Takeovers – will they ever be the same again?

by Philip Goldenberg

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

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

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

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

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

• a developmental review of a company’s business, including market changes, new products and services, and changes in market positioning;

• a company’s purpose, strategy and principal drivers of performance;

• its key relationships with employees, customers, suppliers and others on which its success depends;

• a review of its corporate governance;

• the dynamics of a company’s business, including a full SWOT analysis, which would go beyond the financial to market conditions, technological change, health and safety, environmental exposure, tangible and intellectual capital, brand development, research and development, and training;

• environmental policies and performance; and

• policies and performance on community, social and ethical issues and reputation.

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

SPECIFIC PROPOSAL

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

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

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

CONFLICT

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

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

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

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

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

CRUCIAL

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

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

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