



**BRIEFING PAPER**

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# Contested mergers and takeovers

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**Contents:**

1. Players and powers
2. Development of regime and historical cases
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## Summary

**Please note that this briefing paper is currently being updated. Most of the content is still current, except for changes arising from Brexit and new arrangements for some areas arising from the [National Security and Infrastructure Bill](#).**

Many mergers and takeovers go largely unremarked by the wider public. Some, however, attract a great deal of attention and criticism.

It is shareholders who ultimately accept or reject a merger or takeover, by voting on the offer. But other bodies can intervene in various ways, and significantly alter the deal, or block it altogether.

The most common hurdle that proposed mergers and takeovers must pass is to demonstrate that they do not substantially **reduce competition** in the relevant market. Less frequently, mergers and takeovers may have to show that they do not harm **specified public interests**.

The public interest concerns upon which the Government may intervene in mergers and takeovers are set out in [section 58](#) of the *Enterprise Act 2002*:

- The Secretary of State for Business, Energy & Industrial Strategy can intervene on grounds of **national security** and **financial stability**.
- The Secretary of State for Digital, Culture, Media & Sport can intervene on grounds of **media quality, plurality and standards**.

The Government wants to increase its ability to scrutinise and intervene in investments and transactions that raise national security concerns. Under [proposed reforms](#) published on 24 July 2018, the Government would be able to intervene much more widely and frequently when national security is considered to be at risk.

The procedures by which mergers and takeovers are undertaken are subject to regulation by the [Takeover Panel](#), which issues and administers the [City Code on Takeovers and Mergers](#).

The Takeover Panel also has powers to monitor and enforce “**post-offer undertakings**”. Post-offer undertakings are legally binding commitments made by the acquiror with respect to the future of the target company. For example, the acquiror might commit to maintaining certain levels of employment or expenditure on R&D, or to making certain contributions to the pension fund.

# 1. Players and powers

It is shareholders who ultimately accept or reject a merger or takeover, by voting on the offer. But other bodies can intervene in various ways, and significantly alter the deal, or block it altogether.

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The subsections below describe these bodies and the role they play.

## 1.1 Competition & Markets Authority

In the UK, the primary responsibility for assessing and authorising or blocking mergers and takeovers lies with the [Competition & Markets Authority](#) (CMA), an independent, non-ministerial body.

The aim of the CMA is to ensure that mergers do not **substantially lessen competition** and lead to worse outcomes for consumers, for example, through higher prices, lower quality or reduced choice.

The statutory provisions for the UK's merger regime are set out in part 3 of the *Enterprise Act 2002*, as amended. The CMA has authority to examine mergers if the merged entity has a **turnover of £70m or more**, or **controls 25% or more of its market**.<sup>1</sup> For mergers that raise national security concerns, a lower threshold of £1 million applies (see [section 3.2](#)).

The CMA has a statutory responsibility to begin this process if it believes the merger would result in a 'substantial lessening of competition' within any market or markets for goods or services in the UK. There is a statutory deadline of 40 working days to complete the first stage of the merger review process, which is known as 'Phase 1' of an investigation.

At the end of Phase 1, the CMA may decide to clear the merger without further investigation. To obtain a resolution at Phase 1, the parties concerned can offer specific commitments to prevent or mitigate competition concerns arising from the merger. These commitments are known as "**Undertakings In Lieu**" (UILs).

Alternatively, if the CMA believes there is a realistic prospect that the merger will substantially lessen competition, it launches an in-depth investigation, known as 'Phase 2'. The duration of Phase 2 is generally limited to 24 weeks.

If the investigation finds that the merger is more likely than not to substantially lessen competition, the CMA sets out "**remedies**" to the situation. For instance, the CMA can:

- require the acquiring company to sell off part of its operations to reduce its market power,

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<sup>1</sup> The 'turnover test' and the 'share of supply test', as defined by s23 of the 2002 Act. For more details see, [Mergers ... CMA2](#), April 2014 para 4.47-52 & 4.53-62

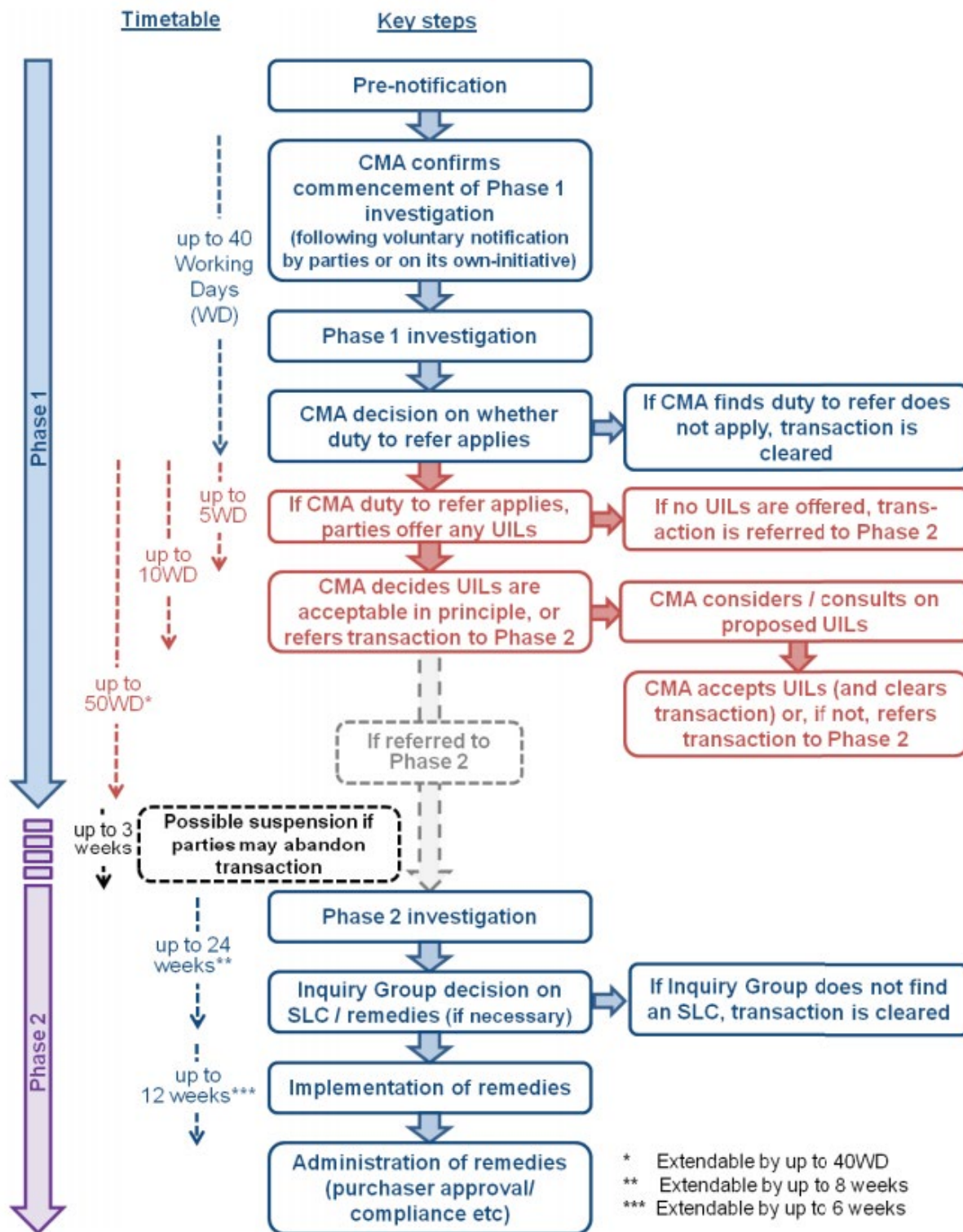
- prohibit the merger,
- reverse the merger if it has already occurred.

Firms usually engage in discussions before the merger takes place, to guard against the costliest outcome of reversing a merger.

The CMA's flow chart below summarises the merger assessment process.<sup>2</sup> The diagram provides a summary only: it does not show, for example, processes that are relevant only in certain limited cases (such as public interest cases, local media mergers or NHS foundation trust mergers, where the Secretary of State, Ofcom and Monitor respectively have a role).

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<sup>2</sup> [Mergers ... CMA2](#), April 2014 p9



## 1.2 European Commission

At present the UK competition regime interlocks with the European one. European legislation on mergers and takeovers is contained in the [EC Merger Regulation](#) (ECMR), *Regulation 139/2004*. The European Commission has jurisdiction over mergers which have a 'Community dimension', determined by a turnover test similar to that applied by the UK competition authorities. As with UK law, the ECMR establishes a

substantive test to determine whether a merger should be permitted or not: specifically, that it would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position, and thus be incompatible with the common market.

As it transpired, the size and scope of Kraft and Cadbury operations across the EU meant that the bid made by Kraft in 2009 was referred to the European Commission, rather than the UK authorities; on 6 January 2010 the European Commission cleared it, subject to Cadbury selling off operations in Poland and Romania.<sup>3</sup>

### 1.3 The Secretary of State

A key feature of the competition regime is that it is quite independent of government. In general, the Secretary of State has no powers to intervene in making a reference, in the conduct of the investigation, or in the decision as to whether a merger should be permitted or not.

The Secretary of State may only intervene if the merger gives rise to certain **specified public interest concerns**. These are set out in [section 58](#) of the *Enterprise Act*:

- The Secretary of State for Business, Energy & Industrial Strategy can intervene on grounds of **national security** and **financial stability**.
- The Secretary of State for Digital, Culture, Media & Sport can intervene on grounds of **media quality, plurality and standards**.

The *Enterprise Act* allows the Government to add, via secondary legislation, new public interest grounds for intervention in mergers. This has been done once. In October 2008, the then Labour Government added the interest of maintaining financial stability to the list of public interest concerns.<sup>4</sup> This allowed the Secretary of State to intervene directly in the takeover of HBOS, the UK's largest mortgage lender, by Lloyds TSB.

The takeover was prompted by the precipitous fall in HBOS's shares, in the turmoil following the collapse of Lehman Brothers in the USA, and the ensuing crisis which gripped the global financial system. The merger raised serious competition concerns. An editorial in the *Financial Times* noted that the combined bank, with "a 30% share of current accounts, and a similar presence in the UK mortgage market", would be "all too likely to try to push existing customers on to higher mortgage rates rather than offer new services or lower prices" once the crisis ended.<sup>5</sup>

However, on 31 October 2008, the then Secretary of State, Lord Mandelson, intervened to *allow* the merger to proceed without further investigation, on the ground that the public interest of financial stability outweighed competition concerns:

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<sup>3</sup> [European Commission press notice IP/10/3, 6 January 2010](#)

<sup>4</sup> Under SI 2008/2645. A Library paper gives more detail on this reform: [The Lloyds-TSB and HBOS Merger: Competition Issues](#), SN4907, 15 December 2008.

<sup>5</sup> "Editorial: Investors should block HBOS deal", *Financial Times*, 11 November 2008

Taking account only of the substantial lessening of competition and the relevant public interest consideration, the Secretary of State believes that the creation of the relevant merger situation is not expected to operate against the public interest. The OFT has decided that it is or may be the case that the creation of the relevant merger situation may be expected to result in an anti-competitive outcome, in particular in view of its potential to result in a substantial lessening of competition in the market for personal current accounts, for banking services to small and medium sized enterprises (SMEs) in Scotland, and in the supply of mortgages.

However, having had regard in particular to the submissions made to the OFT by the tripartite authorities (HM Treasury, the Financial Services Authority and the Bank of England), the Secretary of State considers that the merger will result in significant benefits to the public interest as it relates to ensuring the stability of the UK financial system and that these benefits outweigh the potential for the merger to result in the anti-competitive outcomes identified by the OFT. As a result of this decision, no reference will be made to the CC.<sup>6</sup>

The CMA's guidance on its merger procedures provides more details on public interest cases.<sup>7</sup>

### 1.4 The Takeover Panel

The procedures by which mergers and takeovers are undertaken are subject to regulation by the [Takeover Panel](#), which issues and administers the [City Code on Takeovers and Mergers](#). The Code is designed principally to ensure that shareholders in a target company are treated fairly and are able to decide on the merits of a takeover bid.

General principles and minimum rules governing takeovers of listed companies were laid down in the EU's [Takeovers Directive](#) of 2004.

The Directive is implemented in the UK by the *Companies Act 2006* ([Part 28](#)) and by the City Code on Takeovers and Mergers (the "**Takeover Code**").

The Code is based on six general principles that must be applied in spirit:

1. All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.
2. The holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business.

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<sup>6</sup> For details see, [Decision by Lord Mandelson \[re\] ... Lloyds TSB Group plc and HBOS plc](#), Commons Library Deposited Paper Dep2008-2685, 3 November 2008 para 12.

<sup>7</sup> "[Chapter 16: Public Interest Cases](#)", in [Mergers ... CMA2](#), April 2014 (pp129-37). See also, Appendix 1 to, [A Competition Regime for Growth: a consultation on options for reform](#), March 2011; in particular, pp132-135.



3. The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.
4. False markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.
5. An offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.
6. An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.<sup>8</sup>

The majority of the rules relating to takeovers are contained in the Code. These rules shape the form, structure and timetable of takeovers. Although takeovers can fail because of infringements of the rules, the rules do not constitute, in and of themselves, powers to stop takeovers.

However, the Takeover Panel does have powers to enforce its rules. Significantly, these powers extend to the monitoring and enforcement of “**post-offer undertakings**”. Post-offer undertakings are legally binding commitments made by the acquiror with respect to the future of the target company. For example, the acquiror might commit to maintaining certain levels of employment or expenditure on R&D, or to making certain contributions to the pension fund.

The Panel's enforcement powers include the ability to give any direction that appears necessary to restrain a person from acting (or continuing to act) in breach of the rules. To ensure compliance with undertakings, the party giving the undertaking can be required to submit written reports to the Panel. The Panel can also appoint an independent supervisor to monitor compliance.

To secure compliance, the Panel has the **power to seek enforcement** of its rulings through the courts:

#### **(d) Enforcement by the Courts**

Under section 955 of the [Companies] Act [2006], the Panel may seek enforcement by the courts. If the court is satisfied that:

- (i) there is a reasonable likelihood that a person will contravene a requirement imposed by or under rules; or
- (ii) a person has contravened a requirement imposed by or under rules or a requirement imposed under section 947 of the Act,

the court may make any order it thinks fit to secure compliance with the requirement. Any failure to comply with a resulting court order may be a contempt of court.<sup>9</sup>

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<sup>8</sup> The Panel on Takeovers and Mergers, [The Takeover Code](#), 8 January 2018, B1

<sup>9</sup> The Panel on Takeovers and Mergers, [The Takeover Code](#), 8 January 2018, A13

Contempt of court is punishable by fines and, for individuals (e.g. company directors), by a custodial sentence for a maximum of two years ([section 14\(1\)](#), *Contempt of Court Act 1981*).

Full details of the Panel's information, enforcement and disciplinary powers can be found in Sections 9, 10 and 11 of the Introduction to the [Takeover Code](#).

### 1.5 The board of directors

A takeover can be either “**recommended**” or “**hostile**”, depending on the advice that the board of directors of the target company gives to its shareholders. If the board recommends accepting the offer, the takeover is recommended; if the board recommends rejecting the offer, the takeover is hostile.

To counter a takeover, the target board has to convince a majority of its shareholders to reject the offer. The board is free to argue its case, but it is still under a duty to act in the best interests of the company. In particular, the Code's ‘non-frustration’ rule forbids the board from taking “any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits”.<sup>10</sup> In other words, the board is not allowed to take actions that undermine or forestall the offer, for example, to sell or acquire assets of a material amount.

However, the Code does not require the board to focus only on the offer price when making its recommendation. Instead, the board can consider the long-term success of the company in the round:

[...] when giving its opinion, the board of the offeree company is not required by the Code to consider the offer price as the determining factor and is not precluded by the Code from taking into account any other factors which it considers relevant.<sup>11</sup>

Moreover, the board must include in its response its views on:

- (i) the effects of implementation of the offer on all the company's interests, including, specifically, employment; and
- (ii) the offeror's strategic plans for the offeree company and their likely repercussions on employment and the locations of the offeree company's places of business, [...].<sup>12</sup>

### 1.6 Shareholders

The ultimate decision to accept or reject a takeover rests with shareholders. At the end of the offer process, shareholders vote on the final offer. When a **simple majority** (50% plus) of the total voting rights accept the offer, the acquiror gains control of the target.

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<sup>10</sup> The Panel on Takeovers and Mergers, [The Takeover Code](#), 8 January 2018, rule 21.1

<sup>11</sup> The Panel on Takeovers and Mergers, [The Takeover Code](#), 8 January 2018, rule 25.2

<sup>12</sup> Id.

## 2. Development of regime and historical cases

### 2.1 The 'Tebbit' and 'Lilley' doctrines (pre 2002)

Prior to the 2002 Act, UK mergers were considered under the *Fair Trading Act 1973*, which set a broader public interest test.

Under s84 of the Act, the Competition Commission, and its predecessor, the Monopolies & Mergers Commission (MMC), were required to take into account 'all matters which appear to them in the particular circumstances to be relevant', with regard to the desirability:

- (a) of maintaining and promoting effective competition between persons supplying goods and services in the United Kingdom;
- (b) of promoting the interests of consumers, purchasers and other users of goods and services in the United Kingdom in respect of the prices charged for them and in respect of their quality and the variety of goods and services supplied;
- (c) of promoting, through competition, the reduction of costs and the development and use of new techniques and new products, and of facilitating the entry of new competitors into existing markets;
- (d) of maintaining and promoting the balanced distribution of industry and employment in the United Kingdom; and
- (e) of maintaining and promoting competitive activity in markets outside the United Kingdom on the part of producers of goods, and of suppliers of goods and services, in the United Kingdom.

However, in practice for some years prior to the introduction of the *Enterprise Act 2002* and the new test, most merger decisions were *already* focused on competition.<sup>13</sup> In a report on takeovers and mergers by the Trade and Industry Committee in 1991, the Committee discussed the way mergers had been assessed during the 1980s:

While the emphasis on competition as the main criterion comes from the *Fair Trading Act 1973*, competition was given more prominence in 1984 when the then Secretary of State for Trade and Industry, Mr Norman Tebbit, announced that 'references to the Monopolies & Mergers Commission (MMC) would be made primarily, but not exclusively, on competition grounds, taking into account the international dimension of competition.' Since then only six out of 74 references have been made to the MMC on non-competition grounds. There have been only seven cases since 1976 where the MMC has found the merger to be against the public interest on non-competition grounds, and six of these occurred before 1984.<sup>14</sup>

In July 1990 the then Secretary of State, Peter Lilley, announced a new approach to assessing mergers to resist, as Mr Lilley saw it,

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<sup>13</sup> The issue is examined in some detail in a Library paper, produced at the time the legislation was scrutinised by the House: [Enterprise Bill, Library Research paper 02/21](#), 4 April 2002 (see in particular pp 38-41).

<sup>14</sup> *First report: Takeovers and mergers*, 27 November 1991 HC 90 1991-92 para 233

## 12 Contested mergers and takeovers

'nationalisation by the back door' through the takeover of British companies by state-owned foreign companies. Mr Lilley set out his approach in answer to a PQ, reproduced in full below:

In deciding whether to refer merger situations to the Monopolies and Mergers Commission, I shall in future pay particularly close attention to the degree of state control, if any, of the acquiring company.

One of the Government's fundamental policy objectives has been to allow market forces to determine the most efficient allocation of resources in the interests of industry, commerce and the consumer. We have taken many important steps towards this objective over the last decade including an extensive programme of privatisation, deregulation, and the vigorous application of competition policy. This objective could be undermined by nationalisation by the back door.

State-controlled companies are not subject to the same disciplines as those in the private sector. They tend to have the assurance of Government backing for their business activities and consequently do not compete on even terms with private sector companies which operate under the threat of financial failure. Their managements may be motivated to make non-commercial decisions. They may not deploy resources efficiently; and an increase in the resources they manage may well reduce competitive forces. It is important that the MMC should have the chance to consider in detail mergers involving state-controlled companies.

All bids by state-controlled companies, whether United Kingdom or foreign, will be treated even-handedly. I shall of course continue to exercise my discretion in deciding whether to refer any particular case to the Monopolies and Mergers Commission, after receiving advice from the Director General of Fair Trading. But among the factors to which I shall give particularly close attention will be the degree of state control, if any, of the acquiring company. The Monopolies and Mergers Commission will, of course, continue to weigh up each case on its merits. Referring a merger to the Monopolies and Mergers Commission does not prejudge whether it may be expected to operate against the public interest.<sup>15</sup>

As a standard work on the development of competition policy notes, "the perennial question of the relationship between competition policy and industrial policy" was one major theme of debates at this time.<sup>16</sup>

Mr Lilley's 'doctrine' was controversial because the statutory responsibilities of the MMC required it to look at the specific adverse effects on competition of a merger referred to it. The MMC could not lawfully act on any presumption that acquisition by a state-controlled company was contrary to the public interest. The Minister's statement also raised concerns about the independence of the MMC.

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<sup>15</sup> HC Deb 26 July 1990 cc 415-6W. The statement was reproduced in, Department for Trade and Industry press notice 90/457, *Merger reference policy*, 26 July 1990

<sup>16</sup> Stephen Wilks, *In the public interest: Competition policy and the Monopolies and Mergers Commission*, 1999 p309

As a consequence of this new approach, five cases were referred to the MMC, three of which the Minister referred contrary to the advice of the Director General of Fair Trading (the forerunner to the OFT):

The Commission found against the merger in only one case ... and on the basis of an orthodox competition analysis found no problems with the other four. On this basis ministers had no option under the Fair Trading Act but to allow the takeovers and, in a speech in July 1991, Peter Lilley accepted that the doctrine could not be sustained.

He cited the MMC reports, and the view that the Commission could not work on a general presumption, and conceded that 'I too will take account of the findings in the reports so far published in deciding whether or not to refer any future cases that arise.' Although the CBI had welcomed the Lilley doctrine its demise as seen as evidence of the MMC's independence.<sup>17</sup>

In their 1991 report on takeovers, cited above, the Trade and Industry Committee considered the impact of the Lilley doctrine, summarising first Mr Lilley's case that 'state-controlled' bidders raised public interest concerns:<sup>18</sup>

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<sup>17</sup> Wilks, *In the public interest*, 1999 p310

<sup>18</sup> *First report: Takeovers and mergers*, 27 November 1991 HC 90 1991-92 pp liv-lv

STATE-CONTROLLED BIDDERS	
1	the state-controlled player <u>may</u> be able to dominate the market irrespective of commercial performance
2	management decisions <u>may</u> be influenced by wider "political" considerations such as maintaining a national foothold in an industry no matter what the cost
3	management tenure <u>may</u> be subject to political whim rather than shareholder satisfaction
4	state-controlled players <u>may</u> have access to preferential terms for capital solely because it is assumed that they have Government backing

237. Since the policy of referring such bids to the MMC was announced on 26 July 1990, five cases have been referred to the MMC<sup>254</sup>. Unusually three of these references were contrary to the advice of the DGFT<sup>255</sup>. In none of the three cases did the MMC find against the merger. In one of the other two cases<sup>256</sup>, the MMC found against the merger on competition grounds, exacerbated by the state-controlled character of the acquiror<sup>257</sup>. In the other case, the MMC found that the factors involved in state control of the acquiror would not have an adverse effect on competition and the merger was cleared<sup>258</sup>. The Director General of Fair Trading told us on 7 May 1991 "I imagine the Secretary of State will wish to review the policy"<sup>259</sup>.

238. On 12 June 1991 the Secretary of State re-asserted his policy and pointed out that the MMC had agreed that "state ownership can give rise to legitimate public interest and competition concerns"<sup>260</sup>. The MMC, however, has to look at specific adverse effects in each case and cannot lawfully act on any presumption that acquisition by a state-controlled company is contrary to the public interest. The Secretary of State said that in future he would not refer state-controlled bidders to the MMC when the following factors were small:

POSSIBLE ADVERSE FACTORS IN STATE-CONTROLLED CASES	
1	degree of state control
2	size of the entity concerned
3	share of the market involved
4	likelihood of exercising influence in the particular market
5	evidence of anti-competitive behaviour elsewhere

239. This "Lilley" addition to the "Tebbit doctrine" now seems to have been substantially modified. Following a complaint to the European Commission that this policy discriminated against foreign companies, the Commission asked the Government to explain and justify its policy. The UK Government agreed with the Commission in October 1991 that:

<sup>254</sup> Crédit Lyonnais SA/Woodchester Investments plc; British Aerospace plc/Thomson-CSF SA; Kemira Oy/ICI plc;

Sligos SA/Signet Ltd; Société Nationale Elf Aquitaine/Amoco (UK) see Evidence p207 and p 319

<sup>255</sup> Crédit Lyonnais SA/Woodchester Investments plc; Sligos SA/Signet Ltd; Société Nationale Elf Aquitaine/Amoco (UK) see Evidence p207 and p 319

<sup>256</sup> Kemira Oy/ICI plc

<sup>257</sup> Q 128 (Mr Mountfield), QQ 802 & 861 (Sir Gordon Borrie)

<sup>258</sup> Elf Aquitaine/Amoco

<sup>259</sup> Q 802 (Sir Gordon Borrie)

<sup>260</sup> Speech to the Law Society's Commerce and Industry Group, The Solicitors' European Group and The Bar Association for Commerce, Finance and Industry on 12 June 1991 p2

*“the fact that a company is state-owned or directed by a state will not per se justify a referral to the MMC; unless, exceptionally, other public interest issues (such as security interests) arise, a referral would only be envisaged insofar as competition aspects were at stake”<sup>261</sup>.*

**240. We recommend that, before the Secretary of State decides upon any substantial departure from existing reference policy, he should announce his proposals and give interested parties an opportunity to make representations about their merits and practicality.**

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<sup>261</sup> European Commission press notice 30 October 1991

## 2.2 Introduction of the current competition test for mergers (2002)

The *Enterprise Act 2002* saw the establishment of the competition-based test for mergers. In its regulatory impact assessment on the Act, the Labour Government argued that the new test would make the merger regime “more competition-focused”:

Although in recent years it has been rare for merger cases to be decided on anything other than competition grounds, such a change may help to reduce strategic uncertainty in that companies should have a clearer idea as to the issues that will be taken into account in an investigation ... A merger control regime that is more focused on competition will benefit consumers by promoting the maintenance of open, competitive markets.<sup>19</sup>

A similar case was put by the then Secretary of State, Patricia Hewitt, when the Enterprise Bill, as it was, received a Second Reading in the Commons in April 2002; on this occasion, Ms Hewitt argued that the new test, replacing “the current, less precise, public interest test” would result in “more transparent and predictable decision making.”<sup>20</sup> The change was generally welcomed: speaking for the Conservatives John Whittingdale said:

There are several specific measures in the Bill to which we are happy to give unqualified support. The first is the decision to remove Ministers from the decision-making process on the clearance of mergers. I should declare that I had some experience of such matters when I worked as a special adviser to Norman Tebbit, the then Secretary of State. Lord Tebbit established the Tebbit guidelines, which required that merger references should be made primarily on competition grounds, rather than on any of the wider considerations contained in the Fair Trading Act 1973.

The proposal to remove Ministers from the equation entirely and to leave matters to competition authorities is in some ways the ultimate application of the Tebbit guidelines, although knowing that may not increase the Secretary of State's enthusiasm for her policy.<sup>21</sup>

For the Liberal Democrats, Vincent Cable suggested that the new test might mean a *higher* proportion of mergers being investigated:

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<sup>19</sup> Dept for Trade & Industry, *The Enterprise Act: Competition Reform – Regulatory Impact Assessment*, 2002 p10

<sup>20</sup> HC Deb 10 April 2002 c46

<sup>21</sup> HC Deb 10 April cc 54-5

The second element on which there is general consensus is the competition test. It is right that we should move away from the vague public interest test to a competition test. I am not entirely sure that the Government or the House have appreciated how radical that step will be, because as I understand the legislation, it will now become almost a matter of course for large mergers to be referred for examination. Almost by definition, a large merger reduces competition. Unless there are extenuating circumstances such as national security or palpable consumer benefits, or unless the companies involved are very small, there is no good reason why mergers should not be referred for examination.<sup>22</sup>

Wrapping up the debate the then Parliamentary-Under Secretary of State, Melanie Johnson, contested this view:

The hon. Member for Twickenham anticipated that a far larger number of mergers would be referred to the Competition Commission. I do not share that analysis. I expect that the proportion of mergers to be referred will be broadly the same as at present. In practice, the OFT has already applied a competition test to mergers, but in future the process will be more certain and transparent. That is an advantage of the changes that we have made.<sup>23</sup>

Ms Johnson also set out the purpose of the new test at the Committee stage of the Bill, when amendments to extend the competition test, to allow the competition authorities to give regard to the employment and regional effects of mergers, were resisted by the Government:

There are two core changes to the merger regime. The first is to depoliticise the merger regime by removing Ministers from the vast majority of decisions. The second is to replace the broad public interest test with a competition test. Focusing the legislation on competition will produce better merger regulation and improve the clarity of the framework for decisions and the predictability of decisions made under it. The wider the range of factors that can be taken into account, the less certain and predictable the outcome. The change will also update the statute and bring it into line with the major international jurisdictions—the US, the European Commission, France, Germany, Canada and Australia—all of whom apply a competition-based test. We are introducing a competition test not only to increase the predictability of decisions or to align our regime with others, but because, in the vast majority of cases, the economy is best served if mergers are assessed solely on the basis of their effect on competition. Competition provides a spur for businesses to be more productive, innovative and efficient, and better able to provide long-term sustainable employment and better products and services for consumers.

The amendments, taken with the definition of the public interest ... would allow the authorities to take some account of the employment and regional effects of mergers .... Adding new factors into the test will create barriers to restructuring. It is wrong to do that unless there are significant anti-competitive effects, and restructuring must be possible if companies and markets are to remain dynamic and competitive. I recognise, of course, that mergers can have short-term adverse regional and employment impacts ... [There are] hard cases [of such impacts], but we should

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<sup>22</sup> HC Deb 10 April 2002 c66

<sup>23</sup> HC Deb 10 April 2002 c114



not base our policy on them. The answer is not to block mergers. The Government's task is to make sure that the economy as a whole is strong, to help people to adapt and to get new jobs, and to make sure that for every job and every business that disappears, new companies spring up, and small companies growing bigger.<sup>24</sup>

## 2.3 Kraft's takeover of Cadbury: a new public interest test?

In spring 2006 there were press reports that Ministers had taken advice about extending the coverage of the *Enterprise Act*, to prevent a takeover of the UK gas supplier Centrica by the Russian company Gazprom.<sup>25</sup> There was no official statement, and in April that year the Prime Minister was reported as ruling out any intervention of this kind.<sup>26</sup>

Subsequently in July 2008, during the Committee stage of the Energy Bill in the 2007-08 Session, Lord Puttnam put down an amendment to add energy security as a new public interest term.<sup>27</sup> The Labour Government resisted this proposal on the grounds that in cases where a merger posed "a genuine and serious threat to what is described as societal needs, such as energy supply", this would be covered by the existing provision in the 2002 Act regarding national security - so Ministers would be empowered to directly intervene.<sup>28</sup>

The issue came back to public prominence following the takeover of Cadbury by the US multinational Kraft Foods in January 2010. In the run-up to the successful bid, the then Secretary of State, Lord Mandelson, argued that shareholders should be "genuinely critical" of takeover bids, including Kraft's.<sup>29</sup> However, the fact that Kraft were only successful by increasing their initial bid offer by some £2bn, substantially increasing the company's debt, led to many arguing that the UK competition regime was flawed.<sup>30</sup> Lynne Jones MP put down an EDM calling on the Government to "examine takeover legislation with the greatest urgency with a view to providing some degree of security against predatory takeovers";<sup>31</sup> Ms Jones extended this argument in an adjournment debate that month:

Britain has greatly benefited from overseas investment by companies such as Toyota and Honda. I do not want to discourage such long-term investment, which has brought improved technological and management capabilities. My concern is for those British-owned companies that are well run and have good prospects for retaining high-value-added functions in the UK, creating jobs in research and innovation and jobs requiring high skills. The Government cannot pick winners, but they should

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<sup>24</sup> Standing Committee B, 25 April 2002 cc 293-4

<sup>25</sup> "Centrica threat lead to rethink on mergers", *Financial Times*, 17 April 2006

<sup>26</sup> "Gazprom block over Centrica ruled out", *Financial Times*, 26 April 2006

<sup>27</sup> [HL Deb 1 July 2008 ccGC50-59](#)

<sup>28</sup> Speaking on this occasion for the Government, Lord Bach provided a concise description of the current law: see, [HL Deb 1 July 2008 cGC56](#).

<sup>29</sup> "Mandelson's plea to investors", *Financial Times*, 14 January 2010

<sup>30</sup> For example, Will Hutton & Philip Blond in the *Financial Times* ("End this charter for selling off top British companies", 21 January 2010).

<sup>31</sup> EDM 679 of 2009-10, 20 January 2010. 41 Members signed the motion.

## 18 Contested mergers and takeovers

create a framework in which such companies can prosper but not be so easily subject to predatory activity.<sup>32</sup>

In response, the then Parliamentary Under-Secretary, Ian Lucas, simply underlined the fact that the Government had no powers to intervene directly in this type of takeover:

Let me make it clear that the Government have no statutory power to intervene in this case. The relevant independent competition authorities are responsible for considering whether it gave rise to any concerns about a possible loss of effective competition. Ministers have the power to intervene in merger cases only where they raise specific concerns relevant to a legitimate public interest such as national security. There seems no reason to consider that such an intervention would be appropriate in this particular merger.<sup>33</sup>

In the following days, Kraft announced that, contrary to its statements before its takeover, it would *proceed* with Cadbury's closure programme, including the closure of its factory in Somerdale. In turn, Vincent Cable, then Treasury spokesman for the Liberal Democrats, suggested that this showed the case for a new public interest test: quoted in the *Guardian*, Dr Cable argued there had been expectations the Government would intervene in the Kraft takeover, but that this opposition "just melted away":

We ought to have a public interest test again, and we ought to look at the role of the hedge funds who take over large holdings for small periods during a takeover battle ... The pendulum has swung far too far and the Liberal Democrats believe that there is a legitimate role for government, acting in the wider public interest and in the interest of competition, to make sure that damaging takeovers do not take place.<sup>34</sup>

Writing in the paper a few days later, Brendan Barber, then TUC general secretary, argued for a "new balance" in merger regulation:

At present, the only block on a takeover is whether it will work against the consumer. But we do not have to go back to the days when a vague public interest test allowed ministers to decide the fate of a takeover on a whim. Instead, we need a new kind of economic test handled by an independent mergers and takeovers commission. It would make bidders show that a takeover would be good for the target company. It would take into account the interests of the wider economy, employees, suppliers and local communities. Takeovers funded by unrealistic debt or driven by speculation would be unlikely to pass. Those that make industrial sense would.<sup>35</sup>

The then Secretary of State, Lord Mandelson, addressed these concerns in a detailed speech on 1 March 2010, following an announcement by the Takeover Panel that it would review the existing City code on takeovers.<sup>36</sup> Although Lord Mandelson suggested changes to the

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<sup>32</sup> HC Deb 26 January 2010 c782

<sup>33</sup> HC Deb 26 January 2010 c788

<sup>34</sup> "Public interest for takeovers should be reintroduced, says Vincent Cable", & "A makeover for UK's takeover laws", *Guardian*, 10 February 2010

<sup>35</sup> "Cadbury shows takeovers need reform", *Guardian*, 22 February 2010

<sup>36</sup> "Prospect of stiffer rules for buying UK groups", *Financial Times*, 25 February 2010. The Panel launched a formal consultation 3 months later: *Review of certain aspects of the regulation of takeover bids*, [PCP 2010/2 Issued on 1 June 2010](#).

*procedures* governing how takeover bids were made, he did not propose any change to the merger regime itself, suggesting that a new public interest test could well turn out to be protectionist. An extended extract from Lord Mandelson's speech is reproduced over the next two pages (**emphasis added**):

The open secret of the last two decades is that mergers too often fail to create any long term value at all, except perhaps for the advisors and those who arbitrage the share price of a company in play ... And it seems to me that given that a takeover can have huge implications for workforces and communities as well as investors, this is an area where good governance, and active and responsible shareholding, are absolutely critical. I do believe that there is a strong case for throwing some extra grit in the system ...

In the case of Cadbury and Kraft it is hard to ignore the fact that the fate of a company with a long history and many tens of thousands of employees was decided by people who had not owned the company a few weeks earlier, and probably had no intention of owning it a few weeks later.

Company Directors engaged in takeovers clearly have a legal duty to shareholders. For the Directors of the target this is often interpreted as meaning a duty to accept any price that exceeds their own assessment of the future valuation of the company. However, the Companies Act sets out the duties of directors to consider the best outcome for a company in the long term, considering the interests of all the stakeholders – employees, suppliers, and its brands and capabilities. Getting a higher price in a takeover may not be a perfect proxy for that. It seems to me that we need to have a debate about how these various duties should be understood in the fast-moving circumstances of a takeover, when some of the company's newest shareholders may not have a long term commitment to the company. Obviously we need Directors equipped to be stewards rather than just auctioneers. If this requires re-stating the 2006 Companies Act, then I am willing to do that.

I believe that one of the key ways to strengthen consideration of these wider issues in takeovers is to strengthen the ability of all shareholders on both sides to scrutinize the planning, financing and intentions behind deals. For that reason I welcome last week's decision of the Takeover Panel to consult on the provisions of the Takeover Code, following Roger Carr's sensible suggestions reflecting his Cadbury/Kraft experience. I believe that there is a case for:

- Raising the voting threshold for securing a change of ownership to two thirds;
- Lowering the requirement for disclosure of share ownership during a bid from 1% to 0.5% so companies can see who is building up stakes on their register
- Giving bidders less time to "put up or shut up" so that the phoney takeover war ends more quickly and properly evidenced bids must be tabled.
- Requiring bidders to set out publicly how they intend to finance their bids not just on day one, but over the long term, and their plans for the acquired company, including details of how they intend to make cost savings; and;

- Requiring greater transparency on advisors' fees and incentives.

I also think there is a case for requiring all companies making significant bids in this country to put their plans to their own shareholders for scrutiny ... None of these measures would necessarily have prevented Cadbury changing hands – that is not the point. They would have enabled the owners of both companies more actively to scrutinize the transaction, and better weigh the long term prospects for the merged company.

***Some people have gone further and suggested that we need a new form of public interest test to guard British companies against foreign acquisition. I am happy to have an open debate about this, but I think we need to be very cautious. Britain benefits from inward investment and an open market for corporate control internationally. A political test for policing foreign ownership runs the risk of becoming protectionist, and protectionism is not in our interests.***<sup>37</sup>

Lord Mandelson said a little more about his view of widening the public interest test in evidence to the Business, Innovation & Skills Committee some days before his speech. Roger Berry MP had asked about the way in which companies might be held accountable for undertakings made during a takeover, such as Kraft's public statements prior to their bid being accepted. Lord Mandelson argued that the government of the day was entitled to criticise a successful bidder which had reneged on this kind of promise "in quite stark ... or extreme circumstances" but a wider public interest test would be unwise:

Some have suggested that we should introduce some more open-ended public interest test that a government or arm's length authority should apply to takeovers. The reason I am unconvinced of the desirability of introducing such a test and equipping the Government with such powers is because I think that in those circumstances a government's judgment and intervention could be too exposed to political lobbying and short-term populist pressures which are unable to make an assessment of long-term growth and value that might come from the move. It might give rise to capricious decision-making of one sort or another, depending on the ministers and their official advisers, and it can lead to a loss of transparency and a loss of predictability which at the moment makes the current UK regime open to investors from which, I just underline, we benefit a great deal.<sup>38</sup>

The Committee addressed this point briefly in a report on the Kraft takeover they published in April 2010. When he gave evidence to the Committee, Ian Lucas, then Parliamentary Under-Secretary of State, was asked about the process for adding further public interest considerations to the list currently set out in statute, so that a potential threat to the country's 'food security' by a takeover of this nature could

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<sup>37</sup> Dept for Business, Innovation & Skills press notice, *Lord Mandelson, Secretary of State: Mansion House Speech*, 1 March 2010

<sup>38</sup> *The work of the Department for Business, Innovation and Skills: Evidence given by Rt Hon Lord Mandelson, First Secretary of State ... 19 January 2010*, 10 March 2010 HC 299-i 2009-10 Q13

trigger Ministerial intervention.<sup>39</sup> The Minister set out the position in a letter to the Committee, from which the following is taken:

It is, of course, possible to specify additional public interest considerations. However, as the aim of the Act is to secure consumer interests through effective competition between enterprises, the policy intent was that the reserve power should be used sparingly to avoid inconsistency, uncertainty and a dilution of this aim.

Any proposed new consideration to be specified in the Enterprise Act would need to be approved by a resolution of each House of Parliament. In addition, if it was to be relied upon also in European merger cases, it would need clearance by the European Commission. They would have to be satisfied that the consideration was legitimate and compatible with the objectives of the European Treaty, in particular in relation to the free movement of capital. Anyone making a case for a new public interest consideration would need clear evidence that this power was necessary, meaning that the only way to achieve the relevant public policy objective was to be able to intervene in possible mergers, as opposed to adopting other measures such as, for example, appropriate sectoral regulation. It may be noted that where governments have previously sought to use the powers, available under merger control, to intervene in merger cases in the food sector that action has been blocked by the European Commission.

Further, merger control is a highly transparent process. Any decision to intervene and take action in relation to a proposed merger on public interest grounds is open to legal challenge. Even assuming a suitable public interest consideration had been specified that enabled intervention in a relevant merger, it would remain possible to intervene only where there was a defensible case for doing so. It would need to be a proportionate measure that was demonstrably necessary in order to achieve a specific public policy benefit.<sup>40</sup>

The Committee concluded that it had not had enough time to consider the issue, but that it was certainly worthy of detailed consideration:

We agree with the Secretary of State that an extension of his powers to intervene would come with a risk that the takeover process would be determined by political lobbying rather than economic fundamentals. However, we believe that the Government should consider how other countries act to protect key national assets while at the same time retaining a liberal investment climate. In particular, it should consider how aspects of Research and Development which are in the United Kingdom's national interest may be protected in the event of foreign ownership.

While we have not taken sufficient evidence at this stage to enable us to come to a view on the merits or otherwise of extending the powers of intervention by the Secretary of State, we strongly believe that this issue should be considered as part of the wider debate on takeover regulations.<sup>41</sup>

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<sup>39</sup> [Ninth Report : Mergers, acquisitions and takeovers: the takeover of Cadbury by Kraft, 6 April 2010](#) HC 234 2009-10 Qs 70-79

<sup>40</sup> HC 234 2009-10 Ev48

<sup>41</sup> HC 234 2009-10 paras 74-5

## 2.4 Responses to Kraft-Cadbury & revisions to the Takeover Code

Merger policy was not a major issue in the 2010 General Election, though it was mentioned in two manifestoes. In its manifesto, Labour argued that the public interest test should be extended “so that it is applied to potential takeovers of infrastructure and utility companies.”<sup>42</sup> In their manifesto the Liberal Democrats said that in government it would “restore a public interest test so that a broader range of factors than just competition can be considered by regulators when takeovers are proposed and ... ensure that the outcome of takeover bids is determined by the long-term shareholder base.”<sup>43</sup>

In its programme for government, the new Coalition Government stated that it would “review the range of factors that can be considered by regulators when takeovers are proposed.”<sup>44</sup> The Secretary of State, Vincent Cable, gave evidence to the Business, Innovation & Skills Committee on 20 July 2010, and was asked about his views on the current takeover regime:

We want foreign investment here and we are certainly not going to adopt a nationalistic approach to it. Having said that ... there is quite a lot of research which shows that they reduce shareholder value, let alone the wider social impact, so there is a strong case for looking at the takeover regime again. ... There are ways of, as it were, throwing sand in the machine, increasing the fees that any company would have to pay to the Office of Fair Trading if a competition really took place. At the moment they are £90,000 which is nothing for a big company. The notification procedure could be made longer to give the Takeover Panel more opportunity to scrutinise takeovers.

The Takeover Panel is itself investigating some of the issues you raise in your question, for example, the short-term interest of hedge funds and whether this is distorting decision-making and whether you should have some brake on that process. They are an independent body. I am waiting to see what they have to say, but I have been publicly on the record expressing concern about the way the takeover process works at present.<sup>45</sup>

In the same month the Government gave its response to the Committee’s report on the Kraft takeover, in which it set out its ‘overall approach’ to the regulation of takeovers. It acknowledged that the success rate for takeovers was a cause for concern, but went on to state it had “no current plans” to amend the legislation governing the power to intervene in mergers on public interest grounds (**emphasis added**):

The Government’s overall approach to the regulation of takeovers is based on the following principles.

- It is important that the UK continues to enjoy the benefits of open markets. The Government welcomes inward

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<sup>42</sup> Labour Party, *2010 Election Manifesto: a fair future for all*, April 2011 p 1:7

<sup>43</sup> Liberal Democrats, *Liberal Democrat Manifesto 2010: change that works for you*, April 2011 p26

<sup>44</sup> HM Government, *The Coalition: our programme for government*, 20 May 2010 p10

<sup>45</sup> *The work of the Department : Oral Evidence (uncorrected) – 20 July 2010*, HC 384-i 2010/11 Q59

investment and draws no distinction between foreign or domestic ownership; at the same time, UK companies benefit from their ability to invest overseas.

- A company should be much more than a series of short term financial transactions, and its directors should have a clear strategic vision and sense of purpose.
- The owners of a company also have an important responsibility, not least during a takeover bid. Shareholders should consider bids carefully and seek to gauge long-term value, especially in the case of bids to take over strongly performing companies.
- The relationship between company owners and directors is of fundamental importance to good corporate governance. Where this relationship is strong:
  - There will be a shared vision of the company's strategy and objectives, reflected in the performance criteria for directors' remuneration;
  - Shareholders will receive high quality and timely information from the company, which reflects the information the directors use to manage the business;
  - Shareholders will not try to second guess the directors in their day-to-day management of the company, but will hold the directors to account for their stewardship of the company.
- ***Too many takeovers in the UK fail even by the limited criterion of shareholder value – and often with serious implications for the people who work for the firms on both sides. But that does not mean we should return to the old-fashioned public interest test, which encouraged weak managements to lobby for protection. The Government has no current plans to amend the legislation governing the power to intervene in mergers on public interest grounds. We are satisfied that the existing powers provide the appropriate scope to take action to protect legitimate national interests that might be affected as a result of a merger.***
- Instead, we plan to review whether there are other aspects of the merger framework which could be tightened up, such as an increase in merger fees and a requirement for pre-notification of some mergers, as is done in most other European jurisdictions, in order to prevent some of the hasty deal-making (and the difficulties associated with breaking up mergers after the event).

The Takeover Panel's current review is playing an important part in addressing a large part of this agenda. The Government will publish a further paper on the regulation of takeovers in the light of the responses to the Panel's consultation.<sup>46</sup>

As the Government noted in its response, in June 2010 the Takeover Panel consulted on the regulation of bids, and in October announced a

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<sup>46</sup> Cm 7915 July 2010 pp5-6

number of changes to the Takeover Code.<sup>47</sup> These were set out in a BIS paper on corporate governance published at this time;<sup>48</sup> one issue the paper touched on was how bids were affected by the relationship between directors and shareholders – and it asked for views on whether shareholders in an acquiring company should be invited to vote on any takeover bid. An extended extract is given over the next three pages:

### 6. Takeovers

6.1 Takeover bids shine a spotlight on issues relating to long-termism and shareholder engagement. The directors of both the bidding company and the target company need to take a view on the long-term implications of the bid. Institutional shareholders and fund managers need in turn to decide whether the bid is in the interests of their clients and of those on whose behalf they are making investments. It is also the moment at which shareholders' confidence in the boards they have appointed is thrown into sharpest relief. This is true whether the bid is hostile or, more usually, agreed between the two companies.

6.2 Takeovers are a vital part of a vibrant market economy. It is essential that underperforming companies and their boards can be challenged by the threat of takeover, and many takeovers result in successful companies that are far stronger than their predecessors were.

6.3 At the same time, takeovers raise important economic issues:

- there are incentives for some parties to focus on short-term financial gain rather than a proper analysis of what will make business sense for the companies involved in the long-term. The evidence suggests that many mergers and acquisitions are motivated less by economic value for shareholders and more by managers' own objectives and desire to increase company size;<sup>49</sup>
- there is broad consensus that takeover bids result in large share premiums for target firms.<sup>50</sup> However, the returns to shareholders of acquiring firms are often zero or negative. This is because the bidder often incurs debt to make its bid, or pays well above market value for the target company's shares;
- despite the evidence of productivity gains from takeover activity in aggregate, not all takeovers are successful in producing long-term economic benefits.<sup>51</sup> Studies have shown that there can often be productivity gains but also

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<sup>47</sup> [Review of certain aspects of the regulation of takeover bids: Statement 2010/22](#), 21 October 2010. The Panel consulted on further changes in March 2011, which it implemented later that year ([RS 2011/1, 21 July 2011](#)). See also, ["The Cadbury deal: How it changed takeovers"](#), *BBC News online*, 2 May 2014

<sup>48</sup> BIS press notice, *Review on corporate governance and short-termism opens*, 25 October 2010

<sup>49</sup> *The determinants of merger waves*, Klaus Gugler, Dennis Mueller & B. Burcin Yurtoglu, 2004 Working Paper University of Vienna

<sup>50</sup> *Key Drivers of Good Governance and the Appropriateness of UK Policy Responses*, Filatotchev et al, 2007, King's College London, and *Mergers and Acquisitions in Europe*, Martynova & Renneboog, 2006, Tilburg University, Centre for Economic Research.

<sup>51</sup> Economic studies of takeovers have been numerous but their findings have often pointed in different directions. The findings depend on the rationale of the merger, the benchmark used to assess the impact of the merger, the counterfactual, and the time frame under consideration.



falls in employment, short-term sales of assets and, particularly in hostile takeovers, lower levels of investment.<sup>52</sup> These poor post-merger outcomes might arise because management do not understand the technology, the business model or the working environment of the new company; and

- the empirical literature does not provide strong evidence that target firms have underperformed prior to takeovers, suggesting a limited disciplinary function of the market for corporate control.<sup>53</sup> There are concerns that the constant fear of takeover can hinder growth and stifle innovation (as managers may be inclined to sacrifice long-term investments in order to engage in short-term strategies to bolster share earnings) as well as generating fears among employees about job security.

6.4 Studies of takeovers have been numerous but their findings have pointed in different directions. The findings depend on the rationale of the merger, the benchmark used to assess the impact of the merger, the counterfactual, and the time frame under consideration.

6.5 Researchers<sup>54</sup> have come to the following conclusions from the literature:

- there is broad consensus that takeover bids result in large share premiums for target firms. However, the returns to shareholders of acquiring firms are often zero or negative;
- the overall empirical literature does not provide strong evidence that target firms have underperformed prior to takeovers, but this could reflect that the threat of takeover acts as a discipline; and
- there are productivity gains associated with takeovers, as well as falls in employment and short-term sale of assets. Generally, takeovers, particularly hostile takeovers result in a reduced level of investment and an increase in dividends paid to shareholders.<sup>55</sup> This suggests in some cases that, due to the takeover threat, directors could have incentives to sacrifice long-term investments in order to bolster short-term profitability.

6.6 Takeovers of UK public companies are regulated by the Takeover Panel. The Panel issues and administers the Takeover Code, which is designed principally to ensure that shareholders in a target company are treated fairly and are able to decide on the merits of a takeover bid. The Takeover Code also provides an orderly framework within which takeovers are conducted. The financial and commercial merits of takeovers are not the responsibility of the Panel. These are matters for the companies concerned and their shareholders.

6.7 The Takeover Panel published a wide ranging consultation in June 2010 which addressed certain aspects of the regulation of takeover bids. The Panel announced on 21 October that, in the

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<sup>52</sup> *An Empirical Analysis of the Effects of the Threat of Takeover on UK Company Performance Working Paper No. 5*, Nuttall R., 1999, Nuffield College, University of Oxford

<sup>53</sup> Filatotchev et al, 2007, and, Martynova & Renneboog, 2006

<sup>54</sup> *ibid*

<sup>55</sup> Nuttall R., 1999

light of the responses to its consultation, it intends to amend its Takeover Code to:

- increase the protection for offeree companies against protracted “virtual bid” periods;
- strengthen the position of the offeree company by prohibiting most deal protection measures and inducement fees and clarifying that offeree company boards are not limited in the factors that they may take into account in giving their opinion and recommendation on an offer;
- increase transparency and improve the quality of disclosure by requiring the disclosure of offer-related fees and requiring the disclosure of the same financial information in relation to an offeror irrespective of the nature of the offer; and
- provide greater recognition of the interests of offeree company employees.

6.8 The Government welcomes the Panel’s proposed changes to the Takeover Code relating to the conduct of bids. In particular, it agrees with the Panel that some rebalancing of the rules is needed to check the evolution of market practice which has run in favour of the offeror. In the light of the Panel’s review, the Government wishes to look further at broader issues relating to the economic case, and the corporate law framework, for takeovers. In particular, it would like to consider whether:

- on balance, the economic framework for takeovers is likely to improve the long-term competitiveness of UK companies;
- boards consider sufficiently carefully the long-term implications of takeover bids, and whether they communicate these effectively to shareholders and wider stakeholders; and
- shareholders of an acquiring company should always be invited to vote on takeover bids.<sup>56</sup>

In March 2010 the Department published a summary of responses it had received. On this specific issue, there was no consensus for a major change in the law. Apparently “there was general support for more transparency but many respondents thought that the Takeover Panel’s proposed changes to the Code could achieve this.” More generally, “there was a mixed response on the issue of whether boards understand effectively the long-term implications of takeovers or communicate these effectively to investors. However, there was not much support for requiring a vote for shareholders in acquiring companies involved in a takeover.”<sup>57</sup>

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<sup>56</sup> [A long-term focus for corporate Britain: a call for evidence](#), October 2010 pp31-33

<sup>57</sup> *A long-term focus for corporate Britain: summary of responses*, March 2011 p22, p6

## 2.5 The establishment of the Competition & Markets Authority

In a related development, as part of a review of Public Bodies completed in October 2010, the Coalition Government announced that it would consult on merging the OFT and the CC to form a single Competition & Markets Authority (CMA).<sup>58</sup> The consultation was launched in March 2011, and first reactions were quite positive both from the competition authorities and from business.<sup>59</sup> (A second strand to this reform were changes made to the institutional arrangements for advising consumers on their rights, and enforcing legislation for their protection: these responsibilities are now the work of the [Citizens Advice Bureau](#), and local authorities Trading Standards services (TSS) respectively.<sup>60</sup>)

The Government's consultation document underlined that none of its proposals would affect "the ultimate independence of the UK's competition regime. They do not, for example, extend Ministers' involvement in the processes of referral of mergers or markets for investigation, decision-making on competition remedies, or in public interest considerations."<sup>61</sup> In March 2012 the Government announced that it would proceed with the merger; the new authority would be operational from April 2014.<sup>62</sup> Provision to this effect was included in the *Enterprise and Regulatory Reform Bill* published in May that year.<sup>63</sup>

This legislation makes no changes either to the 'substantial lessening of competition test' or to the scope of Ministerial involvement in mergers. At the Committee stage of the Bill, the Opposition put down a number of amendments to amend the public interest test; in moving these amendments, Chi Onwurah MP argued the CMA should be able to take "a longer term view of the possible merits and demerits of mergers and takeovers in the UK," taking into account "the longer-term ability of the merged entity to compete effectively." To buttress her case, Ms Onwurah cited the impact of Kraft's takeover of Cadbury in 2010:

Kraft's takeover of Cadbury is perhaps the best—or worst—example of short-term interests taking precedence over the long-term interests of a great British company ... The amendment would give the CMA the power to take a longer-term view on the impact of such deals when deciding whether to investigate further ... We believe the Government should be putting in place

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<sup>58</sup> Department for Business, Innovation & Skills (BIS) press notice, *Reform of competition and consumer bodies*, 14 October 2010

<sup>59</sup> BIS press notice, *New business-friendly competition proposals announced*, 16 March 2011 & "Competition regime faces shake-up", *Financial Times*, 17 March 2011

<sup>60</sup> see, [New consumer landscape](#), Library standard note SN6759, 19 November 2013

<sup>61</sup> *A Competition Regime for Growth ...*, March 2011 p7

<sup>62</sup> HC Deb 15 March 2012 cc27-29WS; BIS, [Growth, competition and the competition regime: response to consultation](#), March 2012.

<sup>63</sup> These provisions now form part 3 of the *Enterprise & Regulatory Reform Act 2013*. Part 4 of the Act makes a number of changes to the way the CMA assesses mergers, investigates markets and prosecutes both anti-competitive agreements and the abuse of market dominance. A detailed summary of the Bill is given in the Library paper prepared for its Second Reading debate ([Library Research paper 12/33, 7 June 2012](#)).

measures to ensure that short-termism is not rewarded in Britain.<sup>64</sup>

In response, the then Minister for Employment Relations, Consumer and Postal Affairs, Norman Lamb, argued that such a test would put the international standing of the UK regime at risk “because it would introduce factors that would not be central and appropriate for its competition duty into the equation that the CMA would have to consider”:

To the extent that the ability of the merging parties or the merged entity to compete impacts on the level of competition in the market, the CMA will already have to consider that as part of its assessment of any merger, just as the OFT and the Competition Commission do. Their task is to assess whether the merger will substantially lessen competition in the market, which would be bad for consumers and the economy more widely. It is very much a competition test, in line with tests used in other countries around the world. However, if the CMA was required to take a broader view of the ability of the merged entity to compete, it would take the UK’s regime out of step with the international standard and blur the clear lines between the current competition test and other considerations ...

Currently the OFT and Competition Commission consider the impacts of any merger versus the counterfactual—what would have happened if it had not gone ahead—over the foreseeable future. There is no precise period for how long this is, and it will vary from market to market. For example, the appropriate period in, say, power generation markets and social media markets is likely to be quite different. The further one looks out from that particular point in time, the harder it becomes to predict what the competition environment will look like in the years ahead. Furthermore, there will be all sorts of other external factors that would have an effect on the ability of the merged entity to compete effectively, and which competition authorities are not best placed to try to predict. I therefore think that we need to be careful about extending the competition regime in the way that the amendments propose.<sup>65</sup>

Mr Lamb also suggested that there was a risk of making the test incoherent, since “a merger creating a monopoly would almost certainly create an entity with an enhanced ability to operate effectively in the long run.” Ms Onwurah argued that the amendment was “very reasonable and quite a small step,” but the amendment was defeated by 12 votes to 9.<sup>66</sup>

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<sup>64</sup> Public Bill Committee, [Twelfth sitting, 10 July 2012](#) cc512-3. John Cryer MP had raised this issue at an earlier stage of the Committee’s proceedings ([Eleventh sitting, 5 July 2010](#) cc443-4), and also contributed at this point in the debate (*Twelfth sitting*, 10 July 2012 cc516-8).

<sup>65</sup> PBC 10 July 2012 c520

<sup>66</sup> *op.cit.* c523, c524. Ms Onwurah tabled a similar amendment at the end of the Committee’s proceedings, but this was not called (Public Bill Committee Proceedings, 17 July 2012 p49 – New Clause 10).

## 2.6 Kay review of equity markets

At this time, Professor John Kay completed a review, commissioned by the Government, on the operation of UK equity markets.<sup>67</sup> On the question of takeovers, Professor Kay expressed some scepticism about the benefits of many of these deals. He recommended that “the British Government should adopt a more sceptical attitude to claims of the benefits from large corporate transactions”, but suggested that it was neither “necessary – or at this stage desirable – that the Secretary of State should have extended authority to block merger proposals.” Professor Kay also argued that the test applied by the competition authorities should remain focused on the impact of competition in the relevant market, “not on the overall actual or potential economic significance of the transaction for the UK economy.”<sup>68</sup> An extract from this part of the report is reproduced below:

8.16 There is considerable variation between jurisdictions in the legal powers a government has to block unwanted takeovers. There is also considerable variation between jurisdictions in the ability of private actors to block takeovers to which they are opposed. In continental Europe, there are many legal differences and more concentrated shareholding is common. In the United States, law and market practice have been more favourable to ‘poison pills’ and other means of resistance by incumbent management to unwanted bids. Britain is distinguished from these jurisdictions by the combination of low public and private barriers to takeover and the laissez-faire attitude which successive governments have adopted since the 1980s.

8.17 The existing formal and informal authority of government and its agencies to discourage bids is considerable. The relevant regulators could arguably have prevented the BAA or ABN Amro transactions. Many large foreign companies would think twice before pursuing a major UK acquisition in the face of clearly expressed hostility from the UK Government.

8.18 We take the view that the Government should use its informal and formal authority as effectively as possible. It should take a more active approach towards companies planning major acquisitions of UK businesses, or UK businesses planning major acquisitions outside the UK. It should take a negative view of a transaction only in cases where at least one of the following conditions was fulfilled; the acquirer appeared to have significantly less capacity to manage the business than the existing management team; the combined concern appeared likely to be substantially weaker financially than the existing UK business; a probable consequence of the transaction was a material loss of high level functions, or of employment from the UK. Assurances given to allay these concerns should be regarded as binding on the company, by legal means if necessary.

8.19 The power to make references to the Competition Commission would of course continue. Such references would, as now, be based principally on the significance of the deal in relation to the relevant market, not on the overall actual or

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<sup>67</sup> The Review was announced in June 2011 (HC Deb 22 June 2011 cc13-4WS). Full details are [collated on Gov.uk](#).

<sup>68</sup> [The Kay Review of UK Equity Markets and Long-Term Decision Making : final report](#), July 2012 para 8.15 & para 8.19

potential economic significance of the transaction for the UK economy.

8.20 We consider that this change of approach would bring British practice more in line with that of other countries while retaining a relatively liberal stance, balancing legitimate public policy concerns against support for the exercise of honest business judgment. If companies and their advisers were resistant to such informal guidance, or if assurances about behaviour were regularly flouted, it would be appropriate to consider fresh legislation.<sup>69</sup>

In their report on the Kay Review, the BIS Committee noted Professor Kay's scepticism about the benefit of some large takeovers, and argued that the Government should look more closely at the impact that foreign takeovers had had on the British economy.<sup>70</sup>

The Government published its response to the Committee's report in November 2013. In this, it argued that "attracting investment to the UK from around the world is a vital element of the Government's strategy to ensure sustainable long-term growth", but that it would review the impact of foreign ownership of UK businesses during 2014:

Inward investment by foreign companies can benefit the UK bringing in new ideas, technologies and skills, stimulating productivity and growth in UK business and opening up markets for trade. Attracting investment to the UK from around the world is a vital element of the Government's strategy to ensure sustainable long-term growth. Professor Kay agreed with this analysis when he argued against a general hostility to foreign ownership, acknowledging the continued importance of open markets for growth.

The Government has a variety of powers to engage in specific merger activity, set out in Part 3 of the *Enterprise Act*. The Government already uses these powers in exceptional cases to ensure UK interests are protected, such as where there may be national security issues ...

The Economic and Social Research Council (ESRC), which funds independent, high quality research on economic and social issues and is itself funded by the Government, commissioned a survey of the evidence on the impact on foreign ownership in 2011.<sup>71</sup> The survey concluded that there are positive overall effects for UK competitiveness and business performance, and an overall positive effect on UK employment, from having an open economy. The survey identified that the experience of individual companies and communities vary and can involve both positive and negative consequences from a takeover, depending on other factors including the intentions of the acquiring company and the specific circumstances in the company and industry sector.

Given the importance of the subject matter, the Government will update this research in its progress report [on implementing Professor Kay's wider recommendations regarding UK equity markets] in summer 2014.<sup>72</sup>

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<sup>69</sup> [op.cit.](#) p60

<sup>70</sup> [The Kay Review of UK Equity Markets and Long-Term Decision Making](#), HC 603 of 2013-14, 25 July 2013 (see pp47-53).

<sup>71</sup> ESRC, [Foreign ownership and consequences for British business](#), January 2011

<sup>72</sup> [Government Response to the Committee's Third Report](#), 4 November 2013, HC 762 of 2013-14, paras 67-8, 77-8, 80

In October 2014 the Government published a report on its progress in implementing the recommendations made by the Kay Review; in this, it suggested that “the broad conclusions of the 2011 [ESRC] survey remain valid ... accordingly, the Government continues to believe our approach is sound in light of the available evidence: welcoming foreign investment in UK industry, while expanding and improving the Government’s strategic relationships with business to ensure that investment supports sustainable long-term growth”:

Studies since 2011 have focused on precise aspects of the takeover process, rather than on the impact of foreign takeovers on the British economy. However, a 2013 study carried out for BIS by the M&A Research Centre (MARC) at Cass Business School, found that in the UK from 1997 to 2010, takeovers have added, on average, £178m to the economy per deal through increased shareholder value. Analysis of the longer term impact is less conclusive, however the study found that there was a positive employment impact following M&A, driven by either further acquisitions or organic growth. Analysis of the combined firm, measuring the effect on employment provided some evidence that firms involved in M&A transactions add to overall employment at a higher rate than their industry peers.<sup>73</sup>

Overall we believe that the broad conclusions of the 2011 survey remain valid. In summary, the evidence shows that there are positive overall effects for UK competitiveness and business performance, and an overall positive effect on UK employment, from having an open economy.<sup>74</sup>

## 2.7 The Pfizer-AstraZeneca bid

In May 2014 debate on the public interest test was rekindled by the plans of US pharmaceuticals company Pfizer to make a bid for the UK company AstraZeneca.<sup>75</sup> There was widespread concern that a takeover would risk the closure of R&D facilities in the UK, with a knock-on impact on the country’s science base.<sup>76</sup> In a public letter to the Prime Minister, the then leader of the Opposition, Ed Miliband, argued that, “there should be a stronger public interest test which encompasses cases such as these where strategic elements of our science base, with impacts well beyond the firm concerned, are involved.”<sup>77</sup>

Although a formal bid had not been made, the company’s plans were the subject of an urgent question in the Commons on 6 May. On this occasion the then Secretary of State, Vince Cable, did not propose any changes to the statutory regime, though he noted that there was a question, if the Government decided to intervene, as to whether the

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<sup>73</sup> CASS, *A Guide to M&A in the UK: A study of post-transaction shareholder wealth creation, company financial performance and employment*, September 2011

<sup>74</sup> [Implementation of the Kay Review: Progress Report](#), 27 October 2014 para 2.103-4

<sup>75</sup> “Political row intensifies over Pfizer bid”, *Financial Times*, 4 May 2014

<sup>76</sup> [“Pfizer’s AstraZeneca bid under scrutiny by MPs amid fears over industry future”](#), *Guardian*, 5 May 2014

<sup>77</sup> [“Ed Miliband’s letter to David Cameron on proposed Pfizer/AstraZeneca deal”](#), *Guardian*, 4 May 2014. See also, [“Pfizer’s AstraZeneca bid: Miliband wants ‘national interest’ probe”](#) *BBC News online*, 4 May 2014 & “Labour raises political stakes with threat to block Pfizer bid”, *Financial Times*, 17 May 2014.

nature of this merger met the test for this type of involvement as established in European competition law:

There has been much comment and debate in the press recently on this important issue. I stress, however, that Pfizer has not yet made a formal bid to take over AstraZeneca. The Government must, and will, approach it from the position of even-handed neutrality and recognise that it is ultimately a matter for the shareholders of both companies. I assure the House that I and my colleagues across Government engaged early with both companies to ensure that the outcome is positive for the UK, precisely to avoid the failures of previous Governments in such situations.

The Opposition are calling for changes to the law, but we are operating within the framework that they introduced in 2002, when they removed Ministers from decision making about mergers, apart from in a few specified public interest areas. I note that they chose not to reform the regime in response to the Cadbury-Kraft merger. One of the Government's options would be to consider using our public interest test powers. That would be a serious step, and not one that should be taken lightly. I am open-minded about that, while stressing that we are operating within serious European legal constraints.<sup>78</sup>

At a later stage in these exchanges Mr Cable referred to the evidence given to the BIS Committee on this question, in the wake of the Kraft takeover:

There is a question about whether it would be desirable to extend a public interest test in that way. My predecessor made it very clear in his comments to the Business, Innovation and Skills Committee that he rejected it on principle. I am not doing that, but it is worth recalling the practical problems involved, as set out by the hon. Member for Wrexham (Ian Lucas) when he held the key post in the Department. He said that "it would need clearance by the European Commission. They would have to be satisfied that the consideration was legitimate and compatible with the objectives of the European Treaty, in particular in relation to the free movement of capital." We have to bear that in mind.<sup>79</sup>

Adrian Bailey, chair of the BIS Committee, suggested that Kraft's takeover showed that "we cannot necessarily take the assurances of the takeover company literally." As both the BIS Committee and the Science & Technology Committee had announced evidence sessions on the potential implications of the bid, Mr Bailey asked, "if the evidence from the Select Committee investigations demonstrates that we may not be able to do that, will the Secretary of State undertake to ensure that the Government will intervene?" Dr Cable replied, "I am not making any assurances at this stage; I am merely keeping the options open."<sup>80</sup>

On 26 May 2014, Pfizer abandoned its offer before the four week deadline set by the Takeover Code for potential bidders to make a firm bid, or secure agreement from the potential target company for more

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<sup>78</sup> [HC Deb 6 May 2014 c23](#)

<sup>79</sup> *op.cit.* c27. This is in the BIS Committee report, [Mergers, acquisitions and takeovers: the takeover of Cadbury by Kraft, 6 April 2010 HC 234 2009-10](#) (Ev48). On this point, and Pfizer's controversial past record in takeovers, see, "Sweden offers cautionary tale to UK over potential Pfizer deal", *Financial Times*, 6 May 2014.

<sup>80</sup> HC Deb 6 May 2014 cc26-7. The Committees held sessions on [13](#) & [14 May](#).



talks – the so-called ‘put up or shut up’ rule.<sup>81</sup> Giving evidence to the BIS Committee two weeks before, the Secretary of State underlined the importance of the Code, when asked about the options for government intervention:

**Q180 Chair:** I understand Pfizer has to lodge a bid by 26 May. If they do lodge a bid by that time and you and the Government are not satisfied with the commitments that are made, is there any way that you could change the Takeover Code or introduce any sort of Government intervention after that point?

**Vince Cable:** Let me just explain the role of the Takeover Code. When I came into office, there was a lot of discussion around Kraft and Cadbury. I encouraged the Takeover Code to reforms, and there were some really quite major reforms that we are now seeing played out, not least of which is the 28-day rule, “put up and shut up”, and the fact that the directors of the company will have an obligation to look at this from a long-term perspective, and to look at the whole bid, not simply at the price. That was never explicit before. There is greater transparency over the fees involved and there is a greater commitment to employee consultation. There are a whole lot of new provisions in the code that have not been tested before in this way.

However, the Takeover Code is as it is, and I do not think there is any suggestion that we should be trying to change that. If a bid is made, of course, because of the national interests involved, we will want to talk to the two parties and make it very clear what we would like to see coming out of that. I am keeping all the options open about how we would secure assurances, and we would obviously seek them. You have had some public discussion of their letter to the Government, which provides a reasonable framework. Should those assurances not be satisfactory, there are the other options as well that we have discussed.<sup>82</sup>

One legal practitioner writing in the *Financial Times* argued that the collapse of Pfizer’s bid had shown that the new rules had “served their intended purpose”, in contrast with the position which Cadbury found itself in when Kraft first announced its plans for a takeover bid:

After Kraft’s initial announcement, it waited two months to make a firm bid for Cadbury, ... During this virtual bid period, Cadbury was the subject of constant media speculation, disrupting its ability to plan and distracting its management ... No company can allow this kind of stasis to go on for long, with the risk that the market’s perception of its value begins to ebb ... The long period of uncertainty also allowed time for long-term investors in Cadbury to sell their shares to a crowd of nimble opportunists ...

[By the introduction of the 4 week deadline in the Code] the Takeover Panel intended to shift the balance of power from bidder to target. It worked. Pfizer found itself under real public pressure. It could not force its target to languish under the oppressive heat of bid speculation, as Kraft had done in 2009. Deprived of the option of playing for time, there was little it could do to pressure AstraZeneca’s board to enter into further discussions to narrow the valuation gap ...

Some object that a longer period might have increased the chances of a mutually agreed breakthrough. In fact, Pfizer had

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<sup>81</sup> “Pfizer admits defeat on Astra”, *Financial Times*, 27 May 2014

<sup>82</sup> [The future of AstraZeneca: Oral Evidence, HC 1286-i](#), 13 May 2014 p48

foregone the option of lifting its bid when it declared that it was making a final offer. But there is a broader point. Those who sold their Cadbury shares during the virtual bid period did not necessarily support Kraft's offer (indeed, they did not sell to Kraft); they sold because the prevailing share price was inflated by a possible bid. Kraft had every right at that stage to pull out, at which point the price might have fallen back.

In other words, during the virtual bid period, the market's valuation of the target is, by its nature, speculative. Target shareholders are entitled to expect that this period of uncertainty will be fixed and reasonably short. That is what the new rules have achieved. This is welcome. They have served their intended purpose.<sup>83</sup>

## 2.8 Further debate following the Pfizer bid

### Enforcement of assurances

Following the collapse of Pfizer's bid, on 13 July 2014 the Secretary of State gave an interview to Andrew Marr on the BBC, when he indicated that the Government were considering a change in the law:

**Vince Cable:** We're probably going to get other big takeovers coming down the track and I think there are two big lessons from [AstraZeneca] ... One is that it's actually good for Britain to have inward investment – we've had very good foreign companies investing here, the Jaguar Land Rovers of this world. We want more of that. On the other hand, there will be cases – and [AstraZeneca] was one – where there are vital national interests – in this case large-scale investment of R&D. The question is how you protect it. What the Government did then was to engage in negotiations to seek assurances, and I think where we now have to strengthen that ... we're talking to the Takeover Panel about how to do that and we may well get into the area of having financial penalties in order to make sure that those commitments are binding ... there is wriggle room in the existing rules and we want to deal with it in such a way that there is no escape clause.

**Andrew Marr:** And you need to change the law to make that happen?

**Vince Cable:** ... Supposing the company don't want to negotiate or they're not willing to give the assurances you need. What do you do then? And I think you then need some fallback powers. You need a last resort where the Government can intervene, can invoke the public interest under the existing legislation ... we're going to proceed as a Coalition to deal with that ... A lot of Conservatives would agree with it, but we haven't got to that point.

**Andrew Marr:** You haven't won agreement inside the Government about that at the moment?

**Vince Cable:** Not at the moment, no.<sup>84</sup>

Dr Cable mentioned this issue during the Second Reading of the *Small Business, Enterprise & Employment Bill*, a few days after this interview:

<sup>83</sup> "The regulators were right to force Pfizer's hand", *Financial Times*, 29 May 2014

<sup>84</sup> BBC One, [The Andrew Marr Show – transcript for interview with Vince Cable](#), 13 July 2014 pp1-4

I have made it clear publicly that we need to take action in [relation to takeovers] ... that may well—not certainly, but very probably—involve legislation for which this Bill would be the vehicle ... What emerged as a result of the recent high-profile case of AstraZeneca and Pfizer was a lack of clarity around the enforcement of assurances ... The issue arises of how we make sure that any commitments given are clear and, absolutely crucially, binding. In order to ensure that that aim is realised, we are currently talking to the Takeover Panel. Legislation may well also be necessary to underpin cases where a commitment is not honoured. I will bring these proposals back to the House in due course.<sup>85</sup>

Members did not discuss Mr Cable's comments at any length, though the then Shadow Business Secretary, Chuka Umunna, suggested that the Opposition supported the Government's aims in this area:

[The Secretary of State] made two announcements on the BBC's "The Andrew Marr Show" over the weekend. First, he said that he wished to introduce measures that would ensure that commitments given by bidders for British companies had some teeth, and that a sanction could be applied if those commitments were reneged on. Secondly, he said he believed that the Government should have a backstop power to strengthen the existing public interest tests if that proved necessary ... According to the legal advice that I have received, primary legislation would be required; simply amending the City code would be insufficient. I think that that is sensible, and I am happy to work on it with the Secretary of State in the context of this Bill.

As for the proposal to strengthen the public interest test, my own view—based on the legal advice that I have received—is that, if the Secretary of State wishes to change the current set of criteria, there will be no need for primary legislation. He has expressed concern—as did we, some months ago—about the need to protect our science and research and development bases in the national interest. Obviously, the way in which any provisions were crafted would be important—in particular, we would need to ensure that there was clearance from the European Commission—but, as I have already said on several occasions, we are happy to work with the Secretary of State on that.<sup>86</sup>

After the Pfizer-AstraZeneca bid collapsed, the Lords Economic Affairs Committee held two evidence sessions on foreign takeovers and the public interest on 8 July 2014.<sup>87</sup> When the Secretary of State gave evidence, he was asked by Lord Lawson whether he thought an extra public interest reason for Ministerial intervention would be desirable, or not:

**Lord Lawson of Blaby:** Do you or do you not think that it would be desirable to have an extra public interest reason for intervening to prevent a takeover, extra to those that are already under the CMA rubric? If so, what precisely would that public interest test be? It cannot simply be whether it is in the opinion of the

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<sup>85</sup> [HC Deb 16 July 2014 cc910-1](#). [The legislation](#) provides for a series of measures across different areas, including employment law, company regulation and insolvency.

<sup>86</sup> [HC Deb 16 July 2014 cc925-6](#)

<sup>87</sup> [Select Committee on Economic Affairs, \*Foreign takeovers and the public interest, Evidence Session No.1\* & \*Session No.2\*, 8 July 2014](#)

Secretary of State that it is in the public interest. It would need to be much more closely defined than that, so what would it be?

**Vince Cable:** ... I did not give you a yes or no answer [when asked before], and I do not think there is one. I think it depends entirely how such a public interest test was framed. It would indeed have to avoid the scope for capricious activity by Ministers, and crucially it would have to be capable of being accommodated within the European framework, otherwise it would have no legal force—a problem which the French are running into. I do not think there is a precise answer to your question.<sup>88</sup>

The Committee wrote to Mr Cable to ask him to clarify the Government's position, in the light of press reports suggesting plans for rewriting the definition of public interest.<sup>89</sup> The Secretary of State wrote back on 4 September 2014; an extract is reproduced below:

Since my appearance at the Committee, I have announced my intention to ensure that the Takeover Panel have the tools that they need to monitor and enforce more effectively commitments given by a company. Legislation may be necessary in order to underpin cases where a commitment is not honoured, and I made clear in my Second Reading speech on 16 July that should this be the case, I intend to use the Small Business, Enterprise and Employment Bill as the legislative vehicle to achieve this. This was not yet cleared Government policy at the time of the evidence session but I was able to update the House as soon as it was.

Your letter suggested that I doubted a new public interest test could be introduced into the present legal framework. In fact, what I said during the Committee session was that any new public interest test would need to be accommodated within the European legal framework in which we operate and that it would very much depend on how the test is framed. These challenges should not be underestimated but are not insurmountable.<sup>90</sup>

Later that month the Takeover Panel launched a consultation on proposed changes to the Takeover Code, to distinguish between two types of commitment made by a company making a bid:

[This reform would] introduce a new framework for the regulation of statements made by the parties to an offer (ie, offerors and offeree companies) which would draw a clear distinction between statements relating to any particular course of action they commit to take, or not take, after the end of the offer period and statements relating to any particular course of action they intend to take, or not take, after the end of the offer period.<sup>91</sup>

As noted [above](#), in October 2014 the Government had published a report on its progress in implementing the recommendations made by the Kay Review. In this it welcomed the Panel's proposals, and confirmed that, "following extensive discussions with the Panel, the Government has accepted the Panel's advice that there is no need for

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<sup>88</sup> *Foreign takeovers and the public interest*, 8 July 2014 Q26

<sup>89</sup> Select Committee on Economic Affairs, [Chairman's letter to Rt Hon Vince Cable MP](#), 16 July 2014. See, "Cable threatens national interest test on foreign takeovers", *Sunday Times*, 13 July 2014

<sup>90</sup> [Rt Hon Vince Cable MP's reply to the Chairman's letter of 16 July](#), 4 September 2014

<sup>91</sup> Takeover Panel, [Public Consultation Paper: Post-offer undertakings and intention statements – Statement 2014/6](#), 15 September 2014. Full details are in the [Panel's consultation paper: PCP 2014/2](#).

additional sanctions over and above those that are already available to the Panel.”<sup>92</sup> A longer extract from this section of the Government’s report is reproduced below:

2.108. The Takeover Panel [has consulted on proposed changes to the Code](#) to introduce a two-tier regime that would distinguish between “post-offer undertakings” and “post-offer intention statements”. Amongst other things, it has proposed that companies giving “post-offer undertakings” should be required to comply with the course of action(s) set out for the period of time specified; that currently permissible qualifications such as “material change of circumstances” clauses should be prohibited for such undertakings, with only explicit qualifications and conditions allowed in future; and that a new monitoring regime should be introduced.

2.109. The Government welcomes the Panel’s proposals. The increased clarity in the statements that a company would need to provide when making undertakings would help all parties understand better the strength of its commitment. And the proposed new monitoring arrangements will allow the Panel to intervene quickly to take enforcement action if it is satisfied that there is a reasonable likelihood that a company will breach a commitment.

2.110. We have considered whether there is any action that the Government itself needs to take to support the introduction of this new two-tier system. This was specifically in relation to introducing sanctions to apply in cases where commitments are not honoured. Following extensive discussions with the Panel, the Government has accepted the Panel’s advice that there is no need for additional sanctions over and above those that are already available to the Panel.

The Panel has assured the Government that it is confident that the new arrangements would provide it with an effective means of supervising compliance, which would alert it to any actual or threatened breach. In the event that action is needed, the powers and sanctions already available to the Panel, with recourse to the courts if necessary, should enable the Panel to enforce such undertakings effectively. These new arrangements are very similar to the sanctions regime already available to the Competition and Markets Authority for breaches of mergers undertakings.

2.111. It is also worth recalling that these changes follow an earlier review of aspects of the Code in 2011, encouraged by the Government, which led to the Takeover Panel making a series of changes designed to strengthen the position of target companies in the face of unwelcome takeovers.<sup>93</sup> Specifically, the Panel:

- increased the protection for target companies. Potential bidders now have only 28 days to “put up or shut up”, i.e. to announce a firm intention to bid or withdraw.
- strengthened target companies’ position. The Code is now explicit that target boards can consider other longer-term

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<sup>92</sup> BIS, [Implementation of the Kay Review: Progress Report](#), 27 October 2014 para 2.110. see also the comments made by the Minister, Baroness Neville-Rolfe, at the Second Reading of the Small Business, Enterprise and Employment Bill ([HL Deb 2 December 2014 c1309](#)).

<sup>93</sup> Takeover Panel, [Consultation Paper PCP2010/2](#), June 2010 & [PCP2011/1](#), March 2011

considerations, not just the offer price. In addition most inducement fees were banned.

- Improved transparency, by requiring greater disclosure of the bidder's plans, disclosure of offer related fees, and greater detail on the financing of the offer.
- gave greater recognition to the interests of employees. Employee representatives were also given an improved ability to make their views known.

2.112. The Takeover Panel reviewed these amendments in November 2012 and found that they have operated satisfactorily. It continues to keep these broader aspects of the Code under review.

2.113. The combination of the 2011 Code changes and the current proposed Code changes represent a step-change in ensuring that company mergers are motivated by long-term considerations, with appropriate opportunities for stakeholders' views to be heard, and that companies are then held to their commitments. In turn, this will strengthen the UK's takeover regime, to the benefit of the UK's companies, employees, and wider economy.<sup>94</sup>

### Short-term shareholders

As discussed above, the BIS Committee published a report on the Kay Review in July 2013, in which it argued that the Government should look more closely at the impact that foreign takeovers had had on the British economy.<sup>95</sup>

Reflecting on the Kraft-Cadbury takeover, the Committee noted concerns about the problem of short-term investors – hedge funds and other arbitrageurs – forcing takeovers against the wishes of longer-term shareholders, to secure the profits from a successful bid. In Cadbury's case, at the beginning of the bidding process only five percent of owners were considered 'short-term', but this rose strongly to reach about 31% by its close. Professor Kay acknowledged that differential voting rights on shares could address this, but thought it impracticable because "the introduction of such provisions by legislation or regulation would involve practical difficulties and would be unlikely to achieve the intended effect."<sup>96</sup>

In his evidence the Secretary of State said that he would look again at this option, while setting out three major obstacles:

- If you stop the short-term investors, you reduce the demand for shares, you drive down the share price and you then make the takeover more attractive.
- If you stop long-term investors from acquiring shares in order to build up their stake in the company during the takeover period.

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<sup>94</sup> [Implementation of the Kay Review: Progress Report](#), 27 October 2014 pp 49-50

<sup>95</sup> [The Kay Review of UK Equity Markets and Long-Term Decision Making](#), HC 603 of 2013-14, 25 July 2013 (see pp47-53).

<sup>96</sup> HC 603 of 2013-14 para 122

- We do not have an effective system, at the moment, for distinguishing between nominees and original owners. In the UK, we do not have that, so it is not possible to divide the share register in the way that one would ideally like.<sup>97</sup>

In its report the Committee concluded that BIS should produce “a feasibility study which clearly outlines the risks and benefits of introducing a policy that differentiates between shareholders and voting rights based on the length of time a share has been held.”<sup>98</sup>

As noted above, the Government published its response to the Committee’s report in November 2013. On this specific issue, the Government provided a note on the case for disenfranchising short-term shareholders during a takeover bid, drawing on earlier work by the Takeover Panel and the Kay Review – concluding that this would not be practical or effective.<sup>99</sup> It asked for comments on this analysis, prior to convening a roundtable of stakeholders to discuss the issue.

In October 2014, at the time the Government published its report on implementing the Kay Review, it also published the outcome of its roundtable discussion on the practical and legal issues to limiting the rights of short-term shareholders – which found a ‘broad consensus’ for the Government’s position:

Overall, the discussion reached a broad consensus, in line with the Government’s previous analysis, that:

- there were a series of legal and technical implementation issues which would be extremely difficult to overcome;
- the practical consequences and impacts of a disenfranchisement measure risked being at best ineffective and at worst damaging; and
- it appeared unlikely that a disenfranchisement measure would eliminate the influence of short-term shareholders in a takeover bid.<sup>100</sup>

## Information provided to shareholders

As noted, in October 2014 the Government confirmed that it would *not* introduce any additional legislative sanctions to enforce assurances, in the light of the Takeover Panel’s proposals to amend the Code. In December the Panel confirmed that it would implement these changes, with certain modifications, with effect from the New Year.<sup>101</sup>

Subsequently this issue was raised during the proceedings of the *Small Business, Enterprise and Employment Bill* in the House of Lords in early 2015. At the Committee stage in January Lord Mendelsohn, Opposition spokesman, moved an amendment to make it one of the statutory duties of a company director to fully inform shareholders, in the event of a merger, takeover or other transaction changing the ownership of

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<sup>97</sup> *op.cit.* para 124

<sup>98</sup> *op.cit.* para 126

<sup>99</sup> [Government Response to the Committee's Third Report](#), 4 November 2013, HC 762 of 2013-14 pp29-31 (Annex B)

<sup>100</sup> BIS, [Limiting the rights of short-term shareholders during takeover bids: practical and legal issues](#), October 2014 para 6

<sup>101</sup> Takeover Panel, [Post-offer undertakings and intention statements – Response Statement RS 2014/2](#), 23 December 2014

the company, of how they had discharged their duties to promote the success of the company ‘for the benefits of its members as a whole’.<sup>102</sup> In her response the Minister, Baroness Neville-Rolfe, discussed how the changes made to the Code would have affected the Pfizer bid:

The changes that have been made to the code would have meant that a formal mechanism for giving post-offer undertakings would have existed. Stakeholders would have been clear what undertakings had been given, how they would be monitored and in what circumstances they could be set aside. For instance, Pfizer would not have been able to say that its commitments would be subject to a “material change of circumstances” condition or “subject to its fiduciary duties”. There would have been much greater clarity about what Pfizer’s commitments meant and much greater certainty that they would be honoured.<sup>103</sup>

The Minister took the position that the amended Code, alongside the existing statutory provisions for directors’ duties, was sufficient to ensure shareholders were properly informed in these circumstances:

The Government agree with the noble Lord’s intention behind the amendment. As we all know, directors should at all times comply with their duties as directors. This includes during takeovers, as directors of both a target company and an acquiring company. Most people who have served as directors are aware of this. I am pleased to reassure the noble Lord that the takeover code already allows for this in practice and that there is therefore no need for further legislation.

Section 172 of the *Companies Act* already makes it clear that directors have a general duty to promote the success of the company. This includes, among other things, having regard to the six matters listed in the amendment. This duty applies at all times, including, obviously, during takeovers. Moreover, Rule 25.2 of the code already requires board circulars of offeree companies to explicitly set out the board’s opinion on the offer’s effect on all the company’s interests, including specifically employment.

I accept that this is not the same as requiring a board to set out its views on how its opinion meets every factor listed in Section 172 of the *Companies Act* but, in forming its opinion, the board will need to consider those factors among other matters and, where appropriate, will be likely to set out its view of how it is affected by the others.<sup>104</sup>

She went on to argue that it was unlikely that amending directors’ statutory duties as Lord Mendelsohn suggested would have any practical effect:

It is also important to note that the code was amended in 2011 to make explicit that the board of an offeree company is not required to consider the offer price as the determining factor in a bid and can take into account any other factors it thinks relevant. This was to make sure that target companies can take account of factors other than short-term interests in bid situations—in other words, that they act in the best interests of the company. There is an inherent difficulty in making statements that relate to the effect of another party’s—the bidder’s—future conduct. There has to be a real risk that this would simply result in boilerplate

<sup>102</sup> This general duty is established by s172 of the *Companies Act 2006*.

<sup>103</sup> [HL Deb 19 January 2015 c349GC](#)

<sup>104</sup> *ibid.*



disclosures and those of us who have been directors know the risk of that. It is therefore questionable whether, in practical terms, the proposed amendment would result in meaningful disclosures being made by target boards in the majority of cases.<sup>105</sup>

At the Report stage of the Bill in March Lord Mendelsohn moved this amendment a second time. On this occasion he argued that the most recent changes that the Takeover Panel had made to the Code might not be enough:

[The changes made to the Code] centre on takeovers and do not deal with mergers, or even non-listed company mergers. Our amendment would enshrine the obligation for the directors of the company affected by all transactions to set out in a public statement when making recommendations how they have discharged their duties as shareholders. All those duties are laid out in the Companies Acts, and we want through the amendment to bring them to the forefront of directors' thinking.

We are encouraged that after consultation during Committee, many in business and the City see that as a useful complement to the current work, role and position of the Takeover Panel. We are sure that that would fulfil the Secretary of State's commitment during Second Reading and would also deliver for many practitioners a more dynamic and modern framework and approach. On a number of occasions, there have been transactions where a fulsome explanation was provided for the offeree directors' recommendation where wider issues and considerations were fully taken into account.

I urge the Government to examine the letters issued by the chairman of Manchester United in May 2005, of Beale plc in January 2015, of Dixons Retail in June 2014 and the offer rejection letter of the AstraZeneca board in May 2014. Our amendment would make that practice, which is fully consistent with the Takeover Panel's approach, mandatory.<sup>106</sup>

In response the Minister, Baroness Neville-Rolfe, raised concerns about the potential impact this change might have, but promised to seek the views of the Takeover Panel and the FCA:

Requiring all companies to make disclosures in the broad way proposed would place a heavy burden on business and stifle innovation and entrepreneurship. This is partly because we believe that this amendment could be read as covering not only transactions for publicly traded companies, such as those regulated by the takeover code, but all purchases and sales of private companies. There are 3.3 million private companies in the UK, so the potential for business burden is substantial.

We would also need to consider the possibilities of unintended consequences. This includes considering whether the introduction of such a measure would impact on the overall competitiveness of the UK as a place to do business or as a place to list. It also includes whether a new reporting requirement might result in boiler-plate disclosure, which I think we all agree tends to be better avoided.

The takeover code is overseen by the Takeover Panel, which is independent of government. It is not for government to suggest changes to the code. That said, the panel may wish to reflect

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<sup>105</sup> *ibid.*

<sup>106</sup> [HL Deb 9 March 2015 c524](#)

upon whether the provisions on disclosure in the code are as effective as they could be in providing shareholders with all the information that they need.

I am therefore happy to commit to write to the panel to outline the issues raised during debate in the House today and to seek its view. If the noble Lord feels that it would be helpful, I can write in similar terms to the FCA, which is responsible for the UK listing rules and which dealt, for example, with acquisitions such as that of ABN AMRO by RBS.<sup>107</sup>

Given the Minister's response, Lord Mendelsohn withdrew the amendment.

Later that month the Minister confirmed she had written to both the FAC and the Takeover Panel on this issue.<sup>108</sup> No further details of this correspondence appear to have been published as yet.

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<sup>107</sup> HL Deb 9 March 2015 c525

<sup>108</sup> *Letter from Baroness Neville-Rolfe regarding changes to the Takeover Code 19/3/2015*, Lords Library Deposited paper [DEP2015-0364](#), 19 March 2015.

### 3. Recent developments and cases (2016 onwards)

How the rules governing takeovers might be reformed have been part of a wider industrial strategy and debate sponsored by the Prime Minister, Theresa May. Following the referendum vote to leave the EU, and the decision of the Prime Minister, David Cameron, to resign, Ms May gave a speech to launch her national campaign to be leader of the Conservative Party on 11 July 2016. In her speech Ms May set out proposals to “make the economy work for everyone”, including changes to the regulation of takeovers and to the application of competition law:

If we are going to have an economy that works for everyone, we are going to need to give people more control of their lives. And that means cutting out all the political platitudes about “stakeholder societies” – and doing something radical.

Because as we saw when Cadbury’s – that great Birmingham company – was bought by Kraft, or when AstraZeneca was almost sold to Pfizer, transient shareholders – who are mostly companies investing other people’s money – are not the only people with an interest when firms are sold or close. Workers have a stake, local communities have a stake, and often the whole country has a stake.

It is hard to think of an industry of greater strategic importance to Britain than its pharmaceutical industry, and AstraZeneca is one of the jewels in its crown. Yet two years ago the Government almost allowed AstraZeneca to be sold to Pfizer, the US company with a track record of asset stripping and whose self-confessed attraction to the deal was to avoid tax. A proper industrial strategy wouldn’t automatically stop the sale of British firms to foreign ones, but it should be capable of stepping in to defend a sector that is as important as pharmaceuticals is to Britain. [...]

I also want us to be prepared to use – and reform – competition law so that markets work better for people. If there is evidence that the big utility firms and the retail banks are abusing their roles in highly-consolidated markets, we shouldn’t just complain about it, we shouldn’t say it’s too difficult, we should do something about it.<sup>109</sup>

#### 3.1 Softbank’s takeover of ARM

On the same day as the Prime Minister’s statement, Japan’s SoftBank announced a £24 billion bid for the Cambridge-based tech company ARM Holdings. The Business Secretary, Greg Clark, gave a short statement on the bid, saying, “this potential investment is a huge vote of confidence in the British economy and our continued future as a world-leading destination for global investment. The investor wants to grow the number of jobs in the UK and keep its headquarters in

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<sup>109</sup> Conservative Party, [Speech by Theresa May: Together we can make Britain a country that works for everyone](#), 11 July 2016

Cambridge, the government wants to see the companies work together to make sure these commitments are binding.”<sup>110</sup>

The *Financial Times* reported that in preparing for its bid, SoftBank’s chairman and chief executive Masayoshi Son had given the UK Government a “series of legally binding assurances to maintain Arm’s headquarters, double its UK-based staff over the next five years and increase its overseas headcount.” The paper went on to quote a spokesman for 10 Downing Street as saying that the prospective deal was “in the national interest”, and that “whether a foreign takeover is in the national interest is something that should be decided on a case by case basis.”<sup>111</sup> The Takeover Panel has the responsibility for enforcing these post-offer undertakings, as explained in [section 1.4](#) of this briefing.

## 3.2 Melrose’s takeover of GKN

Founded in 1759 as an ironworks in South Wales, GKN today designs, manufactures and services systems and components for aircraft, vehicle and machinery manufacturers.<sup>112</sup> Melrose is a company that buys manufacturing businesses in the hope of making them more valuable and selling them on at a profit some years later.<sup>113</sup>

On 12 January 2018, GKN’s Board announced that it had received a proposal from Melrose to acquire GKN, four days earlier:

The Board confirms that on 8 January 2018 it received a preliminary and unsolicited proposal from Melrose to acquire the entire issued and to be issued share capital of GKN at a price of 405 pence per share, comprising 80% in new Melrose shares and 20% in cash (the “Proposal”).<sup>114</sup>

Under the terms of the Proposal, GKN shareholders would hold approximately 57% of the enlarged company and Melrose shareholders would hold 43%.

GKN’s Board unanimously rejected Melrose’s proposal, ‘having concluded that the Proposal is entirely opportunistic and that the terms fundamentally undervalue the Company and its prospects.’<sup>115</sup>

Melrose confirmed it made the Proposal, and stated:

The terms represent a premium of approximately 24% over the closing share price of GKN on 5 January 2018, the last business day prior to the approach. The cash element of the consideration would be funded with a new debt facility, which is in an agreed form. It is expected that the combined group’s net leverage will be in line with Melrose’s declared strategy of 2.5x.<sup>116</sup>

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<sup>110</sup> BEIS press notice, [Statement on the proposed takeover of ARM Holdings](#), 18 July 2016

<sup>111</sup> “SoftBank to acquire UK’s Arm Holdings for £24.3bn”, *Financial Times*, 18 July 2016

<sup>112</sup> GKN, [GKN’s history](#), accessed 6 March 2018

<sup>113</sup> Melrose, [About us](#), accessed 7 March 2018

<sup>114</sup> GKN, [Statement re Possible Offer](#), 12 January 2018

<sup>115</sup> Ibid.

<sup>116</sup> Melrose, [Response to statement re possible offer](#) (RNS Number: 7437B), 12 January 2018

In accordance with Rule 2.6(a) of the Takeover Code, Melrose was required to either announce a firm intention to make an offer for GKN or announce that it does not intend to make an offer, by no later than 9 February 2018.

On 17 January 2018, Melrose announced its hostile cash and share offer for GKN. The terms of the offer were unchanged from Melrose's unsolicited proposal of 8 January 2018.

On 12 March 2018, Melrose increased its offer to GKN shareholders, stating the following terms:

1. Final offer valued at 467 pence per share, valuing GKN at £8.1 billion
2. GKN shareholders to own 60% of Melrose, a UK listed manufacturing powerhouse, and receive £1.4 billion in cash
3. Attractive immediate premium of 43%
4. Deadline for acceptances is 1.00 p.m. on Thursday, 29 March 2018
5. Offer will not be increased under any circumstances<sup>117</sup>

This revised and final offer was also rejected by the Board of GKN.<sup>118</sup>

By the deadline of Thursday 29 March 2018, Melrose had received acceptances in respect of a total of 901,318,533 GKN shares, representing 52.4% of the voting rights of GKN, thus winning the takeover battle.<sup>119</sup>

The Government demanded binding commitments from Melrose in respect of the future of GKN and national security. Melrose obliged and entered into deeds of undertaking with the BEIS Secretary and the Defence Secretary. Among other things, it committed to not selling any of the core GKN Aerospace businesses for a period of five years, and to maintaining GKN's capacity as a government supplier and contractor.<sup>120</sup>

Melrose also agreed these legally binding "post-offer undertakings" (POUs) with the Takeover Panel (POUs are explained in [section 1.4](#) of this briefing):

- an undertaking for a period of five years to maintain the Melrose Group headquarters in the UK by Melrose occupying a designated area in one or more buildings in the UK, one of which buildings is publicly designated as the Melrose Group headquarters and is the registered office of Melrose;
- an undertaking for a period of five years to maintain the listing of Melrose's shares on the Official List as maintained by the UKLA and admitted to trading on the London Stock Exchange's main market for listed securities;

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<sup>117</sup> Melrose, [Increased and Final Offer Announcement](#), 12 March 2018

<sup>118</sup> GKN, [Rejection of Melrose's Revised and Final Offer](#), 12 March 2018

<sup>119</sup> GKN, [Recommendation to accept offer](#), 29 March 2018

<sup>120</sup> Melrose, [Deed of Covenant and Undertaking with BEIS Secretary](#), 22 April 2018  
Melrose, [Deed of Covenant and Undertaking with Defence Secretary](#), 22 April 2018

- an undertaking for a period of five years that no director will be appointed or reappointed, or recommended to be appointed or reappointed, to the Melrose Board if following such appointment or reappointment a majority of the Melrose Directors would not be resident in the UK;
- an undertaking for a period of five years that the GKN Aerospace and GKN Driveline businesses will continue to retain the same rights (if any) which they have at 26 March 2018 (and which they continue to have as at the Effective Date) to use the GKN Trade Marks; and
- an undertaking that Melrose will procure that expensed research and development spend of the GKN Group during the period from 1 January 2019 to 31 December 2023 will be at least 2.2 per cent. of the aggregate of GKN Group sales.<sup>121</sup>

### 3.3 National security and infrastructure investment review

On 17 October 2017, the Government launched a [consultation](#) seeking views on how best to ensure that investments and takeovers do not raise national security concerns.

In the short term, the Government proposed to **lower thresholds for intervention** in mergers and takeovers in these two areas:

- the **military** use and dual use (civilian and military) sector
- parts of the **advanced technology** sector such as quantum computing

The changes were enacted by amendments to the *Enterprise Act* to lower the thresholds for the Secretary of State to intervene in mergers which have national security implications.

Specifically, the Government decided to lower the UK turnover threshold for intervention from £70 million to £1 million, and to change the share of supply threshold so that the threshold is met if a target has 25% or more share of supply, with no need for the merger or takeover to increase that share.<sup>122</sup> Secondary legislation which lowers these thresholds came into force on 11 June 2018.

*The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018* lowers the share of supply test:

This Order amends section 23 of the Enterprise Act [2002 \(c. 40\)](#) (the Act) which sets out the criteria for a merger to be a “relevant merger situation”, thereby qualifying it for investigation by the Competition and Markets Authority. The Secretary of State has the power under section 42 of the Act to intervene in a “relevant merger situation” on the grounds of specified public interest considerations, where appropriate.

A “relevant merger situation” is created if: two or more enterprises have ceased to be distinct at a time or in

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<sup>121</sup> Melrose, [Final Offer for GKN – Post-Offer Undertakings](#), 27 March 2018

<sup>122</sup> BEIS, [National Security and Infrastructure Investment Review: Government response to first consultation](#), March 2018, p3

circumstances set out in section 24 of the Act, and at least one of the following thresholds is met:

- (a) the value of the turnover in the UK of the enterprise being taken over exceeds £70m (the “turnover test”); or
- (b) the merger would result in the creation or enhancement of at least a 25% share of supply of goods or services in the UK, or in a substantial part of the UK (the “share of supply” test).

Article 3 of the Order amends the share of supply test so that, in cases where the enterprise being taken over is a “relevant enterprise” that test is additionally met, if the relevant enterprise has a 25% share of supply of goods or services in the UK before the merger. The relevant goods or services for this purpose are those by virtue of which it qualifies as a “relevant enterprise”.

Article 4 inserts a new section 23A into the Act which defines a “relevant enterprise”. The definition covers enterprises which are involved in specified activities in connection with the following: military or dual-use goods which are subject to export control, computer processing units and quantum technology.<sup>123</sup>

*The Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018* lowers the turnover test:

Article 2 of this Order amends the turnover test so that, in cases where the enterprise being taken over is a “relevant enterprise”, the test is met if that enterprise has turnover in the UK of over £1m instead of £70 million.<sup>124</sup>

Further [guidance](#) is available on the government’s website.<sup>125</sup>

The Government also sought views about potential long-term reforms in this area ([green paper consultation](#), 17 October 2017), and published [proposals](#) on 24 July 2018. Consultation on the white paper proposals closed on 16 October 2018.

### **The Government wants to overhaul its capacity to scrutinise and intervene in investments that raise national security concerns.**

The Government would be directly responsible for national security assessments (the CMA would no longer have a role), and would be able to intervene much more widely in the economy.<sup>126</sup> There would also be a much broader set of “trigger events” that the Government could call in, such as the gaining of significant influence over a company or a sensitive asset of the company (e.g. intellectual property, key infrastructure).<sup>127</sup>

The Government expects that there will be around 100 notifications each year that will be subject to a full national security assessment.<sup>128</sup> If

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<sup>123</sup> *The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018*, [Explanatory note](#)

<sup>124</sup> *The Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018*, [Explanatory note](#)

<sup>125</sup> The debate on the Share of Supply Test (Amendment) Order in the Lords may also be of interest, [HL790](#) 1 May 2018.

<sup>126</sup> BEIS, [National security and investment: a consultation on proposed legislative reforms](#), p54

<sup>127</sup> BEIS, [National security and investment: a consultation on proposed legislative reforms](#), p30

<sup>128</sup> BEIS, [National security and investment: a consultation on proposed legislative reforms](#), p12

the Government concludes that national security is at risk, it will impose such remedies as necessary and proportionate. The Government expects to impose some remedies in around half of those cases subject to a full national security assessment, or about 50 per year<sup>129</sup>, compared with fewer than one a year now<sup>130</sup>.

The proposals **expand the range of circumstances where the Government has powers to intervene**, in addition to the turnover and market share thresholds discussed earlier. The new “trigger events” cover the range of means by which a hostile actor can acquire the ability to undermine national security in the short or long term. They include the acquisition of:

- more than 25% of an entity’s shares or votes; or
- significant influence or control over an entity or an asset; or
- further acquisitions of significant influence or control over an entity or an asset beyond the above thresholds.<sup>131</sup>

The proposed changes will require primary legislation (an act of parliament) to be implemented.

The Government says that the proposals do not seek to reintroduce some wider public interest test or to create new grounds for intervention by the Secretary of State. They are exclusively focussed on national security.<sup>132</sup>

Not everyone agrees, though. John Fingleton, formerly CEO of the Office of Fair Trading and Chair of the International Competition Network, has reservations. He argues that the proposals are a radical departure from the existing regime:

First, they would create an entirely new merger review regime which by-passes existing institutions, structures and the transparent processes that accompany them. Second, they greatly expand the number and types of transactions over which the government has the right to intervene. Third, while much of the language is around national security and the threat from foreign actors, they apply to any takeover, not just those involving foreign companies, and the concept of national security is not adequately defined. Fourth, while focussed on certain sectors of the economy, they would enable the government to intervene in any sector.

The government envisages examining 200 cases per year under the new regime. This would be a vast increase, considering it has used existing powers to intervene on national security grounds fewer than ten times since 2003. Although the consultation does not point to a single historic case where national security was impaired but where the government was unable to intervene, the consultation envisages that under the new regime 50 or so cases a year will need to be remedied or blocked to protect national

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<sup>129</sup> Id.

<sup>130</sup> See recent [public interest interventions](#) by the CMA

<sup>131</sup> BEIS, [National security and investment: a consultation on proposed legislative reforms](#), p30

<sup>132</sup> BEIS, [National security and investment: a consultation on proposed legislative reforms](#), p9



security. By contrast, the CMA currently only remedies approximately 20 cases a year on competition grounds.

In addition to greatly expanding the size and scope of the government's interventions in the market, the changes are likely to have two further harmful effects.

First, they would introduce a much more restrictive approach towards foreign investment into the UK. [...] Second, the changes provide a mechanism by which the government can use the threat of a national security intervention to extract commitments related solely to continued economic activity in the UK, and not to national security. This is not a theoretical concern; the government has shown an increased appetite for doing so recently. In March 2018, the government extracted substantial commitments from Melrose in respect of its purchase of GKN. This takeover did not involve a foreign business and any impact on national security was at best limited. National security powers can and will be used to intervene for politically motivated reasons.<sup>133</sup>

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<sup>133</sup> John Fingleton, [Mergers and the public interest: a wolf in sheep's clothing?](#), 16 October 2018

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