

THE TAKEOVER PANEL

JOHNSON & FIRTH BROWN LIMITED ("JFB")/ DUNFORD & ELLIOTT LIMITED ("D & E")

After a Panel meeting on 6th December, a statement was issued that, in the Panel's opinion, there would be no detriment to the shareholders of D & E if the offer by JFB went ahead. The offer documents have since been posted. The Panel also indicated that it proposed to give further consideration to the questions of confidentiality which had been raised in this case.

This consideration has now taken place. The Panel has had further discussions with the parties principally involved.

In the summer and autumn of this year various schemes were considered by D & E and its financial advisers for securing further capital and for re-negotiating loan repayments. These were aimed at correcting the imbalance between equity and debt and providing funds to deal with its pressing financial difficulties.

On 21st October, 1976 Morgan Grenfell & Co. Limited ("Morgan Grenfell"), who were advising D & E, were told that a number of institutional shareholders in D & E (the "Committee") would like to have a meeting with the board of D & E to learn what was happening. These institutional shareholders - mainly insurance companies and pension funds - held some 43% of the equity. The leading institutional shareholder was the Prudential Assurance Company Limited ("the Prudential"), with a 7% holding. Morgan Grenfell indicated that there were difficulties in providing some shareholders with information not available to the rest. The Committee pressed for a meeting and in further exchanges it became clear that the Committee was considering whether to provide finance for D & E, one form of which might be the underwriting of a rights issue. Morgan Grenfell considered that the position was altered if they were dealing with prospective underwriters and that it would accord with usual practice if appropriate confidential information was provided to them. Accordingly, Morgan Grenfell, with the agreement of D & E, provided the secretary of the Committee with a detailed financial budget for the year ending 30th September, 1977, D & E's five-year plan containing profit and cash flow projections for the years 1976/77 to 1980/81, and a report by a firm of consulting engineers, which commented on the capability of certain plants

within the D & E group and their ability to support budgeted sales targets for the next five years. Morgan Grenfell reminded the secretary of the Committee that the confidential information, which was regarded as price-sensitive, was being provided to the Committee in the capacity of its members as potential underwriters and should not be used "in any way to influence investment decisions (including subscription of any shares offered by way of rights) by the institutions represented on your Committee".

The scheme under consideration by the Committee was a rights issue to raise approximately £3 million. As the largest institutional shareholder, the Prudential took the lead in the discussions with Morgan Grenfell. D & E and its advisers regarded the scheme put forward by the Committee as less favourable than another scheme then under negotiation, while the Prudential and other institutional shareholders considered at that time that D & E needed more than the £3 million proposed under either scheme.

JFB, who had heard of D & E's financial difficulties, had kept the position under review throughout 1976. On 7th October, 1976 JFB had approached the Prudential to ascertain whether the Prudential would sell its holding in D & E to JFB as JFB was considering whether to build up a holding of D & E shares, with a view to having an influence on D & E's policy and possibly, although this was not disclosed to the Prudential at the time, as a basis for a bid for D & E. The Prudential declined to sell its shares to JFB.

On 26th October the Prudential decided to ascertain whether JFB and another company in the steel industry would be prepared to underwrite a further £500,000 each, so that the rights issue would yield £4 million. The Prudential did not consult Morgan Grenfell or D & E before making this approach. It was explained to the Panel that the Prudential was acting under severe pressure of time, since D & E could at any time adopt some other scheme of financing which might, in the view of the Prudential and other shareholders, be less favourable to share-holders in the long run. It had also formed the impression that D & E and its advisers did not view the Committee's scheme with much favour.

On 27th October, the general manager of JFB, Mr. Philip Ling, and his financial analyst went to the offices of the Prudential and were shown the budget for 1976/77 and the consulting engineers' report. It is agreed that both the Prudential and JFB regarded the information as confidential and that the Prudential was not prepared to let the representatives

of JFB take away copies of the documents. There is some disagreement as to whether the Prudential intended that the representatives should take notes: in fact, extensive notes were taken at the offices of the Prudential, and with the knowledge of Prudential employees. The Panel does not regard the difference between showing the documents and allowing notes to be taken as material to the issues which the Panel has to consider.

The Prudential informed the Finance Director of D & E on 28th October that the Committee wished to add a further £1 million to the rights issue to be provided by JFB and the other industrial company and that these companies were agreeable to their inclusion in the underwriting consortium. D & E next day objected that it was not prepared to have competitors in the scheme, particularly JFB, which, earlier in the year, had discussed with D & E the possibility of acquiring parts of D & E's business and had even mooted the idea of a full merger. Further discussions disclosed the fact that confidential information had been made available to JFB.

In the meantime JFB was engaged in active consideration of its attitude to the D & E situation. The Steel Division board of JFB favoured, on commercial grounds, a full bid for D & E. The main board of JFB, faced with the fact that D & E had very substantial borrowings, favoured the limited participation involved in the Committee's scheme.

On 28th October, the Steel Division board of JFB had a day long meeting towards the end of which its five members were provided with copies of the notes taken at the meeting with the Prudential. Morgan Grenfell represented to the Panel on behalf of D & E that these notes would have been of great value to a competitor, in particular one contemplating a bid. The Chairman of the Steel Division board of JFB however told the Panel that he regarded D & E's financial budget for 1976/77 as too optimistic and that his board relied entirely on more conservative estimates that JFB had previously prepared. He also said that the consulting engineers' report only covered part of D & E's plants and added nothing to what JFB already knew. The report was based on possible outputs in the next five years, but, in his view, because the report covered such a long period, not much significance should be attached to it. The Chairman of JFB confirmed that the confidential reports added nothing; to JFB's knowledge and that in any event the final decision by JFB to make the bid for D & E followed from the rejection of the revised Committee scheme by D & E and was based on broad consideration of company policy.

JFB therefore announced the terms of its offer on 8th November, having by then secured the underwriting of a £10 million rights issue, conditional on the bid succeeding; the main purpose of the rights issue was to provide additional finance for D & E. Subsequently the Committee improved the terms of its own scheme in ways that made it more acceptable to D & E.

On 15th November D & E issued a writ seeking an injunction to restrain JFB from proceeding with its offer. The application was heard and an interlocutory injunction was granted by Mr. Justice Mocatta on 30th November. JFB appealed and on 3rd December the Court of Appeal discharged the injunction. Some of the issues which this case raises are discussed in the judgments given in the Court of Appeal, which the Panel has had the advantage of reading.

So far as the Panel is concerned, there are three issues on which it thinks it desirable to set out its views.

The first is whether D & E and Morgan Grenfell were justified in supplying to the institutional shareholders, as potential underwriters, confidential information of a price-sensitive character which at that stage was not available to the other share-holders of D & E. The Stock Exchange's Listing Agreement provides that directors should not divulge price-sensitive information in such a way as to place in a privileged position any person or class of person outside the company and its advisers. In normal circumstances this question would not be one for the Panel's consideration but the circumstances of this case were such as to give rise to a take-over offer. In this context the City Code provides that some shareholders should not be given information not available to the rest, although it is recognised that this principle does not apply to the furnishing of information in confidence by an offeree company to a bona fide potential offeror or vice versa. The issues in this case go wider than the field of take-overs and raise questions for The Stock Exchange and the Issuing Houses Association. The Panel considers that in this case, which led to a take-over bid, Morgan Grenfell, with the assent of D & E, were justified in giving confidential, price-sensitive information to the institutional shareholders in order that they might consider whether they should underwrite a rights issue. Morgan Grenfell and D & E were exploring various ways of meeting D & E's urgent financial needs. Admittedly, it was difficult to distinguish the institutional shareholders as underwriters from their position as shareholders, particularly as they

could be taking up shares either by way of rights or as under-writers: but the schemes that were being put forward by the Committee were intended to be in the interests of the share-holders as a whole. Much of the information given to the Committee has since been provided in summary form to all the shareholders of D & E. The present rules do not seem adequately to deal with the supply of confidential information to under-writers in situations of this kind and the Panel has no doubt that the bodies represented on it will look into this aspect of the matter.

The second issue to which the Panel addressed itself was whether the Prudential was justified in passing confidential information to competitors of D & E (and particularly JFB) without obtaining the consent of Morgan Grenfell or D & E. The Prudential's record of serving the public interest in cases of this kind is impressive and it accorded with its past record that it should take a lead in endeavouring to sort out a difficult position and to put forward constructive proposals. What it did was done in good faith and in the public interest and in the interest of D & E shareholders as it saw them. In the Panel's view, however, its failure to consult Morgan Grenfell or D & E before passing confidential information to industrial competitors was undoubtedly an error of judgment. Certainly it is not an error that the Prudential is likely to repeat.

Finally, the Panel has given much thought to the propriety of the action of JFB in accepting confidential information, given to it in the context of an underwriting operation only, and in the circulation within its organisation of this information at a time when consideration was also being given to the alternative of a take-over bid. The Panel finds it difficult to accept that the possession of this information might not have assisted JFB in reaching its decision to make a bid even if only by confirming facts already known to it. However, this decision was only taken after JFB's offer to participate in the underwriting operation had been opposed by D & E and after the Committee's original underwriting proposals had been rejected by D & E. In these very special circumstances, and despite its anxieties, the Panel does not consider it appropriate to criticise JFB for the action it took.

23rd December, 1976.