency.

SPECIFIC PROPOSAL

There is a specific related proposal in 'Developing the Framework' whose significance has so far been under-appreciated. In the event of a takeover bid, a revised OFR will need to be published; in the case of a recommended offer, this will presumably be a single OFR relating to the proposed enlarged group. This will significantly change the culture of takeovers, because offerors will no longer be able to get away with anodyne statements; for example, they will have to be much more specific about earnings enhancement or dilution.

The proposal will have a much greater impact on hostile takeovers. At the moment, the conventional wisdom is that the board of an offeree company which does not welcome a bid should limit its response to the fairness or otherwise of the consideration offered. Indeed, in some prominent cases, financial or legal advisers have cowed offeree boards into not robustly defending a bid on non-financial grounds.

For example, the directors of BOC could have chosen to contest the proposed takeover by Air Products. The eventual decision by the US competition authorities demonstrated after the event that there were good grounds for resisting the bid. Yet the board felt obliged to take the advice of lawyers who claimed that it was their duty to shareholders to recommend the bid. Likewise, the directors of Manchester United were advised that they were obliged to recommend without reservation the BSkyB bid for the Club. They (or at least some of them, including Mr Greg Dyke), would have preferred to warn of the undesirability of a football club becoming the cat's paw of a multinational media enterprise.

CONFLICT

Here is the point of conflict. The City Code on Takeovers and Mergers obligates directors of offeree companies to pronounce on the fairness and reasonableness (or otherwise) of a hostile bid. That is too often misinterpreted as being the totality of their duties in such a situation, and misstated as being such by financial and/or legal advisers.

The prospective new Companies Act will include a restatement of directors' duties – not by way of alteration, but by way of clarification and accessibility. These duties will make clear that directors are not obliged to think only of the short-term financial gains to shareholders when taking major decisions about the future. It should be perfectly legitimate for directors of an offeree company to say:

'This is a reasonable price. But the consequences of selling to this bidder at this price will be undesirable and we recommend against selling.'

Their reasons may include the impact upon the industry, its customers, its employees, its community or its future potential.

The shareholders can then decide whether or not to take this view into account. But neither the law, nor its interpretation by professionals, should drive directors to abdicate responsibility to financial or legal advisers, and claim that they are legally obliged to recommend a bid even if they think it will be bad for the company.

CRUCIAL

This is why the proposed OFR is crucial in the case of a hostile bid. The offeror and offeree will be bound to prepare separate OFRs, the offeror on the assumption of the bid's success and the offeree, if it resolves to oppose the bid, on the assumption of its failure. This process will at the very least force the directors of the offeror and offeree companies to set out their resultant plans and analyse their potential implications for customers, suppliers and employees, as well as for shareholders and the wider community. The result will, at the very least, be a more informed decision at the end of a more thorough process of examination.

I do not intend to argue against a market in corporate control, subject only to an appropriate framework of anti-trust legislation. But such a market works best on the basis of transparency.

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