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SECRET

PART ONE

NEW FILE COVER

CONFIDENTIAL FILING

MONOPOLIES AND MERGERS

GOVERNMENT MACHINERY

PART ONE:

JUNE 1983

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~12/86~~							
~~17.12.86~~							
~~22.12.86~~							
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26.2.87							
PART ENDS							

PREM 19/2193

Dd 8398366 2M 11/83 JET

PART 1 ends:-

CDP to FCO 26.2.87

PART 2 begins:-

FCO to CDP 3.3.87

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
ES(84) 3	23.03.84
ES(84) 4	23.03.84

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed R Wayland Date 21 October 2015

PREM Records Team

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

26 February 1987

Dear Robert,

I enclose a copy of a letter to the Prime Minister from the Prime Minister of Barbados about the referral to the Monopolies and Mergers Commission of the takeover bids by Tate and Lyle and the Ferruzzi group for the British Sugar Corporation. The letter is, of course, overtaken by the publication of the Trade and Industry Secretary's decision. That makes a reply all the easier. I should be grateful for a draft.

I am copying this letter to Paul Steeples (Department of Trade and Industry) and Shirley Stagg (Ministry of Agriculture, Fisheries and Food).

yours ever,

Charles Powell

Charles Powell

R.N. Culshaw, Esq., MVO.,
Foreign and Commonwealth Office.

CONFIDENTIAL

SCEBT

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Paul Channon MP
Department of Trade and Industry
Victoria Street
LONDON
SW1

25 February 1987

Dear Paul

COMPETITION ACT 1980: 1987 PROGRAMME OF NATIONALISED INDUSTRY REFERENCES TO THE MONOPOLIES AND MERGERS COMMISSION

Thank you for sending me a copy of your letter of 17 February 1987 to Nigel Lawson.

You will not be surprised that I have no water authority candidates for a section 11 reference in 1987. As in 1986, the prospect of early privatisation of the water authorities remains the overriding reason. Kenneth Baker set out the thinking on this in his letter to you of 7 February last year and reaffirmed it in subsequent letters to you of 20 March and 23 April 1986. We cannot rule out the possibility of early action on privatisation and flotation, and decisions have not yet been taken on the order in which authorities might be floated on the market.

I should add that five authorities have already been examined by the MMC in the last 7 years. The conclusions of these studies have been drawn to the attention of all the authorities and responses requested. Effectively therefore because of the water industry's federal structure, all authorities have been made well aware of MMC findings through the scrutiny of an authority almost continuously for a number of years. This kind of continuous examination, if it goes on, is not helpful in encouraging sales prospects.

Of the authorities investigated, none is a candidate for re-examination. Follow up action has been good; you will have seen, for example, the recent report from Yorkshire. The remaining authorities are Northumbrian, Thames, South West and Wessex. Thames and South West are both financially strong, which makes them candidates for early privatisation, and in South West's case there is the additional complication of a new Chairman later in the year which would complicate the timing of any reference. Northumbrian is a very well managed cost-conscious authority; Wessex have taken a commercial approach to their investment needs,

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GOVT MACH: Mon + Mergers
June 83.

and are particularly strong on new technology. While Northumbria and Wessex are not among the strongest authorities financially, this does not necessarily rule out early flotation. The position of the Welsh Water authority is of course for Nicholas Edwards but he may have some views about their performance.

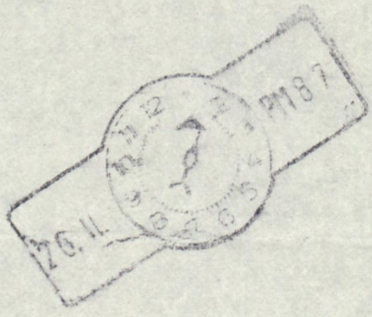
We are really in the same position as last year. Ministers are committed to early privatisation after a general election, and an MMC investigation in the meantime would not be at all helpful. It is unwise to search for water authority weaknesses at a time when we are hoping to encourage a successful sale.

I am sending copies of this letter to the Prime Minister, colleagues in E(NI), and Sir Robert Armstrong.

Yours ever

Nicholas

NICHOLAS RIDLEY



DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
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GTN 215) 5422
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

PS/

25 February 1987

Lyn Parker Esq
Private Secretary to the
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1

Dear Lyn,

TATE & LYLE AND FERRUZZI BIDS FOR BERISFORD

Your Secretary of State wrote to mine on 17 February about these bids. / will request if required

I am enclosing a copy of the Press Release Mr Channon issued today. As you will see, he has accepted the conclusions of the MMC that the bids are against the public interest, and that the acquisitions should not be permitted. He has also noted the MMC's supplementary comments.

I am copying this letter and attachment to David Norgrove (No 10), Shirley Stagg (MAFF), Jill Rutter (Chief Secretary's Office), and Robert Gordon (Scottish Office).

Yours ever,
Paul Steeples

PAUL STEEPLES
Private Secretary

DW3BSZ

DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 4470
Out of hours: 01-215 7877

Number: 87/111

Date: 25 February 1987

TATE AND LYLE PLC/FERRUZZI FINANZIARIA SPA/S AND W BERISFORD PLC

REPORT BY THE MONOPOLIES AND MERGERS COMMISSION

The Monopolies and Mergers Commission (MMC) has concluded that the proposed acquisitions by Tate and Lyle plc (Tate & Lyle) of S & W Berisford plc (Berisford) and by Ferruzzi Finanziaria SpA (Ferruzzi) of Berisford's wholly owned subsidiary, British Sugar plc (British Sugar) might be expected to operate against the public interest and should not be allowed. The MMC also concluded that Ferruzzi's existing holding of shares in Berisford might be expected to operate against the public interest, and recommended that it should be reduced. In accordance with the advice of the Director General of Fair Trading the Secretary of State for Trade and Industry has accepted these recommendations.

The Tate & Lyle/Berisford Reference

The MMC acknowledged that the structural disadvantage of the cane refiner (Tate and Lyle) under the CAP regime compared to the sugar beet processor (British Sugar) had affected the nature of competition in the United Kingdom sugar market, but concluded that the existence of two separate sugar producers had kept prices lower than they would otherwise have been. The MMC noted that, if the merger took place, it would result in a single company controlling the refining, packing, marketing and distribution of about 95 per cent of the supply of sugar and sugar products in Great Britain. Accordingly, they did not accept Tate & Lyle's view that the merger would not involve a material reduction in competition. The MMC considered that the reduction in competition would be likely to result in price increases, to reduce the standards of service and to have adverse effects on the ability of merchants to provide competition. The MMC considered, and rejected because of their limitations or the difficulties involved, various safeguards that were suggested to avoid or mitigate the adverse effects. Accordingly they recommended that the merger should not be allowed.

MORE/....

The Ferruzzi/Berisford Reference

The MMC identified three adverse effects which might be expected to arise from the merger situation contemplated in the Ferruzzi/Berisford conditional agreement, (which provides for the sale to Ferruzzi of 70 per cent of the issued share capital of British Sugar). First, the merger might be expected to restrict the ability of merchants and major users to import sugar from the rest of the Community. This would raise the ceiling on United Kingdom sugar prices and sooner or later could be expected to lead to higher prices whatever pricing strategy the merged company initially pursued. Secondly, the merger would give Ferruzzi control or influence over nearly 25 per cent of beet sugar quotas in the Community and therefore increased influence in the Community institutions, which could be used in ways which might be adverse to UK interests. Thirdly, the control of British Sugar by Ferruzzi would be detrimental to the maintenance of independent cane refining in the United Kingdom.

The MMC therefore concluded that the merger situation contemplated in the Ferruzzi/Berisford agreement might be expected to operate against the public interest. They were unable to make any recommendation for the application of remedies and accordingly recommended that the contemplated merger should not be allowed.

Ferruzzi's Existing Shareholding in Berisford

The Commission also concluded that the merger situation arising from Ferruzzi's existing shareholding in Berisford might be expected to operate against the public interest. In these circumstances the MMC considered that, in order to prevent these detriments occurring, Ferruzzi should be required to reduce its shareholding to a level at which it no longer had a material influence over Berisford. The Commission therefore recommended that Ferruzzi should be required over a period not exceeding two years to reduce its holding of Berisford's ordinary shares to no more than 15 per cent of Berisford's issued ordinary share capital. In the meantime Ferruzzi should be permitted to exercise voting rights only in respect of shares representing not more than 15 per cent of the issued ordinary share capital of Berisford.

Other Recommendations Related to Tate and Lyle

In reaching its conclusion that the acquisition of control of British Sugar by Tate & Lyle should not be allowed, the MMC emphasised their belief that there were other more appropriate methods of solving the problems of the cane refineries than permitting the merger. They therefore made a number of recommendations intended to maintain Tate & Lyle's position in the market and encourage further investment to improve its efficiency.

MORE/....

Decision of the Secretary of State for Trade and Industry

In accordance with the advice of the Director General of Fair Trading the Secretary of State for Trade and Industry has accepted the conclusions of the MMC that the proposed acquisitions by Tate and Lyle and Ferruzzi of Berisford and British Sugar respectively, and Ferruzzi's existing shareholding in Berisford may be expected to operate against the public interest. He considers that the undertakings proposed by Tate and Lyle and Ferruzzi respectively would not be adequate to safeguard the public interest. Accordingly he has accepted the MMC's recommendations that the proposed acquisitions should not be permitted, and that Ferruzzi should be required to reduce its existing shareholding to no more than 15 per cent.

The Government has taken note of the MMC's supplementary comments relating to the problem of the cane refineries. It remains fully committed to the Sugar Protocol of the Lome Convention under which the Community guarantees access without time limit to a specified quantity of African, Caribbean and Pacific sugar. It must be emphasised, however, that the operation of the Sugar Protocol, and the establishment of fair conditions of competition within the Common Agricultural Policy between cane and beet sugar are Community responsibilities.

For this reason, at the Government's suggestion, the European Commission is currently reviewing the cane refining margin. The Government will be pressing for the establishment of a satisfactory margin on a continuing basis as a result of this review. The Secretary of State's acceptance of the MMC's recommendation against permitting the acquisition of Berisfords by Tate and Lyle is not however linked in any way with the negotiations in Brussels on the sugar regime.

In accordance with the advice of the Director General of Fair Trading, Mr Channon has therefore asked him to consult Tate and Lyle and Ferruzzi, with a view to obtaining undertakings not to proceed with their proposals to acquire S & W Berisford and British Sugar respectively; and in respect of Ferruzzi's existing shareholding in Berisford, to reduce that shareholding to 15 per cent over two years, with a limitation of the exercise of voting rights in the interim period.

ENDS

MORE/....

NOTES FOR EDITORS

1. The Secretary of State for Trade and Industry referred the proposed acquisition of S & W Berisford by Tate & Lyle to the Monopolies and Mergers Commission on 19 May 1986. He referred the existing Ferruzzi Group holding of 23.7 per cent in S & W Berisford and Ferruzzi's full bid for the latter company to the Commission on 2 July 1987. In both cases the Commission were asked to report by 18 November. This was extended by two months in November 1986 by direction of the Secretary of State under section 70 (2) of the Fair Trading Act 1973.

2. The Monopolies and Mergers Commission report on the existing and proposed mergers: Tate & Lyle PLC and Ferruzzi Finanziaria SpA and S & W Berisford PLC. Cm 89; ISBN 0 10 100892 9; available from HMSO price £13.00 net.

CCBG

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

The Rt Hon Paul Channon MP
Secretary of State
for Trade & Industry
Department of Trade & Industry
1 Victoria Street
London
SW1H OET

25 February 1987

NBM

Your letter of 17 February to Nigel Lawson asked us to consider further candidates for the 1987 programme of MMC scrutinies of nationalised industries.

I agree we should produce a substantial MMC programme if there are enough worthwhile scrutinies to be done. In previous years the energy sector has been a regular and significant component. But as you will appreciate, the successful privatisation strategy has now inevitably reduced the field of possibilities in the energy area for which I am responsible. I do not believe it would be sensible now to subject any of the remainder to MMC scrutiny.

I am copying this letter to the Prime Minister, E(NI) colleagues, and Sir Robert Armstrong.

PETER WALKER

GOVT MACH: Monopolies + Mergers: June 83

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

20 February 1987

Dear Paul,

COMPETITION ACT 1980: 1987 PROGRAMME OF NATIONALISED INDUSTRY REFERENCES TO THE MONOPOLIES AND MERGERS COMMISSION

Thank you for sending me a copy of your letter of 17 February to Nigel Lawson, in which you asked sponsoring Ministers to consider whether they could offer additional candidates for the 1987 list of references.

I am glad to see that you now recognise that it is no longer feasible to continue with our declared target of making up to six references a year, and that you now envisage only four references for 1987. We should recognise, however, that it will not be easy to achieve even this lower target in subsequent years, given that we have only once achieved the previous target, and that the number of potential candidates has fallen substantially in recent years as a result of privatisations. I accept, however, that for 1987 we should aim to make four references, and I have therefore considered again whether any of the relevant bodies for which I am responsible should be included in the list for this year. I have, as you know, already agreed that the London Underground should be a candidate for 1987, though only towards the end of the year when we have settled LRT's new objectives.

I have considered your request very seriously, but I am afraid I cannot offer you any more candidates for the 1987 list. In particular I do not think it would be reasonable to expect BR to cope with a further MMC reference this year since they will have to deal with the follow-up to the re-reference of Network South East, which started last September. I gather that Treasury officials have suggested

that BR's Provincial sector should be referred this year, but I see considerable risks in this course, and no political or presentational advantages. In any case, I do not think it would help in any arguments with PAC if the 1987 list of candidates was dominated by transport references. I am therefore afraid I must ask you to look elsewhere for additional candidates.

I am copying this letter to the Prime Minister, to other members of E(NI), and to Sir Robert Armstrong.

JOHN MOORE

GOVT MACH: Monopolies and Mergers Jun 83

610

CCPC

THE PRIME MINISTER'S OFFICE
BRIDGETOWN, BARBADOS

TEL: 809-426-3179

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T20B/87

18th February, 1987.

The Rt. Hon. Margaret Thatcher, M.P.
Prime Minister
10 Downing Street
London S.W.1
ENGLAND.

SUBJECT
cc OPS
master.

Dear Prime Minister,

I thought I should write you on the matter of the Monopolies and Mergers Commission report on the take-over bid by Tate and Lyle and the Italian Ferruzzi for the British Sugar Corporation.

Sir Geoffrey Howe, when he passed through Barbados at the beginning of this year discussed this matter thoroughly with Foreign Minister Sir James Tudor and more recently, Baroness Young and Foreign Minister have also exchanged views on this matter. I am enclosing herewith for quick reference, a copy of an Aide Memoire which Foreign Minister left with Baroness Young on that occasion.

Because of the impact which a decision against Tate and Lyle could have on the economy of Barbados and other ACP sugar producing countries, I bring to your attention the considerations in the Aide Memoire which I trust your Government will bear in mind as it considers the findings of the Commission.

Please accept, Prime Minister, the renewed assurances of my highest consideration.

Errol Barrow

Errol W. Barrow
Prime Minister.

Encl.

AIDE MEMOIRE

The Government of Barbados is anxious that the impending merger of the large sugar refining Companies does not work against the interest of ACP sugar exporting countries.

Tate and Lyle has through the years refined Cane sugar for ACP countries. It has the capacity to deal with ACP quotas of raw cane sugar and its continued existence is regarded as vital to our cause.

A merger of Tate and Lyle with British Sugar PLC, the large beet processing company, will offer greater prospect for the future of ACP sugar and help Tate and Lyle to safeguard its own future financial viability.

The Italian Company, Ferruzzi Finanziera which has extensive European sugar holdings if permitted to acquire British Sugar PLC, will undermine the competitive position of Tate and Lyle as such merger could lead to a natural reduction in cane sugar refining capacity in the United Kingdom. Should this occur the United Kingdom Government would have reneged on its continuing assurances that ACP sugar will always find a market in the United Kingdom.

The relevant Ministry in the United Kingdom, now making a decision on the Monopolies Commission Report on this matter, should pay special regard to arriving at a decision which is consistent with the assurances given by successive British Governments to ACP countries through the years.

The Sugar Protocol of Lome assures ACP Countries of the purchase and importation into the Community of 1.3 million tonnes of raw cane sugar at guaranteed prices annually. Tate and Lyle's interest in ensuring that this quantity of sugar is accommodated remains unchallenged. The ascendancy of beet sugar companies by way of the merger in question will make Tate and Lyle's operation most vulnerable and would lead to a severe reduction in the quantity of ACP sugar finding access into the United Kingdom.

The British Government should recall:

(i) Assurances given to the ACP cane sugar supplying countries by successive British Governments since 1971.

(ii) That access to Britain for the traditional quantity of sugar from developing countries was one of the conditions upon which Britain 's entry into Europe was based.

(iii) That access can only take place within the context of the European Common Agricultural Policy; thus unrestricted free competition between the cane and beet interests cannot arise.

(iv) The actions and views of the British Government will play a decisive role in determining whether the cane refiners are enabled to keep open their existing capacity and to continue to import, refine, and market the existing quantity of ACP sugar.

(v) That the cane refiners in Britain have consistently made known to their suppliers, and to the British Government, the difficulties they would face if Ferruzzi as the owners of substantial interests in the Italian and French sugar industries were permitted to take control of the British beet sugar industry.

(vi) That the supplying countries have been concerned by suggestions that the problem of beet erosion of cane's share of the market would be alleviated if the price paid for cane sugar supplies were reduced.

(vii) That the refiners and the suppliers are effectively partners in the operation of making cane sugar available to British consumers and it is essential that both receive appropriate remuneration.

(viii) That the price paid to the suppliers of cane sugar is determined by the guaranteed price under the Sugar Protocol.

(ix) The assurances given to the suppliers are for continued access at this guaranteed price.

(x) The Commonwealth Sugar Agreement operated for 24 years and the Sugar Protocol has operated for nearly 12 years. The British Government should take steps to enable cane sugar to enter Britain and to assure its refining and marketing at its present level.

(xi) That if the Tate and Lyle refineries are forced to close there is no other cane refining capacity within the EEC that could replace it.

24th January, 1987

DTP

CCBG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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Secretary of State for Trade and Industry

CONFIDENTIAL

17 February 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1

Prime Minister 2

You were interested in last year's programme references.

DLW
17/2

Dear Nigel,

COMPETITION ACT 1980 : 1987 PROGRAMME OF NATIONALISED INDUSTRY REFERENCES TO THE MONOPOLIES & MERGERS COMMISSION

As you will know, we urgently need to put together and announce a credible programme of references for 1987. I believe that these enquiries, which we introduced on taking office, are well worthwhile in their own right; but there is a particular reason why we need a convincing list of candidates this year. The Public Accounts Committee (PAC) will shortly be reporting on their enquiry last year into the S.11 process. Their report is likely to be critical and to argue that the National Audit Office (NAO) would do the job better than the MMC. We have hitherto managed to fight off the proposition that the NAO should have access to the nationalised industries and analogous bodies; but the PAC report will revive Parliamentary interest, and the lack of a convincing 1987 programme of references would provide real ammunition for the NAO protagonists (who are not all on the Opposition side of the House).

Our declared policy stemming from 1981 is that there will be up to six references a year (though in fact we have only once achieved this target). Since then the pool of candidates has been signficantly reduced by privatisation, and I believe that a programme of four references is something that we could comfortably defend. But at present we are a long way short of that. After inter-Departmental discussions officials have been able to agree on only one, or possibly two, references: London Regional Transport's Underground service (a reference in the Autumn, once the Board's

DW1CRD

new objectives are in place); and the Scottish Bus Group (again in the Autumn, always provided that the current enquiries by the Office of Fair Trading into allegations of anti-competitive practices do not lead to a full investigation). I am happy to endorse these recommendations; but (even if the Scottish Bus Group remains a runner) they are clearly not enough.

I should be grateful therefore if all colleagues with responsibility for any bodies falling within the scope of S.11 would urgently and positively consider which of them might be added to the 1987 list. Time is short, and I should therefore be grateful for replies by 25 February at the latest. I hope very much that this will enable a solid programme to be put together; but if this turns out not to be the case I think we shall need to discuss the matter urgently at E(NI).

I shall of course be reconsidering whether any DTI bodies might be put forward, but the most obvious candidate, the Post Office, has already undergone three enquiries, one as recently as last August; and 1986 also saw an enquiry into BSC.

I know that some colleagues are not entirely happy about some aspects of the MMC's handling of S.11 enquiries, and I should report that arrangements for carrying out the review of S.11 procedures mentioned in Ministerial correspondence last year have now been set in train; DTI and Treasury officials aim to draw up a report in the Spring for interdepartmental consideration. To meet some of the concerns that have been expressed the scope of the review has been widened a little to embrace the rationale and objectives as well as the operational aspects. The PAC's findings will clearly provide an important input, as will informal soundings of the Nationalised Industries' Chairmen's Group and the MMC itself; and of course we shall be looking for a major input from all sponsor Departments concerned. But all this must not divert us from the prime immediate task - to agree a fully credible programme of references for 1987.

I am sending copies of this letter to the Prime Minister, colleagues in E(NI), and Sir Robert Armstrong.

PAUL CHANNON

DW1CRD

OID

fc BG.

DEPARTMENT OF TRADE AND INDUSTRY
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LONDON SW1H 0ET
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Secretary of State for Trade and Industry

13 February 1987

Ian Stewart Esq MP
Economic Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

Prime Minister 2

A meeting is scheduled for early Monday. I will keep you in touch.

ACW
mf 13/2

Dear Ian,

with DRN?

Thank you for your letter of 11 February, and for copying to me your letter to Malcolm Rifkind.

I appreciate that a firm statement on the outcome of the current review of mergers is going to be necessary to reassure Members on both sides that our policy takes full account of public interest. I am however concerned about the implications of taking blocking powers just in relation to banks - the insurance companies have also lobbied for additional powers to be taken against foreign take-overs and the provisions in other legislation for which I am responsible, covering manufacturing industry and financial services, are likely to be drawn into the debate. I believe it is essential that we should discuss these matters before you table any amendments. I recognise that you will not want to leave this until the last minute. In any event, I am sure that my Department can help yours to ensure that Press comment on the issues is properly informed well in advance of Thursday's Report Stage.

I am copying this letter to recipients of yours.

Yours ever,
Paul

PAUL CHANNON

JG6ABL

999-1

file

BM

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

13 February 1987

EXTEL GROUP PLC & MR. ROBERT MAXWELL

Mr. Alan Brooker, Chairman of Extel Newspapers, recently passed the enclosed note to Bernard Ingham.

I thought you might be interested to see it in the context of your review of mergers policy.

(David Norgrove)

H.H. Liesner, Esq., C.B.

1601/010

Mr Monger

c. Mr Norgrove No 10 COPY FOR (see below)

CONFIDENTIAL

Reference No E 0219

MR UNWIN

cc Dr Walker

CCBC

Mergers

I asked at the meeting of Mr Liesner's Working Party about progress with Mr Channon's report to his colleagues on merger policy. I stressed particularly that it was in Mr Channon's own interest to get his colleagues' views on whether they wanted to maintain the current 'Tebbit' policy which he had, at some political cost, been defending. Treasury and MAFF representatives supported this point, reporting that their Ministers had doubts about the 'Tebbit' policy (although these doubts go in opposite directions). I also hinted that No 10 had an interest in getting Mr Channon's report.

2. Mr Liesner did not dispute the need for an early report. He said, as we already know, that there had already been innumerable drafts and meetings to discuss them. Mr Channon was still 'reflecting' on how to deal with the subject, but Mr Liesner promised to report these further views to him.

3. I do not think we can do much more with DTI. I suggest that I should ring Mr Liesner early next week to see if he has made any further progress with Mr Channon, and that, if he has not, we should ask No 10 to apply pressure.

G W MONGER

Economic Secretariat
12 February 1987

CONFIDENTIAL

Thanks. I saw Mr Liesner in the street yesterday & pressed him myself. He said that one problem was that the BTR saga had invalidated some of the interim report's findings but I do think that DTI ought to surface on this soon, & it would do no harm for Mr Norgrove to press either for the report or for an explanation of the delay. 12/2

c: Mr Wicks

MR NORGROVE

EXTEL AND ROBERT MAXWELL

I sat next to Alan Brooker, chairman of the Extel Newspapers, at the Newspaper Press Fund lunch on Monday. He was excercised about Robert Maxwell's takeover interest in Extel and said he would send me a note.

I attach a highlighted version. The point marked X seems important.

BERNARD INGHAM
11 February 1987

Our ref

Your ref

Date February, 1987

Extel
GROUP PLC
Head Office and Registered Office:
Extel House East Harding Street
London EC4P 4HB
Telephone: 01-353 1080 Telex: 23721
Facsimile: 01-583 1218
Registered in London No. 6152

EXTEL GROUP PLC & MR ROBERT MAXWELL

Extel received a takeover bid from the Demerger Corporation Plc at the end of January 1986. Just before that bid was defeated Mr Maxwell accepted an offer from Demerger to join their Board if the bid was successful. The Takeover Panel ruled that this indicated that Mr Maxwell was acting in concert with Demerger and therefore under the Takeover Code he would not be able to make a bid for Extel until 28th April 1987.

At that time Mr Maxwell's shareholding in Extel was some 12% and he asked for friendly talks with Extel and was rejected. He let it be known at the time that he would like to bid for Extel.

In August 1986, as part of his opposition to Extel's acquisition of The Dealer's Digest, Inc, a company located in New York, Mr Maxwell acquired further Extel shares up to the maximum 29.9% permitted by the Takeover Code. As a result of this, a merger (and prospective full merger) arose under the provisions of the Fair Trading Act 1973 if it could be demonstrated that by virtue of his shareholding Mr Maxwell was able to control, directly or indirectly, the policy of Extel or materially influence its policy. At the request of the Office of Fair Trading, Extel provided numerous examples of how Mr Maxwell had influenced Extel's businesses to their detriment and the OFT confirmed the existing merger situation.

Mr Maxwell's shareholding was later diluted to the 25% which is now held by Pergamon Media Trust plc.

During 1986 Extel made three submissions to the OFT, the last in response to a request from the Office who were considering the question addressed to them by Mr Maxwell asking them whether a reference to the Monopolies and Mergers Commission would be made if he were to make a bid for Extel.

The principal points to which Extel has constantly drawn the attention of the OFT have been whether it is in the public interest for Extel's financial and sporting news and information services, which are supplied to all newspapers, to be acquired by a single newspaper group. The point here is that proposed newspaper mergers are (except in restricted circumstances) automatically referred to the Monopolies and Mergers Commission but there is no automatic referral in the case of a newspaper proprietor acquiring a news agency. Because of the amount of Extel news agency copy which is published by all newspapers, it seems that this concentration should be a matter of investigation.

Another point is whether Extel's independence and impartial news agency services should be merged with a newspaper whose proprietor has a propensity for intervention and editorial interference.

Furthermore, uncertainty surrounds the ownership of two of Mr Maxwell's vehicles, Pergamon Press Limited and British Printing & Communication Corporation plc. Their ultimate parent company is the Pergamon Holding Foundation, which appears to be a family foundation incorporated in Liechtenstein by the deposit of certain documents which are not available for public inspection. The ownership, nature and purpose of the Foundation are, therefore, secret although Mr Maxwell is reported to be interested in it. Mr Maxwell's interests are so diverse and his ambitions so wide-ranging that neither Extel nor the OFT can be so confident that they are aware of all the competition and public interest issues involved in the present or future merger situation. It is fundamental to these issues that both Extel and the OFT should know what other interests are held by Mr Maxwell's Liechtenstein Foundation and who ultimately controls it.

The acquisition of Extel's news and information services by a group such as Mirror Group Newspapers should also be a matter for concern and investigation because it is not only a user of these services itself but also in actual or potential competition with other users of those services.

The question of whether Extel's financial news services should be owned by a Company whose proprietor is active in the stock market and interventionist in bid situations is also a matter of importance. Extel's financial news services must be, and be seen to be, independent.

A full merger would have repercussions in the market for financial printing. Burrup Mathieson, one of Extel's subsidiary companies, is the leading printer of prospectuses, bid and takeover documents, bond issue and rights issue documents. The number of substantial competitors in this market is small, but includes Mr Maxwell's company Oyez. The takeover would bring about a merger of Burrups and Oyez and significantly reduce competition in that market.

There are serious questions raised as to the desirability of Extel being owned or controlled by a person having the extensive interests which Mr Maxwell has. With Extel independent, its interest and the public interest coincide; the public interest is in the continued impartial provision of Extel's services, while Extel's interest is in maintaining its reputation for impartiality and thus the value of its services. The public interest would be prejudiced if Extel were to become subordinated to Mr Maxwell's interests and ambitions, whether personal or corporate.

In Extel's view, the public interest issues raised by a merger with Mr Maxwell's interests can be summarised as follows, and demonstrate the need for an immediate reference to the Monopolies and Mergers Commission:

(1) Should Extel's news and information services, which are supplied to all newspapers, be merged with <u>any</u> single UK newspaper group?

(2) Should those services be merged with a newspaper whose proprietor has a propensity for intervention and editorial interference?

(3) Should those services be merged with a newspaper, with an interventionist proprietor who is active in the stock market.

(4) Should Extel be merged with a group which also has competing activities in printing and magazine publishing?

February, 1987

PERSONAL

FLE
DA
(62)

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

20 January 1987

Thank you for your letter of 16 January enclosing the note about the Anglo-Chinese film production "The Last Emperor". The Prime Minister has read this with interest. She would, I am sure, wish us to consider how the launching of the film could be exploited to promote wider British interests in China.

I am sending copies of this letter to Lyn Parker (Foreign and Commonwealth Office), John Turner (Department of Employment) and Mike Gilbertson (Department of Trade and Industry).

(Charles Powell)

Miss Jill Rutter,
Chief Secretary's Office.

2

PRIME MINISTER 19/1 19 January 1987

MMC REFERENCES ON GROUNDS OTHER THAN COMPETITION SINCE TEBBIT STATEMENT OF JULY 1984

Brian Griffiths mentioned that at the Strategy Group meeting this morning you discussed the issue of referrals by the Secretary of State to the MMC on grounds other than competition. Since the Tebbit guidelines of 1984, there have been three cases of such reference:

1. Elders XL bid for Allied Lyons - reference decision December 1985.

   The potential acquiror was an Australian and at the time there were restrictive rules in Australia about foreign takeovers. However, reciprocity was not a major factor in the reference decision.

   The fundamental problem was that Elders needed to borrow some £2bn in the UK in order to make the acquisition which valued Allied Lyons at £1.8bn. The debt equity ratio of the merged company after acquisition would have been 500% ie £5 of borrowing to £1 of equity. Such borrowing was considered to be of potential danger to the public interest:

   (i). because of the overall group interest burden, the individual retained businesses could be starved of worthwhile investment;

   (ii). there could be forced liquidations or disposals of underlying businesses not in the long term interests of the combined group, and

(iii). a management borrowed to its limit would have a lack of flexibility to 'respond to the unexpected'.

The issue was therefore gearing and the threat to the subsequent business if the Elders management projections were optimistic about borrowing repayment capability. The bid was actually cleared by the MMC but Elders decided to abandon it and chose the alternative and more managable target of Courage which they subsequently purchased without reference.

2. Bids for S&W Berisford plc (wholly owns British Sugar) by Hillsdown Holdings plc and counterbids from Tate & Lyle plc and Feruzzi. Reference was advised by the OFT in May 1986 and June 1986

The fundamental argument here was not that a monopoly or increased competition would be created but that British Sugar is already a permitted monopoly buyer of beet and plays a central role in the UK's take up of the EC sugar quota. It was therefore argued that there was public interest in BS being permitted to continue this role which it might not have been permitted under different ownership, particularly as Tate & Lyle is a cane sugar producer.

The referral of these cases to the MMC were based therefore on the public good of a monopoly buyer being left undisturbed! The result is not yet known.

3. Proposed acquisition by Gulf Resources of IC Gas plc.

This was referred in December 1986 on the grounds that the enormous gearing Gulf needed to acquire a company many times its size would be against the public interest if Gulf became overstretched. It could then abuse the

monopoly position of Calor Gas (a subsidiary of IC Gas) and raise prices. This could act in the short term against consumers who are currently dependent on Calor Gas, particularly in remote regions and in Northern Ireland where there is no natural gas and where town gas is being phased out.

So here is an interesting case of a pre-existing monopoly permitting a new owner the potential for abuse if his cash flow requirements were pressed by the nature of the financial structure of his bid. The presumption is that, given a safer financial structure, a new owner would not abuse the Calor Gas monopoly because the market would subsequently respond by the appearance of new entrants over time.

Summary

In the second and third of these cases the pre-existence of a monopoly was central to the argument. In the first and third the danger of very high gearing after the acquisition was the key issue. In the third case, it was indeed both!

None of the cases were based on regional considerations or charges of intended 'short termism' such as have been alleged in the case of Pilkington.

Janet Grisun.

pp. GEORGE GUISE

2

PRIME MINISTER

THE THIRTY-NINE DAYS

You asked about the thirty-nine day deadline to which DTI worked in making the announcement about BTR and Pilkington. This was, as I said, a takeover panel deadline. These are informal, but the DTI tries to adhere to them.

I was wrong in saying that BTR had to resume their bid. This was in fact the last day for the target company to issue defensive documents.

(DAVID NORGROVE)

19 January 1987
DCA.55

*002/2769

Personal

Treasury Chambers, Parliame

Charles Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
London
SW1

16 January 1987

Dear Charles,

The Chief Secretary was approached by Mr Brian Quick of Hill Samuel who have been involved in financing an Anglo-Chinese film production called "The Last Emperor". They have had full co-operation with the Chinese Government, and apart from the commercial angle, also see potential for exploiting this for the benefit of Anglo-Chinese relations. The Chief Secretary has already alerted the Foreign Secretary to these possibilities - see his letter attached to Sir Geoffrey Howe - and has sent Sir Geoffrey the synopsis and background note prepared by Hill Samuel.

The Chief Secretary was approached in his personal capacity as a former colleague of Mr Quick. He has asked me to draw this to your attention, in case the Prime Minister might be interested in the project, which looks to the Chief Secretary to be a particularly interesting one with potential for both benefits for the film industry and other commercial spin-offs, but also for promoting Anglo-Chinese relations.

I am copying this letter to Lyn Parker (FCO), John Turner (DE) and Mike Gilbertson (DTI).

Yours sincerely,

JILL RUTTER
Private Secretary

With the assistance of the Ministry of Culture, the production obtained access to all the necessary locations including the throne room in the Forbidden City. The Emperor's brother is still living and is Vice Chairman of the Standing Committee of the National People's Congress, and he agreed to act as historic adviser to the production. The Peoples Liberation Army helped by supplying 1,000 men to assist as extras where their special skills were required in scenes involving troops. The Chinese approved the screenplay without difficulty and gave permission for the use of English-speaking Chinese-American actors. The title role is taken by John Lone who received considerable critical acclaim for his part in Michael Cimino's recent film "Year of the Dragon". The tutor, "R.J." is played by Peter O'Toole and Joan Chen, who took a leading role in the Dino De Laurentiis production "Taipan", plays the Empress.

The scale of this production may be judged from the size of the budget which at $23m makes this the most expensive independently financed film ever attempted and ensures that full advantage can be taken of the unique opportunity presented by the subject matter.

The film will be finished in London for delivery in September/ October and Hill Samuel, having arranged the finance, is able to organise a spectacular premiere in Peking. This would present a wonderful opportunity, unlikely to be repeated in the foreseeble future, for British commercial interests, encourged by the Government, to make a significant gesture of friendship towards China by sponsoring such an event.

BQ/JML
8.1.1987

THE LAST EMPEROR

In 1967 a 62 year old Peking gardener died of cancer; his name was Henry Pu-Yi. Sixty years previously, Pu Yi had been taken from his parents' home on the orders of his notorious aunt, the Empress-Dowager Tzu-Hsi, and placed on the Dragon Throne as Emperor, Lord of Ten Thousand years, the undisputed monarch of all China.

In elevating the infant son of Duke Aisin-Gioro, the Empress had sought to prolong her despotic sway over the country but in 1912 revolutionary forces proclaimed the first Chinese Republic, Dr. Sun Yat Sen was made President, and Pu-Yi was forced to abdicate.

The 267 year rule of the Manchus had ended but behind the gates of the Royal Palace imperial tradition continued almost as though nothing had changed. Under the terms of the abdication, favourable treatment was guaranteed to the Imperial House. Pu-Yi was confined within the boundaries of the vast 1.000 year old palace, the Forbidden City, but he was allowed to retain all the trappings of a great ruler of the Qing Dynasty including more than a thousand eunuch servants.

In 1919, a Scottish tutor, Reginald Johnston was appointed to the Emperor's household and he was exposed for the first time to Western influence. 'RJ', a scholarly official of the Colonial Office, became the Emperor's friend, slowly breaking through the bonds of protocol and ceremonial that had been the dominant force in his life.

This friendship was abruptly terminated when in 1924 the warlord, Feng Yuxiang, expelled Pu-Yi and his followers from the Forbidden City. By now married with two wives - one the Empress, the other a concubine - Pu-Yi found refuge for himself and a large entourage in the Japanese Concession in Tientsin. For years the Japanese allowed the ex-Emperor to enjoy a way of life which combined imperial privilege with the indulgences of a Western playboy.

When they invaded Manchuria in 1931 the Japanese installed Pu-Yi as 'Emperor' of the new state now called Manchukuo. Protected by the soldiers of the conquering army, Pu-Yi was once more playing the part of ruler, however nominally, until in 1945 the Russians parachuted into Changchun, arresting him and his court.

Pu-Yi was held captive in Siberia until Mao Tse Tung's freshly constituted People's Republic of China asked for his return in 1949. Contrary to their expectations, the Emperor and his followers were not executed. Instead, they found themselves in a prison for war criminals required to undergo "re-education". Ten years later Pu-Yi had made the transition from Emperor to citizen. He was released and allowed to live the life of an ordinary man.

After two years' preparation, this extraordinary story is now being filmed. A European team led by Jeremy Thomas, a British film producer and Bernardo Bertolucci, the renowned Italian director, working with the official China Film CoProduction Corporation, have recently completed four months of filming in China.

PERSONAL

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and Commonwealth Affairs
King Charles Street
London
SW1A 2AL

16th January 1987

Dear Geoffrey,

I mentioned to you, and the others to whom I am copying this letter, in the margins of Cabinet yesterday the "The Last Emperor" film project. As I told you Brian Quick, a former colleague from Hill Samuel, approached me to alert the Government to the significance of this Anglo-Chinese project. I attach a note he has prepared giving a synopsis of the film's plot and the background to its preparation.

As I told you this seems to me to be a potentially extremely valuable project to capitalise on both from the film industry and Anglo-Chinese relations view points.

I would like to get back to Brian Quick to let him know what HMG's attitude to the project is. Perhaps your office and those of Paul Channon and David Young to whom I am copying this letter, could get in touch with mine so that I can feed back your initial reactions.

Yours ever,

JOHN MacGREGOR

VK(57)

10 DOWNING STREET

From the Private Secretary

16 January 1987

Thank you for your letter to the Prime Minister of 12 January about the bid by BTR for Pilkington.

The Secretary of State is responsible, under the relevant legislation, for the decision whether to refer a bid to the Monopolies and Mergers Commission. You will know that Mr. Channon yesterday announced his decision, based on advice from the Director General of Fair Trading, not to refer the BTR bid.

The Prime Minister is well aware of the strength of feeling about this bid. The decision is now a matter for Pilkington's shareholders, and I am sure the company will be putting to them some of the arguments you set out in your letter.

(DAVID NORGROVE)

E. Poole, Esq.

KB

PRIME MINISTER 2 DW 16/1 16 January 1987

BTR BID FOR PILKINGTON

A reference of this bid to the Monopolies Commission would ~~be~~ have been a significant Government intervention in a free market. There are provisions for such intervention and the general matter of public interest is sufficient legal grounds for referral. However, Government policy throughout this administration has consistently favoured the operation of free markets within the law unless it was apparent that the customer would suffer through reduction of competition.

Within the OFT, the arguments for reference came from individuals or Government Departments with a vested interest in the Pilkington business remaining undisturbed. The DoE, Scottish Office, Welsh Office, Department of Employment, MOD - all argued that their own corner would be better served if Pilkington escaped from the tough management of BTR.

Competition and Gearing

There is no business overlap of significance between the two companies. In the glass market Pilkington already has a significant UK market share (57% of flat glass and 50% of automotive) although both these markets are accessible to foreign competition. BTR is not involved in the glass business.

Although BTR might need to make significant borrowings in order to acquire Pilkington, gearing considerations are unlikely, for example, to force liquidation of Pilkington immediately after acquisition.

Financial Peformance Compared with R&D Investment

Pilkington has been making glass at St Helens for more than 150 years. The company has been technologically driven and has produced major innovations as the result of its substantial research and development policy. The Group as a whole are spending more than £50m per annum on research and development compared with a pre-tax profit level in 1986 of £105m. Unfortunately, shareholders have not recognised this latent value, until recently when the share prices shot up as a result of the BTR bid. Indeed, return on capital employed has only exceeded 13% in one year out of the last five and shareholders have accordingly valued the Pilkington equity below its underlying assets.

Pilkington has built up a strong technical reputation over the years and is still in the control of the original family. However, its praises have been sung more by its customers than its shareholders, otherwise the bid opportunity which BTR has taken would not have been available.

	1981	1982	1983	1984	1985	~~1987~~ 1986.
Figures in £m						
Turnover	787	959	1022	1214	1227	1321
Pre-tax profit	81	53	50	88	116	106
Cash Flow	(260)	(7.7)	(53.5)	(22.5)	24.8	(66.0)
Capital Employed	1032	1115	1287	1378	1395	1429
Return on Capital Employed %	12	8.5	9.5	11.8	13.4	11.8

From the shareholders point of view it is easy to see why the Pilkington record has not been good. With assets under management of over a billion pounds over the past five years, profit and cash generation has been poor. Most professional investors expect a return on capital of at least fifteen per cent.

Pilkington under BTR Management

If BTR does acquire the company there will be a change of fundamental philosophy and it is unlikely that such a high R&D spend will be permitted in future. That is not to say that it will be BTR's intention to tear the company apart and immediately fire everyone who isn't actually making profits! BTR has a reputation for tough financial management under Owen Green but not the reputation of a wrecker. Indeed, the acquisition of Dunlop was perhaps the best thing that could have happened to that company. I attach a recent article from the Financial Times describing the positive consequences of BTR's ownership of Dunlop.

The BTR policy on R&D is not that it shouldn't be permitted but that Green does expect R&D expenditure to offer a return within a reasonable period, say 5 years - conceivably 10 years. However, he has stated that he would definitely not invest against the possibility of a pay-off in 20 years. That savours more of the philosophy of Pilkington.

BTR intend to keep Pilkington and its management as a discreet operation within BTR, as they have done with Dunlop. They do not intend to decimate the company into small businesses as they did with Thomas Tilling, some say quite justifiably. The Pilkington business will retain its own identify and subsidiary activities. However, it will be managed so that the degree of profit generated by its asset base will be considerably higher. Indeed, it is significant that under threat Pilkington has today produced a doubled profits forecast of £250m. This is a very good illustration

of how a company can discover profits when it is under threat.

The Public Issue

Part of Pilkington's defence in fighting off the BTR bid has been to mount a strong lobby for reference to the MMC and in this it has enlisted the support of MPs, local authorities, trade unions and regional interests from the areas where it operates. It is an important employer in many areas of high unemployment, although it now only has 16,000 employees in the UK as a result of its own programme of retrenchment and rationalisation over the past years.

There is a fundamental philosophical issue here and it is instructive to quote from the words of the ASTMS submission to the OFT - "We do not believe that BTR have made a case for being allowed to take over Pilkington." This is the classical attitude of interventionism. By contrast, Government policy is firmly behind Norman Tebbit's statement of 1984 that reference policy would be focussed on competition issues. Under this policy there is no case for intervention in regard to the BTR bid because the merger would not affect competition within the UK.

Most of the arguments in favour of a reference come back to doubts about BTR's management style and its intentions. In particular the belief that it's planning horizon is short and that its management efforts would put Pilkington under pressure to take a short term view of investment in R&D. It is easy for a management under threat to advance arguments that any proposal which threatens its independence should be referred to the MMC.

Conclusion and Advice

A reference in this case would have signalled a significant

departure from recent Government policy. It would be clearly interventionist and based on the philosophy that market forces cannot be relied upon to produce the best results for British industry.

It is perhaps unfortunate that such a large bid, worth over £1bn, is under the public gaze at the same time as Guinness which has brought the City into some disrepute. However, the issues are totally different. In the former case the DTI uncovered evidence of law-breaking and took prompt action to rectify it. In the latter case it has simply concluded that there are insufficient grounds for taking the powers of decision from Pilkington's shareholders.

GEORGE GUISE

. . but in the UK BTR's acquisition of Dunlop has brought some benefits

A culture shock that won ardent converts

By Martin Dickson

Sir Owen Green, chairman of BTR

A SHIVER of apprehension ran through the management at Dunlop Holdings on the evening of Friday, March 9 1985. BTR, the industrial conglomerate, had just clinched victory in its £101m takeover bid for the company and the future suddenly looked uncertain.

BTR had — and still has — a reputation as one of Britain's most aggressively acquisitive companies, paying minute attention to profits, especially in the short term. How would it handle its new prize? Would heads roll? Would parts of the group —which had previously disposed of its European tyre-making operation to Sumitomo of Japan — be sold? Would BTR milk Dunlop, letting its body degenerate?

Most of these apprehensions were to prove misplaced. Nearly two years on, Dunlop is thriving under BTR's ownership. Profits have risen sharply at the main subsidiaries, but so have levels of capital investment. And Dunlop's managers are almost embarrassingly evangelical in their conversion to BTR's rigorous system of financial controls.

"It produced real culture shock," recalls Mr John Roberts, who has been with Dunlop for 32 years and now heads BTR's aerospace group, "but it has proved a vigorous and disciplined way of controlling operations."

These control methods have been a crucial factor over the past 20 years in the growth of BTR, under the leadership of chairman Sir Owen Green, from humble origins in the rubber sector into one of Britain's largest companies. The story of how Dunlop was integrated into this framework gives an insight into BTR's management system at a time when the group is again a subject of controversy—thanks to its £1.1bn takeover bid for Pilkington Brothers, the glassmaker.

BTR, however, cannot claim all the credit for Dunlop's progress. Much is due to groundwork laid by its managers before the bid, particularly during the brief chairmanship of Sir Michael Edwardes. He was brought in in late 1984 to turn around the debt-laden rump of Dunlop, after the tyre-making sale. That rump included Dunlop Slazenger International, the sporting equipment business; an aerospace division producing aircraft wheels, tyres and sophisticated braking systems; and Dunlop Automotive, Britain's last volume supplier of steel car wheels.

Sir Michael devised a £142m capital reconstruction, shook up the management and worked with divisional heads to produce a strategy for the group's varied components.

BTR's first task was to allay the fears of Dunlop's managers. Within days, the joint chief executives of BTR's European operations, Mr Lionel Stammers and Mr Hugh Laughland, travelled to two or three Dunlop plants a day to explain BTR management philosophy and its financial control methods.

"We demonstrated that, despite what they may have read in the press, BTR takes a strategic view of its businesses," says Mr Stammers. "We proved that we've each got only one head and a couple of eyes."

Simultaneously BTR was working out how to slot the various Dunlop companies into its structure. This consists of groups of related companies, each headed by peripatetic chief executives who report to one of four regional chiefs.

The task needed to be done rapidly to help morale and was completed just four weeks after Dunlop capitulated. A few businesses, such as hose and belting, fitted naturally into BTR groups with similar operations. Some were allocated to broadly related groups, while others, such as the sporting goods operations, were so large and cohesive they needed to be treated separately.

The existing Dunlop management was retained virtually intact. "In every acquisition we have made, we have discovered a wealth of talent at the operational level," says Mr Stammers.

The next task was to get the Dunlop businesses reporting on the same financial basis as the rest of the group—a change of practice which goes to the heart of the BTR management method.

The first element is a series of financial reporting forms refined over the past two decades. Each group files monthly reports to BTR's small, unprepossessing London head office, and these are tracked against the major touchstone of performance, the subsidiary's annual profit plan.

This plan is drawn up, between August and November, in a series of negotiations between line managers and head office. The aim is to set a series of performance targets for the following year which will stretch the companies.

"It's a bit like an elastic band," says Mr Roberts. "You don't know how far you can stretch. You all find you've got a little bit more in you than you thought. It is a very detailed, minute procedure and the plan at the end has been forged in the fire."

The plan stresses return on sales, which BTR has adopted as a simple ratio which ensures good cash flow. It argues that concentrating on return on net assets, a performance criteria used by many companies, including the old Dunlop, can make managers place insufficient emphasis on profits.

The second element is strict supervision of working capital controls. In extreme cases a BTR subsidiary, Clear-a-Debt, will take responsibility for another subsidiary's overdue debts.

"At first I thought this odd," says Mr Alan Finden-Crofts, who heads Dunlop Slazenger International. "BTR was on my territory. But then I warmed to it. If my people aren't delivering, then it helps the business to have others come in. People said it would lose us customers, but it hasn't."

He, like other managers from the old Dunlop, says the BTR control system has helped improve performance. "It is surprising how much else appears to fall into place when return on sales is right," says Mr Roberts.

"Under the old Dunlop, there were financial corners you could hide in. In BTR, if the strategy is going off the defined track for the year, it is very evident and you have to take action."

The third element of control is a three-year strategic plan for each subsidiary, drawn up in the spring. It underscores the other crucial element of the BTR system—the devolution of responsibility for the direction of businesses to managers in the field.

Mr Roberts, for example, says he has much more control than under "the old Mothercare style at Dunlop. There was always interference from head office. They wanted to know what was going on in all corners of the business."

But might not this highly centralised system of financial controls and developed management responsibility lead to clashes over capital expenditure? So far it does not appear to have done so, as is shown by two examples:

A: Dunlop-Slazenger International, like all of the old Dunlop group, had for years before the takeover been desperately short of investment funds. In many areas, its technology was excellent—for example, it developed a process for injecting graphite fibres into tennis rackets. But lack of funds and marketing weaknesses meant it did not capitalise on this lead.

Under BTR, its factories have been updated and rationalised, involving substantial job losses. However, greater technological efficiency and UK labour rates, which now compare better internationally, mean that the company is starting to bring back to the UK some production which it had moved to the Far East.

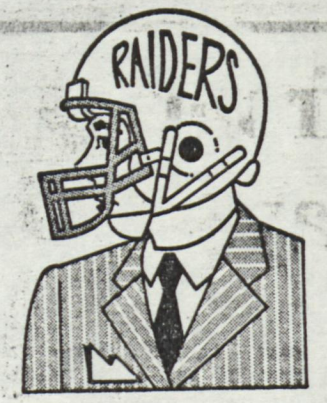
Advertising and promotion is vital for the manufacturer of sporting goods and Dunlop had been concerned about the attitude to this of BTR, a relative newcomer to the consumer goods sector. But, says Mr Finden-Crofts, the 1987 spend will be up to 42 per cent on last year—a decision which did not have to be discussed with head office.

As for profits, these have risen from £9m in 1985 to £16m last year—and more than £22m projected for 1987. Dunlop Slazenger has been gaining market share, and is opening offices in the Far East and an additional operation in the US, where it wants to increase golf ball sales. It is also being encouraged by BTR to look for acquisitions of its own.

B: Dunlop Aviation is Britain's own manufacturer of wheels and braking systems for aircraft, and also produces other high technology aviation components. It has a world lead in carbon brake technology—it produced the first for service on Concorde. This is an operation which depends on long-term planning, given the time it takes to get an aircraft off the drawing board.

Mr Roberts acknowledges that BTR could have come in and quietly "harvested" the business for short-term gains. But this has not happened. A capital spending programme involving several million pounds for computer-aided design is going ahead, while the group is maintaining its 10 per cent ratio of R and D expenditure to sales.

As for profits, while the company will not give precise figures, it says these have doubled in real terms over the past three years on turnover up 40 per cent.



The target for 1987 is an 18 per cent growth in both profits and sales. "Far from there being a hiccup when BTR took over, the whole thing has accelerated," says Mr Roberts. "All the indications so far are that the longterm nature of the business is going to be supported. I have yet to put a major project before the board with negative cash-flow, but all the vibrations are supportive."

Not everyone is quite so enthusiastic about BTR's impact: Dunlop's labour force has been cut by about 10 per cent since the takeover and redundancy terms have been pared. BTR says that the job losses were long overdue — in many cases the old Dunlop simply did not have the cash to make people redundant—and that it leaves these decisions to local management.

Nevertheless, its termination of a national agreement over redundancies has left trade unionists angry. Mr David Warburton, of the General Municipal and Boilermakers' Union (GMBATU), who for many years was the national officer covering both BTR and Dunlop, says: "Industrial relations-wise, BTR is still back in the dark ages."

From the viewpoint of both BTR and Dunlop managements the takeover has been a success. The former has gained a strong earnings stream in some excellent niche businesses; the latter has been allowed to pursue the growth path which its existing managers saw was necessary, but which they lacked the financial muscle to execute confidently.

Admittedly, it would have been remarkable if the takeover had not been successful — Dunlop was set for a bounce back before BTR appeared on the scene. Yet the trend has been accelerated and the former Dunlop managers seem to have few complaints, apart from the odd grumble that BTR does not pay its senior staff enough, or about the intensity of the demands placed on them. "It's a pretty pressured life," says one. "There isn't much time to sit and stare."

This is the first of a series. The next article appears on the Management

PILKINGTON

◂ **Group Engineering** ▸
Pilkington Brothers plc
Group Engineering
Hall Lane Lathom Ormskirk Lancashire England L40 5UF
Telephone Skelmersdale (0695) 21212 Telex 628066 Fax 0695 23249

From Group Engineering Dept.

Our ref 406/EP/PW

Your ref –

Date 12th January 1987

Extension Direct Dial 0695 34774

The Rt. Hon M.H. Thatcher, M.P.,
10 Downing Street,
LONDON.

Dear Madam,

I watched with interest the childrens "phone in" last Saturday and whole heartedly agree with your stand against the aggressors and bully boy tactics of modern society.

As a native of St. Helens and a lifelong Conservative supporter in a predominantly Labour stronghold I would like the question answered -

> "How can normal working people cope with the bully boy tactics of the City financial institutions,"

The unsolicited and unwarranted attention of BTR in the proposed Pilkington takeover is totally rejected by people with a lifelong interest and concern for Pilkington and the local community.

A well attended, orderly and non-political protest march last Saturday has not received the publicity it deserved in both the press and television media.

This protest, also attended by many of my professional colleagues, was to demonstrate the complete rejection of a system which enables short term profit making to take preference over the long term objectives of a well run, far seeing British and International Manufacturing Company.

We request that this proposed takeover is referred to the Monopolies and Mergers Commission.

Long service Pilkington employees do not have any voice in this matter.

It cannot be left to shareholders who may consider purely short term financial inducements to determine the future of British Industry, particularly in a high unemployment area.

Yours faithfully,

E. Poole

SUBJECT
CC MASTER
OPS

PRIME MINISTER
PERSONAL MESSAGE
SERIAL NO.

JA
12.9.86
cc FCO
PC

10 DOWNING STREET
LONDON SW1A 2AA

THE PRIME MINISTER

24 December 1986

Dear Prime Minister

Thank you for your letter of 8 December supporting President Hoyte's comments about the implications for ACP sugar producing countries of recent developments concerning the future ownership of British Sugar plc.

I am sure that you will understand that I cannot comment on the substance of the proposals which are under examination by the Monopolies and Mergers Commission, which is due to report soon. I am, however, well aware of the importance of the sugar cane industry as a major source of employment and foreign earnings in many Caribbean and other ACP states and I have taken careful note of your remarks concerning access to the UK market. I understand that Caribbean sugar producers have made representations direct to the Monopolies and Mergers Commission on a number of occasions. I am sure that the position of ACP suppliers is a consideration which will be taken into account by the Commission in its deliberations.

With best wishes,

Yours sincerely

Margaret Thatcher

The Rt. Hon. Edward P. G. Seaga, P.C., M.P.

cc PJC

Foreign and Commonwealth Office

London SW1A 2AH

22 December 1986

Dear Charles,

Future Ownership of British Sugar plc

In your letter of 17 December you asked for a draft reply to a letter to the Prime Minister, dated 8 December, from the Prime Minister of Jamaica about the implications for African, Caribbean and Pacific (ACP) sugar exporting states of proposals concerning the future of British Sugar which are currently being considered by the Monopolies and Mergers Commission.

Prime Minister Seaga's letter supports and expands on points made in an earlier letter of 14 November from the President of Guyana. The enclosed draft reply is on similar lines to that sent by the Prime Minister to President Hoyte on 2 December.

I am copying this letter and enclosure to Shirley Stagg (MAFF) and Michael Gilbertson (DTI).

Yours ever,

Colin Budd

(C R Budd)
Private Secretary

C D Powell Esq
10 Downing Street

DSR 11 (Revised Sept 85)

DRAFT: minute/letter/teleletter/despatch/note

TYPE: Draft/Final 1 +

FROM:
Prime Minister

DEPARTMENT: TEL. NO:

BUILDING: ROOM NO:

Reference

Your Reference

SECURITY CLASSIFICATION

Top Secret
Secret
Confidential
Restricted
Unclassified

PRIVACY MARKING

..... In Confidence

CAVEAT .....

Enclosures flag(s) .....

TO:

Prime Minister of Jamaica

Copies to:

JAMBDF

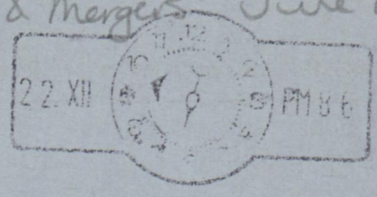
SUBJECT:

Thank you for your letter of 8 December supporting President Hoyte's comments about the implications for ACP sugar producing countries of recent developments concerning the future ownership of British Sugar plc.

I am sure that you will understand that I cannot comment on the substance of the proposals which are under examination by the Monopolies and Mergers Commission, which is due to report soon. I am, however, well aware of the importance of the sugar cane industry as a major source of employment and foreign earnings in many Caribbean and other ACP states and I have taken careful note of your remarks concerning access to the UK market. I understand that Caribbean sugar producers have made representations direct to the Monopolies and Mergers Commission on a number of occasions. I am sure that the position of ACP suppliers is a consideration which will be taken into account by the Commission in its deliberations.

P30ABH

GOVT. MACH: Monopolies & Mergers - June 83



Wle

EC1

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

17 December 1986

I enclose a copy of a letter to the Prime Minister from the Prime Minister of Jamaica about the consequences for the ACP sugar-producing countries of the bid by Feruzzi for British Sugar. I should be grateful for a draft reply.

I am copying this letter and enclosure to Ivor Llewelyn (Ministry of Agriculture, Fisheries and Food) and Michael Gilbertson (Department of Trade and Industry).

(Charles Powell)

Colin Budd, Esq.,
Foreign and Commonwealth Office.

DSG

ccPC

Telephone
01-499 8600
Cables
JAMHICOM, LONDON, S.W.1.

JAMAICAN HIGH COMMISSION,
50, ST. JAMES'S STREET,
LONDON, SWIA IJS.

December 16, 1986

Dear Prime Minister:

I have the honour to forward the enclosed letter to you from my Prime Minister, The Rt. Hon. Edward Seaga.

Yours faithfully,

H Dale Anderson

H. Dale Anderson
Acting High Commissioner

The Rt. Hon. Margaret Thatcher, MP
Prime Minister of the United Kingdom
Prime Minister's Office
10 Downing Street
London SW1A 2AA

SUBJECT CC OPS
MASTER

Jamaica

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL NO. T238A/86

Office of the Prime Minister

Jamaica House
Kingston

8th December, 1986

Dear Prime Minister

FLAP

You will by this time have received a letter from President Hoyte of Guyana, written on behalf of the CARICOM Heads of Government, in which he expresses the concern of our Governments and of other ACP sugar-producing countries that certain developments within the U.K. sugar industry could threaten the continued access of ACP sugar to the U.K. market.

I had the opportunity to discuss this matter briefly with Baroness Young in Miami recently, and I thought I would send you this note in support of President Hoyte's letter.

As you know, the sugar cane industry in our countries is a vital sector of our economies, both as an important earner of foreign exchange and as our largest employer of labour. Continued access to the U.K. market for our sugar was assured as a major feature of the Lomé Convention, and indeed as a major feature of U.K. accession to the EEC. We have always attached the highest importance to these assurances, and we continue to rely on them.

Our understanding of current developments in the U.K. sugar industry is that one possible outcome of take-over bids now being examined by the Monopolies and Mergers Commission, could be that HMG would find itself in a situation where it faces serious difficulty in continuing to fulfil its assurances to the ACP sugar-producing countries. This would have the gravest consequences for all of us.

In specific terms, we are deeply concerned that if the Italian firm, Feruzzi, were successful in their bid, a situation could be created in which the Continental beet sugar surpluses they already control would find a place in the U.K. market; Tate and Lyle, who now refine all our sugar, and the

great..../

Rt. Hon. Margaret Thatcher, M.P.,
Prime Minister of the
United Kingdom

great majority of total ACP sugar, would be driven to the wall, and eventually there would be no one to refine our sugar and our sugar would have no place in the U.K. market.

The irony of such a scenario is that Feruzzi would in fact have achieved a monopoly position in the U.K. at the expense of ACP sugar suppliers.

As your Government comes to grips with these developments over the next few weeks, I urge you to bear in mind the importance of this matter to our economies and our concern that we may continue to rely on the assurances of access to the U.K. market for our sugar.

With kind Regards

Edward Seaga

Cont Mach
Monopolies
& Mergers
6/13

17.XII AM 8 6

AM 8 6

CCBG

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

PRIME MINISTER

Prime Minister
For information.
DHS
4/12

GEC AND NEI

You will wish to be aware that Lord Weinstock has approached the Director General of Fair Trading seeking confidential guidance as to whether a take over bid by GEC of Northern Engineering Industries plc (NEI) would be referred to the Monopolies and Mergers Commission.

2 Sir Gordon Borrie will assess the proposition and advise me, probably towards the end of this month or early in January, on what Lord Weinstock should be told. I will then need to decide whether GEC can be given any guidance, and if so what that guidance should be. The formal reference decision is only made after the bid has been publicly launched and other parties - in this instance, including the target firm, NEI, which as far as we know are not aware of GEC's plans - have had a chance to comment, and in the light of further advice from Sir Gordon Borrie.

3 I obviously do not want to prejudice my consideration of what the Director General may say at the various stages or my ultimate reference decision, but such a merger would clearly be of major significance in the power generation sector. There are on the face of it both advantages and disadvantages in what is proposed. Clearly there would be a reduction in domestic competition for large turbine generators and high voltage switchgear, though in an

JF3AUZ

CONFIDENTIAL

COMMERCIAL IN CONFIDENCE

internationally very competitive sector; but there would also be gains through a rationalisation long regarded as necessary by many in the industry. We ourselves have been involved in a series of difficult choices between GEC and NEI in major power projects overseas involving soft loans or ATP where NEI's weakness in project management has been a problem. There would certainly be regional employment consequences, though since there is currently significant over-capacity these might not be very different from what might occur anyway.

4 In view of the commercial and political sensitivity of this issue I am copying this minute only to the Secretary of State for Energy and Sir Robert Armstrong.

P.C.

P C

December 1986

DEPARTMENT OF TRADE AND INDUSTRY

JF3AUZ

SUBJECT
cc MASTER
O.PS

VC3AOP

PERSONAL MESSAGE
SERIAL No. T232/86

10 DOWNING STREET
LONDON SW1A 2AA

THE PRIME MINISTER

2 December 1986

Dear Mr. President,

Thank you for your letter of 14 November about the implications for Caribbean sugar producers of proposals relating to the future of British Sugar which are currently being examined by the Monopolies and Mergers Commission.

The Monopolies and Mergers Commission is due to report by 18 January. You will, I am sure, understand that it would be wrong for me to comment in detail whilst their study is under way. I am aware of the importance you attach to maintaining existing outlets for your sugar on the UK market. I understand that Caribbean sugar producers have made representations direct to the Monopolies and Mergers Commission on a number of occasions. I am sure that the position of ACP suppliers is a consideration which will be taken into account by the Commission in its deliberations.

With best wishes,

Yours sincerely

Margaret Thatcher

His Excellency Comrade H. Desmond Hoyte, SC, MP.

SUBJECT
CONTRACTOR
COPS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL NO. T209/Acid/86

Georgetown, Guyana.

November 14, 1986

My dear Prime Minister,

On behalf of the Conference of Heads of Government of the Caribbean Community of which I am the current Chairman, I wish to convey our deep concern over some possible adverse implications for Caribbean sugar producers of recent developments involving take-over bids for the British Sugar Corporation now being examined by the United Kingdom Monopolies and Mergers Commission.

In the context of the continuing threat to the cane sugar industry from beet sugar producers, which has been the subject of continual representations by the ACP sugar producers over the years, we of the Caribbean Community have always placed special reliance on the assurances, given by successive British Governments, of secure access of our sugar to the British market.

It therefore remains the hope of the Governments of the Caribbean Community that, whatever is the outcome of the course of action eventually recommended in the Report of the United Kingdom Monopolies and Mergers Commission, the interests of our cane sugar producing territories will continue to be fully taken into account and to receive protection under existing arrangements.

With kind regards.

Yours sincerely,

M Hoyte

Chairman of the Conference
of Heads of Government
of the Caribbean Community

The Right Hon. Margaret Thatcher, M.P.
Prime Minister of the United Kingdom of
Great Britain and Northern Ireland.

CSBC

Foreign and Commonwealth Office

London SW1A 2AH

27 November 1986

Dear Charles,

Future Ownership of British Sugar PLC

We have received from the British Embassy in Georgetown / the attached letter to the Prime Minister from the President of Guyana, in his capacity as Chairman of the Conference of Heads of Government of the Caribbean Community, expressing concern about the implications for Caribbean sugar producers of the rival bids by Tate and Lyle and Ferruzzi for British Sugar PLC. This letter was handed to our Ambassador by President Hoyte on 14 November.

/ I enclose a draft reply for the Prime Minister to send to President Hoyte. This avoids commenting on the substance of the competing bids which are currently being examined by the Monopolies and Mergers Commission. We have also thought it wise to avoid any firm undertakings about continuing outlets for Caribbean cane sugar on the UK market in view of the current uncertainty surrounding the future of the UK sugar industry.

Yours ever,

Colin Budd

(C R Budd)
Private Secretary

C D Powell Esq
PS/10 Downing Street

DSR 1 (Revised Sept 85)

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PRIVACY MARKING

..... In Confidence

CAVEAT .....

Enclosures flag(s) .....

TO:

President Hoyte

Copies to:

K3AOP

SUBJECT:

Thank you for your letter of 14 November about the implications for Caribbean sugar producers of proposals relating to the future of British Sugar which are currently being examined by the Monopolies and Mergers Commission.

The Monopolies and Mergers Commission is due to report by 18 January. You will, I am sure, understand that it would be wrong for me to comment in detail whilst their study is under way. I am aware of the importance you attach to maintaining existing outlets for your sugar on the UK market. I understand that Caribbean sugar producers have made representations direct to the Monopolies and Mergers Commission on a number of occasions. I am sure that the position of ACP suppliers is a consideration which will be taken into account by the Commission in its deliberations.

With best wishes

Yours ever.

P29AAB

NOTE FOR THE RECORD

A Mr. John Russell of Tate and Lyle 'phoned today to try to explain to me the arguments in the current Monopolies Commission enquiry.

I said that the Secretary of State for Trade and Industry acts in this area in a quasi-judicial capacity and that neither the Prime Minister nor No.10 would wish to become involved in any way.

DKN

David Norgrove

18 November 1986

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5422
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

PS/

22 August 1986

CONFIDENTIAL

C D Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Prime Minister (2)
MEA 22/8

Dear Charles,

The Prime Minister may wish to know that the Italian Prime Minister, Signor Craxi, has asked our Ambassador in Rome to draw to her attention his interest in the Italian company Ferruzzi Finanziaria expressed in the attached aide-memoire. Ferruzzi's takeover bid for S and W Berisford is, of course, currently being considered by the Monopolies and Mergers Commission.

My Secretary of State has replied to Signor Craxi to say that his views have been noted. A copy of his letter is also enclosed.

I am copying this letter to Colin Budd (FCO).

Yours sincerely

Catherine Bradley

CATHERINE BRADLEY
Private Secretary

DW1BUM

1786 1986 BOARD OF TRADE BICENTENARY

999-1

Unofficial translation

AIDE MEMOIRE

The company Agricola Finanziaria SpA controlled by Ferruzzi Finanziaria SpA has set up a holding company in the UK entitled Agricola UK for the purpose of acquiring the company S and W Berisford plc.

On the board of Agricola Finanziaria SpA are included, amongst others, Sir Richard Butler, President of the EC Agriculturalists, Sir Alan Campbell, former British Ambassador at Rome and Dr. Raul Gardini, President of the Ferruzzi Group.

Ferruzzi Finanziaria SpA and Agricola Finanziaria SpA are highly qualified companies which operate in the agricultural and agro-industrial fields. They have operated with considerable managerial capacity and with great sensitivity too towards social problems and problems of employment, intervening by agreement with the government to rescue companies in serious economic difficulties which risked having to close down.

H of C

Mr Evans
Miss Elmes

FERRUZZI BID FOR BRITISH SUGAR CORPORATION.

1. Badini called today to give me the attached piece of paper and told me that Craxi was personally interested in the outcome of Gardini's bid for BSC. The basis of this interest was simply that Craxi knew of Gardini's competence as an effective businessman in Italy, and that he wanted Mrs Thatcher to be aware of this opinion in case there turned out to be some role for contact between the Italian and British Governments on this question. Of course, he had no financial interest in the matter at all.

2. We discussed the bid for some time and I was able to explain some of the complexities to Badini, emphasising the very unusual nature of the British Sugar market, the anxieties felt by beet producers in Britain about the future of their market, the problems of Tate and Lyle and the cane producers in the Third World, the insufficiency of the refining margin on cane sugar, and the predominant position which Ferruzzi would occupy in the EC market for sugar if this bid succeeded. However, while I would readily undertake to forward Badini's message, I was sure that the British Government would not desirable to take up Craxi's suggestion, ~~particularly~~ while the issue was under consideration by the MMC. If the latter were to be impressed by the merit of the bid, they would now no doubt wish to be reassured on some of the points I have mentioned, and presumably Gardini was doing his best with the aid of his British advisers to do so.

3. Badini understood what I told him but repeated that he would be grateful if Craxi's personal interest in this matter could be brought to Mrs Thatcher's notice as he requested. He also told me that Pandolfi had been in touch with Mr Jopling and that Ambassador Bottai had been active on this question also.

4. Finally I told Badini that if a reply came from London during my absence, it would be communicated to the Chigi without delay.

A. Bridges

1 August 1986

DE 18-77

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5422
GTN 215) .....
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

22 August 1986

On Benedetto Craxi
Office of the Prime Minister
Palazzo Chigi
Piazza Colonna 370
00100 ROME

Dear Prime Minister,

HM Ambassador in Rome has told me that you have expressed a personal interest in the takeover bid by Ferruzzi Finanziaria SpA for S & W Berisford PLC. This has been drawn to my attention since I have responsibility for decisions on merger proposals as Secretary of State for Trade and Industry. I shall, of course, ensure that the Prime Minister is also told of your interest; as your Private Secretary asked.

United Kingdom legislation provides for the investigation of mergers which appear to raise questions of public interest by a body independent of government, the Monopolies and Mergers Commission. In this case - as with the rival bid for S & W Berisford PLC by the UK company Tate and Lyle PLC - I considered that the proposal raised issues of public interest arising from the special nature of the sugar market and British Sugar's place in it, and that these complex issues should be investigated by the Commission.

As the Ferruzzi proposal is currently being considered by the Commission, it would be inappropriate for me to comment on the issues involved at this stage. I will however, certainly bear your interest in mine when the Commission make their report to me at around the end of this year.

Yours sincerely,
Paul Channon

PAUL CHANNON

DW1BUN

1786 BOARD OF TRADE BICENTENARY

999-1

10 DOWNING STREET

From the Private Secretary

Prime Minister

Guinness

Guinness told Dr Howard today that they were anxious to help, but that they would like to think about their position.

(The undertakings they gave earlier did not include running Guinness and Distillers separately but they did say they would

(i) appoint Sir Thomas Risk as non executive Chairman;

(ii) appoint non-executive directors to protect the Scottish interest;

(iii) move their HQ to Scotland.)

AJC
2/7.

2

PRIME MINISTER

TODAY

below Further to David's note about Today, DTI tell me this evening that according to BPCC (Maxwell's group), Eddie Shah has accepted BPCC's offer to take over the title and assets of the newspaper. DTI have not yet confirmed this with Mr. Shah.

DTI tell me that in order to avoid a reference to the Monopolies and Mergers Commission, it is necessary for the owners to demonstrate that the transfer of assets and title was urgent in order to preserve Today's financial viability.

N.L.W.

MS

N.L. WICKS
9 June 1986

EL3BEY

PRIME MINISTER

cc Mr Ingham

TODAY

Robert Maxwell has been in touch with the DTI about "Today".

Thomson McLintock have apparently advised that "Today" needs £5m immediately. Eddie Shah is reported to be telling his investors, back me or sack me. The likely answer is not known. But Eddie Shah has been in touch with Robert Maxwell suggesting that the "Today" presses should print Robert Maxwell's new evening paper in return for an immediate payment of £5m. Mr Maxwell understandably is not attracted by that and is himself considering buying the assets of "Today" and possibly even the newspaper itself.

DTI say that other possible purchasers of "Today" include Kerry Packer and Mr Fairfax, the owner of "The Spectator".

DTI are not sure how much line spinning there is in this information, but they will keep us in touch.

David Norgrove
9 June 1986

Press Notice

Prime Minister ?

DTI 25/3

4470

Department of Trade and Industry

1 Victoria Street, SW1H 0ET Press Office: 01-215
Out of hours: 01-215 7877

Ref: 238

25 March 1986

CLEARANCE OF MERGER PROPOSALS

Paul Channon, Secretary of State for Trade and Industry, has decided, on the information at present before him, and in accordance with the recommendation of the Director General of Fair Trading, not to refer

- the proposed acquisition by United Biscuits (Holdings) PLC (UB) of Imperial Group PLC (Imperial)

- the proposed acquisition by Dalgety PLC of Golden Wonder Ltd.

to the Monopolies and Mergers Commission under the provisions of the Fair Trading Act 1973.

In reaching his decision on the proposed merger between UB and Imperial, Mr Channon took into account the agreement reached between Imperial and Dalgety PLC on the sale of the former's Golden Wonder subsidiary. He was satisfied that under these arrangements the proposed acquisition by UB of Imperial would not reduce competition in snack foods markets, and that Golden Wonder would continue as an independent competitor in the market.

ENDS

LYONS, CHAMBERLAYNE & CO. LTD.
FROM THE CHAIRMAN'S OFFICE

30 LEDBURY ROAD, KENSINGTON
LONDON WII 2SH

01-221 1828

RJ Margrove
Thanks have
to letter
I think
RT
NW
7.3

Our ref: JL/acg/6410/JLCCL

6 March, 1986.

The Prime Minister
10 Downing Street
LONDON SW1

My Dear Prime Minister,

With NW?

re: GUINNESS/DISTILLERS/ARGYLL

pa

Many thanks for your letter of 5 March.

I regret that I cannot sign this letter personally as I am dictating it over the telephone whilst on my way to the airport as I am going abroad for the next 2 weeks.

I have asked my secretary to phone your office which she has no doubt already done to say that I have no objections to your office passing on my letter to Geoffrey Pattie.

With my best wishes.

Yours ever,

A.C. Grant

Dictated by and
Signed in the absence of
SIR JACK LYONS CBE D.Univ.

p.p.

File

JAIAMA

10 DOWNING STREET

THE PRIME MINISTER

5 March 1986

Dear Sir Jack.

Thank you for your letter of 3 March about Guinness/Distillers/Argyll.

The position is that, under the Fair Trading Act 1973, decisions on references to the Monopolies and Mergers Commission are entirely the responsibility of the Secretary of State for Trade and Industry. They are not matters for collective Government decision.

Paul Channon has, as you say, delegated this particular decision to the Minister of State, Geoffrey Pattie. I feel that Geoffrey Pattie should know the contents of your letter, but as you marked the envelope private and personal, I would not want to pass it to him unless you wished me to do so. Perhaps you could telephone my office if you would like this to be done.

Yours sincerely

Margaret Thatcher

Sir Jack Lyons, C.B.E.

BM

10 DOWNING STREET

THE PRIME MINISTER

Dear Sir Jack,

Thank you for your letter of 3 March about Guinness/Distillers/Argyll.

As I am sure you are aware, decisions on references to the Monopolies and Mergers Commission are not a matter for me. Under the Fair Trading Act 1973, such decisions are entirely the responsibility of the Secretary of State for Trade and Industry, having received the advice of the Director General of Fair Trading. ~~The particular case to which you refer in your letter has been delegated to the Minister of State, Geoffrey Pattie, in view of Paul Channon's connections with Guinness.~~

You marked the envelope ~~in which you sent your letter~~ Private and Personal, so I would not want to pass your letter to Geoffrey Pattie unless you wished me to do so. Perhaps you could let me know if you would like this to be done.

Yours

Sir Jack Lyons, C.B.E.

LYONS, CHAMBERLAYNE & CO. LTD.
30 LEDBURY ROAD, KENSINGTON
LONDON WII 2SH
FROM THE CHAIRMAN'S OFFICE
01-221 1828

Our ref: JL/acg/6384/JLCCL

3 March, 1986.

The Prime Minister
10 Downing Street
LONDON SW1

My dear Prime Minister,

re: GUINNESS/DISTILLERS/ARGYLL

You will no doubt recall at your NSPCC Dinner I introduced you to Mr Ernest Saunders, the Chief Executive of Guinness plc.

We discussed for a few minutes the importance of Scotch Whisky to the National Economy and in particular the export potential which Mr Saunders was so keen to have the opportunity to develop. Your response by quoting the percentage decline in the sales of Scotch Whisky immediately demonstrated your familiarity with the urgency for a restructioning of the industry.

Despite the fact that 90% of Scotch Whisky sales go overseas, Mr Saunders' hopes were dashed when his company's 'bid' for Distillers was referred. This seems to have been based on the narrow issue of sales in the U.K.

The opposing bidder, Argyll plc, were not referred as they are a Supermarket group whose experience of the liquor business, and especially international export, is at the cheap end of the market and they have no experience whatsoever in the marketing of prestige export brands. Guinness therefore withdrew their original 'bid' and proceeded to launch a new 'bid', which not only contained terms more favourable to the Shareholders of Distillers but -

1. Distillers Company agreed to sell off certain brands so that any fear of U.K. competition was eliminated

2. They stated they would move their Head Office to Scotland and so increase employment in the area.

3. They would devote their marketing expertise to the development of exports to World Markets and so increase the value of Scotland's No. 1 export and Britain's 5th export (90% overseas). Guinness has proven that they are ideally equipped to rebuild Distillers Company as has been shown by the rebirth of Guinness since Mr E.W. Saunders was engaged as Chief Executive.

CONTD/2.....

4. When we met we discussed the media and it's deliberate distortions. In the above situation it will be noted that with 'paid for' space Guinness have only emphasised their plan for growth whereas Argyll has used a distortion of words which could be described as 'mud throwing' tactics.

If I may sum up, Prime Minister, whilst Guinness's intentions are to build an international company, Argyll's would appear to be short-term financial gain through asset stripping apart from the fact that they have partners of a hightly unsuitable nature that has not been disclosed, ready to step in and buy such major brands as for example "Johnnie Walker".

I understand that the OFT's original decision to refer Guinness and not Argyll was against the advice of the professionals at OFT and was commercially unfair.

I am writing to you personally because I am concerned with the fact that the right stewardship for the Scotch Whisky Industry is an important national matter (more at this time than ever during your leadership) and that the next decision (probably due within the next one to three days) should not be left to the OFT or a junior DTI Minister because of a relationship of the Secretary of State.

I do therefore hope that you will take steps that will lead to an 'even handed' decision.

Yours ever,

Jack

SIR JACK LYONS CBE D.Univ.

Sunke

10 DOWNING STREET

Nigel

Guiness letter at flap.
You acknowledged
on 14.2.86 (top paper).

Mr Saunders
subsequently sent an
identical letter to
Mr Pattie which has
been answered.
They don't therefore
feel it is necessary
for another reply to
our letter of 13th.

Agree to leave it
at that? Yes

Julie
28/2.

Executive Editor Kenneth Fleet

Distillers' fate hangs in Borrie's balance

Historically the most remarkable event in the latest phase of merger mania is the complete internal collapse of two major Scottish businesses, Distillers and Coats Patons, when confronted with takeover bids. The fact that their boards could simply cave in speaks volumes about the decline in the quality and mental fibre at the top of two major, and previously dominating, groups.

The speed with which the Coats' board opted for Vantona Viyella, spurning Dawson International, was not becoming in Scottish eyes.

Distillers' fate still hangs in the balance, with, it appears, Sir Gordon Borrie, director general of Fair Trading, holding the power. His power, at least for the time being, is enhanced by two factors. One is the confusion that now exists in what the Government would still like to pretend is a mergers and competition policy. The second factor is the disarray at the Department of Trade and Industry, which seems to have an extraordinary facility for attracting either unsuitable or unlucky ministers.

Perhaps in time it will be revealed whether, as Guinness believes, both the secretariat and the OFT advisory panel were disposed to recommend that the first Guinness bid for Distillers should not be refered to the Monopolies and Mergers Commission: the decision to recommend referal, hastily endorsed by Geoffrey Pattie, Industry and Technology Minister, as Sir Paul Channon because of his Guinness family connection was in baulk, was Sir Gordon's own.

The important thing now is whether Sir Gordon will recommend that the second Guinness bid should be refered to the commission, despite Guinness's claim that its willingness to dispose of certain Distillers' brands in order to reduce the Guinness (Arthur Bell)-Distillers share of the home Scotch market below the offending 25 per cent limit should remove the competition obstacle to the merger. Guinness has succeeded in convincing Sir Godfray Le Quesne, chairman of the commission, that the first bid had been entirely and properly withdrawn before proceding to the revised offer.

This is currently being tested in Court at the instigation of Argyll, which is naturally looking for a second reference. It is worth noting at this point the exctraordinary value to Argyll of Alex Fletcher, who lost his job as parliamentary under secretary at the DTI last year and who is now a highly paid adviser to Jimmy Gulliver. He "senses" a second reference — and he knows better than anyone how the Borrie mind works.

The DTI needs to climb down from the fence. If it is not prepared to do so, the Prime Minister should look over Sir Paul Channon's shoulder: her belief in the importance of size and muscle in international markets has come through loud and clear in her eagerness to dispose of British Leyland. The future of a major UK exporter is at stake in the bidding for Distillers. Guinness is better placed to restore Distillers as an international force than Argyll. If faces need to be saved and a reference to the commission is considered to be diplomatic, the DTI should insist that the commission reports within a month at the most. It is absurd that Distillers should be delivered into Argyll's hands by the bureacratic machinations of a system that is already discredited by the lack of a coherent and sensible mergers and competition policy.

TIMES 27th FEB.

Press Notice

Department of Trade and Industry

1 Victoria Street, SW1H 0ET Press Office: 01-215 4470
Out of hours: 01-215 7877

Ref: 158

26 February 1986

PAUL CHANNON'S LETTER TO DAVID STEEL ON MERGER POLICY

Attached is a copy of a letter sent to Mr David Steel MP in reply to Mr Steel's letter of 13 February to the Prime Minister about the Government's policy on current merger decisions.

Mr Steel has agreed to publication of Mr Channon's letter.

ENDS

JU515
Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) .....
(Switchboard) 01-215 7877

25 February 1986

The Rt Hon David Steel MP
House of Commons
London
SW1A OAA

Dear David,

I am replying to your letter of 13 February to the Prime Minister.

I do not accept that the recent merger decisions referred to were in any sense inconsistent with declared Government policy. As you acknowledged, the decision that I took on the Imperial/United Biscuits case and that Geoffrey Pattie took on the Guinness/Distillers case both followed the Director General of Fair Trading's advice. Our decisions, and the Director General's advice were based strictly on the merits of the individual cases. I deeply resent the offensive innuendo in your letter that other factors had any influence whatever.

It would have been quite wrong, and justifiably open to criticism, not to have referred to the MMC a merger proposal which had clear implications for competition policy. It would equally have been wrong to have asked the MMC to examine a bid where there were no competition or other public interest issues such as to justify a reference. It is understandable that the interested parties may feel aggrieved but I do not believe that there is justifiable cause for any uncertainty as to the reasons.

As my predecessor Leon Brittan said in his letter of 20 January to Bryan Gould MP - to which you refer - our policy towards mergers remains that announced by Norman Tebbit in his statement of 5 July 1984: that is, that references to the MMC should continue to be made primarily on competition grounds. All references to the Commission made since that statement apart from one exception (the Elders' bid for Allied Lyons) were made on the

grounds that they raised competition issues This includes the two references to which you refer made last week: Imperial's bid for United Biscuits and Guinness' bid for Distillers (in which latter decision I had no personal involvement whatsoever).

I hope to be making an announcement shortly about the review of competition policy. A general look at mergers policy will fall naturally within the scope of that review, but I see no advantage in considering mergers policy more urgently in isolation from that review.

PAUL CHANNON

1786 1986 BOARD OF TRADE BICENTENARY

File

OA

cc DTI

10 DOWNING STREET

From the Principal Private Secretary 14 February 1986

The Prime Minister has asked me to thank you for your letter of 13 February about the proposed merger between Guinness and Distillers. Since you wrote, Mr. Geoffrey Pattie, the Minister of State for Industry and Information Technology at the Department of Trade and Industry has announced that the proposed acquisition has been referred to the Monopolies and Mergers Commission.

The Prime Minister has asked me to say that the matters raised in your letter are for the Minister at the Department of Trade and Industry and she has therefore passed your letter to Mr. Pattie.

BF 1

(N. L. WICKS)

E. W. Saunders, Esq.

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) .....
(Switchboard) 01-215 7877

From the Parliamentary Under Secretary of State
for Corporate and Consumer Affairs

Nigel Wicks Esq
Principal Private Secretary
10 Downing Street
London SW1

14 February 1986

Dear Nigel

I attach a draft reply for your signature to respond to the letter which Mr Ernest Saunders sent to the Prime Minister on 13 February about the Guinness/Distillers merger proposal.

Ministers' decision to refer the merger was announced this morning.

Yours sincerely

Paul Madden
Private Secretary

LT7ACH

999-9

1786 1986 BOARD OF TRADE BICENTENARY

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DRAFT REPLY FOR THE PRIME MINISTER TO SEND TO

Ernest W Saunders Esq
~~Chie~~
Guinness plc
39 Portman Square
London W1H 9HB

The PM has asked me to say that

~~The PM has asked me to~~

Thank you for your letter of 13 February about the proposed merger between Guinness and Distillers. This is a matter for Ministers at the Department of Trade and Industry and she has passed your letter to the Minister of State for ~~As you will know~~, Geoffrey Pattie, announced today that he had decided to refer the proposed merger to the Monopolies and Mergers Commission for investigation. His decision was taken after full consideration of all the relevant issues.

I enclose a copy of the press release announcing his decision.

Industry and Information Technology

As you can see from,

Press Notice

Department of Trade and Industry

1 Victoria Street, SW1H 0ET Press Office: 01-215 4470
Out of hours: 01-215 7877

Ref: 119

14 February 1986

PROPOSED ACQUISITION BY GUINNESS PLC
OF THE DISTILLERS COMPANY PLC

Geoffrey Pattie, Minister of State for Industry and Information Technology, has decided, in accordance with the recommendation of the Director General of Fair Trading, to refer the proposed acquisition by Guinness PLC of the Distillers Company PLC to the Monopolies and Mergers Commission for investigation and report under the provisions of the Fair Trading Act 1973. The Commission are being required to make their report within six months.

In making his decision to refer the proposal to the MMC, Mr Pattie took into account the announcement by the then Secretary of State, Leon Brittan on 9 January 1986 that the proposed acquisition of Distillers by Argyll Group plc was not to be referred. He concluded, however, that the Guinness proposal raised sufficiently serious questions about its impact on competition as to deserve further investigation by the Commission.

The decision to make a reference to the Commission does not in any way prejudge the question whether or not the merger concerned would be against the public interest. It is for the Commission to report on this after investigation.

ENDS

MORE/....

NOTES FOR EDITORS

1 The Fair Trading Act 1973 empowers the Secretary of State to refer to the Monopolies and Mergers Commission for investigation and report actual or proposed mergers which create or intensify a 'monopoly' (25 per cent or more of the supply in the UK or a substantial part of the UK of a particular good or service) or involve the takeover of a company with assets exceeding £30m. The previous £15m threshold was increased by the Merger References (Increase in Value of Assets) Order 1984 (SI 1984/932) which came into force on 26 July 1984. The Commission are required to investigate and report to the Secretary of State whether the merger operates or may be expected to operate against the public interest.

2 Section 75 of the Act enables the Secretary of State to make a reference in anticipation of a merger, that is to say where arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation.

3 The Commission have four other merger references before them:

Elders IXL/Allied Lyons
BET/SGB
GEC/Plessey
Imperial/United Biscuits

File

DG2AVM

10 DOWNING STREET

From the Principal Private Secretary

13 February 1986

I attach a copy of a letter which the Chief Executive of Guinness plc has today sent to the Prime Minister about his Company's bid for Distillers. I should be grateful if you would let me have as soon as possible tomorrow a draft letter which I might send, on behalf of the Prime Minister, to Mr. Saunders informing him that this is a matter for your Department's Ministers, not the Prime Minister.

I know that your Secretary of State is not dealing with this particular case, but I should be grateful if you would draw my letter to the attention of the Minister in your Department concerned with this matter.

N. L Wicks

Michael Gilbertson, Esq.,
Department of Trade and Industry.

EL3AWP

NOTE FOR THE RECORD (pa) Mr. Norgrove to see ✓

Mr. Saunders, Chief Executive of Guinness, telephoned me this afternoon about this morning's decision to refer his company's bid for Distillers to the Monopolies Commission.

Mr. Saunders said that since the Argyll bid had not been referred (which was news to me), this effectively meant that his company's bid could not go forward. He therefore wanted to see the Prime Minister to explain to her his disquiet with the decision on his company's bid.

I explained to him that decisions on mergers matters were not taken by the Prime Minister and referred to her practice, for understandable reasons, of not seeing industrialists involved in mergers. I advised him to convey his views to the DTI.

Mr. Saunders said that the problem there was that the top man, Mr. Channon, had been disqualified from dealing with this bid. They thought that Mr. Howard was in charge of the matter, but had learnt today that Mr. Pattie was. I explained that Mr. Pattie was a senior Minister who ranked higher than Mr. Howard. Mr. Saunders said that in any event neither were available today. It had been suggested that he should see Mr. Leisner. I told him that Mr. Leisner was a senior official - Deputy Secretary - and that if he, Mr. Saunders, believed it essential to talk to the DTI today, Mr. Leisner was a suitable person. He was certainly not being fobbed off with a junior official.

I told Mr. Saunders that if he wished, I would certainly draw his request for a meeting to the Prime Minister's attention and she would make the decision on whether to see him. Mr. Saunders thanked me for my advice, but said that in the circumstances he would withdraw the request.

The conversation throughout was in friendly terms.

I reported this conversation to John Mogg in the DTI.

N.L.W.

N.L. WICKS

14 February 1986

Prime Minister!

If you agree, I will write tomorrow, on the basis of a) DTI don't, saying this is a matter for DTI. (Not Chancellor, probably Paltrie). Agree?

DTI now say the announcement is to be made tomorrow morning.

GUINNESS PLC
39 PORTMAN SQUARE · LONDON W1H 9HB · TELEPHONE 01 486 0288
TELEX 23800 · FAX 01 486 4897

FROM
ERNEST W. SAUNDERS
CHIEF EXECUTIVE

13 February 1986

Dear Prime Minister,

I understand that the reference decision in respect of our bid for Distillers is still undecided and in these circumstances feel it essential to stress the importance of your decision for the industry as a whole.

N.L.W.

You are, of course, aware that a decision to refer our bid will, in practice, destroy any prospect of the recommended merger receiving fair consideration by all shareholders.

I believe you are also aware of a widely-held view that the Guinness merger with Distillers represents the only real prospect of establishing an international drinks group capable of restoring the UK's performance in vital export markets and I would urge you to consider this most seriously. We have independent public opinion surveys to support this view.

We have presented a sound case establishing that there will be no adverse effect on competition in the domestic market. Mere numerical market share has never been a conclusive indicator of the real impact on competition.

I cannot stress too strongly that any decision which deprives the shareholders of real choice between the competing bids will have an irreparably damaging effect on the industry. Major institutional shareholders will be prevented from exercising an educated long-term choice as to the stewardship of the industry; recognition of this by the MMC will come too late.

I must urge you in these very special circumstances to let the market decide. To rule us out of the merger at this stage would be a grave disservice to the public interest.

../.

In all conscience our commitment to this merger is such that we could not accept a decision which effectively prevents the recommended merger from having a fair chance.

If you would like to raise any issues with me tonight I will be available through my office.

Yours sincerely

Strictly Confidential

The Rt. Hon. Margaret Thatcher, MP,
The Prime Minister,
10 Downing Street,
Whitehall,
London SW1.

PS Norgrove to see

F.

10 DOWNING STREET

Prime Minister

DTI tell me the timetable for the announcement of decisions on references of bids to the MMC is

Argyll - Distillers
Next 2-3 days.

GEC/Plessey
Hanson Trust/Imperial
Bolt in the week beginning 20 January

PT

Imperial / United Biscuits

Early February

These dates may change, but not by much. Final offer dates mid-late bids determine final dates for announcements.

N. L. W.

7.1

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

21 June 1984

Andrew Lansley Esq
Private Secretary to the Secretary of State
for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1

NBPM
22/6.

Dear Andrew,

MERGERS POLICY AND FOREIGN TAKEOVERS: ES(84)3 AND ES(84)4

The Chancellor has seen a copy of your Secretary of State's minute of 18 June to the Prime Minister and the draft statement attached to it.

He has no comments on the draft and is content for the statement to issue as planned.

I am sending copies of this letter to Andrew Turnbull (No 10), to the private secretaries to the other members of E(S), to John Graham (Scottish Office), Colin Jones (Welsh Office) to Ivor Llewelyn (MAFF) and to Richard Hatfield (Cabinet Office).

Yours sincerely,

Margaret O'Mara

Miss M O'Mara
Private Secretary

Seminar
Monopolies
+ Mergers
June 83

cc E(S)
The Queen
Ld Pres
FCS
Ch/Ex
S/Energy
Ch/Duchy of Lanc.
S/Emp.

GLa

ECL

bc: Nick Owen

10 DOWNING STREET

From the Private Secretary

21 June 1984

MERGERS POLICY AND FOREIGN TAKE-OVERS

The Prime Minister has seen your Secretary of State's minute of 18 June and the draft Written Answer which was attached to it. Subject to the views of colleagues, she was content with the statement.

On the question of Section 84(1)D of the Fair Trading Act, the Prime Minister recognises that no change in legislation is currently planned but doubts whether your Secretary of State needs to state this explicitly. This would keep all options open for the future.

I am copying this letter to Private Secretaries of members of E(S), to John Graham (Scottish Office), Colin Jones (Welsh Office), Ivor Llewelyn (Ministry of Agriculture, Fisheries and Food) and to Richard Hatfield (Cabinet Office).

Andrew Turnbull

Callum McCarthy, Esq.,
Department of Trade and Industry.

ECL.

NSPT a AO

AT 21/6

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

21 June 1984

Dear Norman

MERGERS POLICY AND FOREIGN TAKEOVERS

I have seen a copy of your minute of 18 June to the Prime Minister and your proposed statement about mergers policy and foreign takeovers.

I am pleased to see that you do not propose any changes in the basic framework of the Fair Trading Act and I am content with the terms of the proposed statement.

Copies of this go to the Prime Minister, Members of E(S), the Secretary of State for Scotland, the Minister of Agriculture and to Sir Robert Armstrong.

Yours ever

Nick

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry
Department of Trade and Industry

GAT MACH. Monospheres

June 83

CONFIDENTIAL

PRIME MINISTER

MERGERS POLICY AND FOREIGN TAKE-OVERS

The Secretary of State for Trade and Industry has resisted attempts by the Secretaries of State for Scotland, Wales, Energy and the Minister of Agriculture to water down his wish to give greater emphasis to competition in deciding on references to the MMC.

You expressed a concern about Section 84(1)D which allows as a relevant concern "maintaining and promoting the balanced distribution of industry and employment in the UK". You were worried that this could be invoked too often and you hoped that the possibility of legislation to remove this at a later date would not be blocked off. Mr. Younger - see attached letter - would strongly oppose any attempt to remove this criterion. Mr. Tebbit's reply is that he has no plans to remove it and that he proposes to indicate that no change in legislation is envisaged. I am not convinced that he needs to say anything explicit about future legislation; this will be inferred from the statement itself.

Agree Mr. Tebbit's announcement provided he avoids any explicit statement that no new legislation is planned?

AT

20 June 1984

CONFIDENTIAL

CONFIDENTIAL

PRIME MINISTER

MERGERS POLICY AND FOREIGN TAKEOVERS: ES(84)3 and ES(84)4

I am grateful for the comments of colleagues on these ES papers. I believe that I am now in a position to make a statement and would be grateful for agreement, if possible by 22 June, to the attached draft. Since I would not be announcing major changes of policy or foreshadowing new legislation a Written Answer would seem more appropriate than an oral statement.

2 You commented that Section 84(1)(d) of the Fair Trading Act (the regional policy public interest criterion) could provide a source of difficulty and expressed the hope that my statement would not rule out the possibility of legislation at some later date. The Secretaries of State for Scotland and Wales have drawn attention to the sensitivity of the issue. In the interests of stability I think I must indicate that I have no major legislative change in mind at present:

JH2AOX

in any event, given my other priorities, I would not expect to be seeking legislative time in this area in this Parliament. The criterion applies of course only to the MMC in its determination of the public interest. It will be for me to take account of regional considerations in decisions on references.

3 The Secretaries of State for Energy, Scotland and Employment and the Minister of Agriculture stress the need to keep open the possibility of references on grounds other than competition. I accept this in principle, but I emphasise that my policy is to make decisions primarily on competition grounds and I would expect to make references on other grounds only in exceptional circumstances.

4 The Minister of Agriculture sought clarification of what is intended on confidential guidance. My concern is to reduce the proportion of cases in which no guidance can be given (and thereby encourage more companies to seek guidance). I accept that situations will still arise in which guidance cannot be given in

the absence of knowledge of the reactions of interested parties.

5 The Secretary of State for Energy expressed concern about my proposals not to extend existing powers in relation to foreign takeovers. I am happy for my officials to examine with his the case for extending the Industry Act 1975 to the offshore services area, although my initial reaction is to doubt the Justification for special treatment.

6 The Chancellor of the Duchy advocated the abolition of mergers control. For the reasons given in my earlier paper I do not believe that this would justified. And the majority of colleagues see a need for some safeguard against undesirable acquisitions.

7 I am copying this minute to other members of E(S), to the Secretaries of State for Scotland and Wales, to the Minister of Agriculture and to Sir Robert Armstrong.

NT

18 June 1984

Department of Trade & Industry

JH2AOX

JF6701

CONFIDENTIAL

Q. TO ASK THE SECRETARY OF STATE FOR TRADE AND INDUSTRY IF HE HAS COMPLETED HIS REVIEW OF MERGERS POLICY.

A. Yes. I have been reviewing mergers policy in the light of the Government's general belief in the efficacy of market forces and in the contribution that competition can make to efficiency, growth and jobs. I have also had in mind the desire of companies for stability and predictability in this field of policy.

I am satisfied that the mergers provisions of the Fair Trading Act remain an appropriate legislative framework for mergers policy. They leave to Ministers who are accountable to Parliament the decisions on references to the Monopolies and Mergers Commission (MMC) and on action following adverse MMC reports. They also give Ministers the benefit of independent expert advice from the Director General of Fair Trading and leave the task of investigating the public interest in the hands of another independent body, the MMC. This system provides the flexibility that is necessary in dealing with commercial arrangements. It also allows for an authoritative independent evaluation of the public interest where necessary.

I do not favour either increased rigidity or increased Ministerial discretion. I therefore propose no change in the basic framework of the Act. I am, however, raising the assets threshold in Section 64(1)(b) of the Fair Trading Act from £15m to £30m. Under an order which I have made today the change will come into force on [1 August].

The threshold was last increased in 1980. The increase is greater than the adjustment needed to allow for inflation and is intended to secure a worthwhile reduction in the number of small and insignificant mergers caught by the legislation. It is estimated that the change will initially reduce the number of mergers qualifying for investigation under the Fair Trading Act from some 200 a year to some 150 a year.

Apart from the market share and assets tests in Section 64, the Fair Trading Act lays down no statutory criteria for references to the MMC. I regard mergers policy as an important part of the Government's general policy of promoting competition within the economy in the interests of the customer and of efficiency and hence of growth and jobs. Accordingly my policy has been and will continue to be to make references primarily on competition grounds. In evaluating the competitive situation in individual cases I shall have regard to the international context; to the extent of competition in the home market from non-UK sources; and to the competitive position of UK companies in overseas markets.

An important aspect of the administration of merger control is the 'confidential guidance' system operated by the Office of Fair Trading. The Office is already able to provide in a considerable proportion of cases positive guidance as to whether or not a reference is likely. This service is much appreciated by companies. I expect my policy on references

to enable guidance to be given in an even greater proportion of cases in future.

The independent competition authorities in this country have a justifiably high reputation and in reaching my decisions I expect to be guided by their advice in the great majority of cases.

GOVT MARK: Monopolies – Mergers

June 83

File

NOTE FOR THE FILE

MEETING ON FRIDAY, 8 JUNE 1984 WITH THE MANAGING DIRECTOR, CHARTERHOUSE ROTHSCHILD

I asked the Managing Director for his comments on the failure to merge the new Charterhouse Rothschild Group with Hambro Life. The original intention had been to form the first integreted financial services business capable of doing everything from traditional banking through unit trust investment, to insurance and portable pensions.

He commented that the two sides to the deal had called off the negotiations when the stock prices of both companies fell precipitously. They had decided that the Market was not yet ready for such a move, and the Charterhouse Rothschild Group took the hint that they had been expanding too rapidly. The Stock Market was somewhat concerned about their ability to shake down all the businesses they had been taking over recently, and may also have been a little concerned about their liquidity.

It is still the intention both of Hambro Life and of Charterhouse Rothschild to go ahead at some stage with a wide-scale financial services operation in retail contact with the customer.

J.R.

LAUABF

NBPM
DT 7/6

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GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

~~7~~ June 1984

Dear Norman

I understand that you have circulated to Members of E(S) your proposals emanating from the review of mergers policy. I have not seen these papers but have had sight of some of the responses from colleagues. My prime concern is that we should not lose sight of the regional dimension of mergers policy and I am, therefore, in full agreement with the views of George Younger set out in his letter of 17 May. In particular I believe that there should be very serious consideration of the full implications of the repeal of the relevant part of the Fair Trading Act and I would certainly wish to be involved with any discussions if this was proposed.

I understand that you will shortly be consulting colleagues on the terms of your proposed Statement on this subject. I should be grateful if you would let me too have an advance copy of what you propose to say.

I am copying this to Members of E(S), George Younger and Sir Robert Armstrong.

Yours ever

Nick

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
London
SW1H OET

Gout Nach: Monopolus
Mergus
6/83

CC NO

NBPM
AS
25/5

01 211 6402

The Rt Hon Norman Tebbit MP
Secretary of State for Trade & Industry
1 Victoria Street
London SW1H OET

25 May 1984

MERGERS POLICY AND FOREIGN TAKEOVERS: ES(84)3 AND ES(84)4

I have seen your minute of 8 May to the Prime Minister and subsequent correspondence.

I am psrticularly concerned that, as the critical second phase of North Sea development unfolds, your proposals on foreign takeovers might well undermine our effort to ensure that the new generation of advanced offshore technology is retained firmly in the control of indigenous British companies.

Developing British companies with expertise in this important area are particularly vulnerable to foreign takeovers. Once this happens, our longer term prospects for exports of offshore equipment and services are at risk. Foreign firms have no fundamental loyalty to Britain, and when the North Sea market starts to decline they are likely to transfer their activities and exports elsewhere for their own commercial reasons or under pressure from Governments in other offshore markets.

The Fair Trading Act offers only limited protection because even the existing asset test of £15 million is too high to catch many of the firms at risk. Nevertheless, if on general grounds we do raise the asset threshold it remains important that your proposed statement should fully safeguard our freedom to refer off-shore cases on grounds other than competition. I should like to have an adequate opportunity to consider it in advance.

I also see a case for extending the 1975 Industry Act - either by elastic interpretation or limited amendment - to the offshore services area, where UK technology as important as that in manufacturing is vulnerable. I am not convinced that your general arguments against extension of the Act outweigh the need to do all we can to protect a developing UK technology of the future which is particularly exposed to non-EEC predators. If you agree, I should like your officials to examine this aspect with mine.

I am copying this letter to the recipients of your minute.

PETER WALKER

Got Nach: Monopolies v. MIS
6/83

KS/Wd

CONFIDENTIAL

Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 6400
Switchboard 01-213 3000

The Rt Hon Norman Tebbit MP
Secretary of State
Department of Trade and
Industry
1 Victoria Street
LONDON
SW1

24TH May 1984

Dear Norman,

MERGERS POLICY AND FOREIGN TAKEOVERS: ES(84)3 AND ES(84)4

I have seen a copy of your minute to the Prime Minister of 8 May about these papers.

I support your proposals concerning foreign takeovers. I agree that existing powers under the Fair Trading Act to refer foreign takeovers to the Monopolies and Mergers Commission (MMC) are sufficient and that we should not be seeking to extend the Industry Act powers.

I am also broadly conent with the paper on Mergers Policy. I fully accept the need to limit Government intervention in the market as much as possible. And I also agree that the vast majority of references to the MMC should be on competition grounds.

I am glad to see, however, that you do not rule out altogether the possibility of references for other reasons. As in the past, there may well be the very occasional proposed merger with significant employment implications where it would be difficult to resist pressure to refer the case to the MMC, when current legislation allows us to do so.

I am copying this letter to the Prime Minister, other members of ES, to George Younger and to Sir Robert Armstrong.

Yours ever,

CONFIDENTIAL

24 MAY 1982

[illegible]
[illegible]
6/83

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

The Rt Hon Norman Tebbit MP
Secretary of State for Trade
and Industry
1 Victoria Street
LONDON
SW1H OET

21 May 1984

Dear Norman.

MERGERS POLICY: FOREIGN TAKEOVERS: ES(84)3 AND ES(84)4

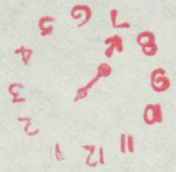
I have only just received your minute of 8 May to the Prime Minister which was not copied to me.

As you will know, because of my sponsorship responsibility for agriculture and for the food and drink manufacturing industries my department is more directly involved in merger issues than any other except your own. For that reason I would have welcomed an opportunity to discuss these papers in ES. I applaud the intention of making clearer the Government's general approach on mergers policy, but two aspects of your proposals give me some concern.

First, I think it important that the freedom to refer cases on grounds other than competition should be fully safeguarded. The need is relatively infrequent, but the national interest alone could necessitate a reference, particularly where foreign takeovers are involved. For example the need could arise where we have built up a valuable technical, financial or commercial expertise, the benefits of which we would prefer to retain in the United Kingdom. Equally it could arise where commercially sensitive products are involved, e.g high quality Scotch malt fillings which might be diverted to overseas competitors. We would therefore need to look very carefully at the terms of any policy announcement to ensure that this freedom was preserved.

/Secondly, I am ....

GOVT. MACH. : Monopolies - Mergers June 83



Secondly, I am not clear what is intended on confidential guidance. I agree that increased use of confidential guidance procedures could be helpful. Hitherto, however, the obstacle to its greater use has been the inability of the OFT to take a view without knowing how interested parties might react following the public announcement of a proposed merger. I am not clear how this obstacle can be overcome. If what is proposed is only a very slight change of emphasis, then we must be careful that expectations are not unduly raised by any policy statement.

It will follow from these comments that I regard the terms of the proposed policy announcement as critical and I hope that I - and my officials - will be given sufficient opportunity to consider it in advance.

I am copying this letter to the Prime Minister and to members of ES, to George Younger and to Sir Robert Armstrong.

Yours

Michael

MICHAEL JOPLING

SCOTTISH OFFICE
WHITEHALL LONDON SW1A 2AU

cc: PS/DS
PS/mr Stewart
PS/US of S
Mr J A Scott

CONFIDENTIAL

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
London SW1H OET

17 May 1984

Dear Secretary of State,

MERGERS POLICY: FOREIGN TAKEOVERS: ES(84)3 AND ES(84)4

Although I was included in the copy recipients of your minute of 8 May to the Prime Minister, no copy reached my office until I was alerted by seeing the responses of the Prime Minister and Arthur Cockfield. Mergers policy has, as you say, attracted a good deal of attention in - and in relation to - Scotland; so although I do not want to reopen the matter and have it discussed, I should like to record two points, to which I attach importance.

First, the empirical evidence adduced in the background papers to ES(84)3 of which your Department's accompanying note is a summary casts doubt on the economic benefits of mergers to an extent which makes me less than enthusiastic about narrowing the grounds for resisting mergers in the way you suggest. I believe the Government has an interest in, for instance, management efficiency, and that we should not rule out the public interest considerations presently allowed for in the Fair Trading Act.

Secondly - and more specifically - we should think very seriously before contemplating the repeal of section 84(ii)(d) of the Act. I believe the consideration of "maintaining and promoting the balanced distribution of industry and employment in the UK" is an important one for the nations's economic health generally. It is a feature of this country that much of industry, and particularly of headquarters' activities, is already concentrated in one geographical area; and we must be concerned about a process which could go so far as to damage economic motivation in the "regions" and could lead to a drain on skills and talent with, in turn, a poorer economic climate and adverse consequences for investment and growth in these areas. This would run counter to what I see as the aims of our regional policy. I should also have thought that any change to the Fair Trading Act to remove regional policy considerations from the public interest would be politically sensitive in the regions generally, and not simply within Scotland.

I am copying this letter to members of ES and to Sir Robert Armstrong.

Yours sincerely,

John S. Graham

(Private Secretary)

Approved by the Secretary of State
and signed in his absence.

CONFIDENTIAL

CC DD
NBPM
AT
18/5

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

16 May 1984

The Rt Hon Norman Tebbit MP
Secretary of State for Trade
and Industry

Dear Norman

MERGERS POLICY: FOREIGN TAKEOVERS:
ES(84)3 AND ES(84)4

I have seen a copy of your minute to the Prime Minister of 8 May and the subsequent correspondence.

I am content with the proposals you set out in the papers produced for ES and note that you will be circulating a draft statement in due course.

I am copying this letter to the Prime Minister, to the other members of ES, to George Younger and to Sir Robert Armstrong.

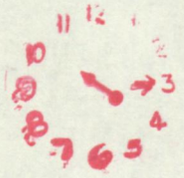
Yours

NIGEL LAWSON

Government Machinery

Monopolies & Mergers

June 83



CONFIDENTIAL

FLE SH

bcc: N. Owen

cc: FCO
SO
LPCO
HMT
DTEn.
CDLO
DTEmp.
CO

10 DOWNING STREET

From the Private Secretary

14 May, 1984

Dear Callum.

Mergers Policy: Foreign Takeovers: ES (84) 3 and ES (84) 4

The Prime Minister has seen your Secretary of State's minute of 8 May seeking agreement to the proposals put forward in these papers. She is content with the proposals to raise the threshold for the assets test; to make competition the dominant, though not the exclusive factor in deciding upon references to the MMC; to improve the confidential guidance procedure operated by the OFT; and to ensure that the dimension of UK trade is fully recognised in determining the competitive position of UK markets. The Prime Minister also accepts the recommendations on foreign takeovers.

She has commented that Section 84(i)(d) of the Fair Trading Act, which provides that "maintaining and promoting the balanced distribution of industrial and employment in the UK" shall be relevant to assessing the public interest, could provide a source of difficulty to the operation of the policy. She hopes that the Secretary of State's statement will not rule out the possibility of legislation at some later date.

I am copying this letter to Private Secretaries to other members of ES, to John Graham (Scottish Office) and to Richard Hatfield (Cabinet Office).

Yours sincerely
Andrew Turnbull

ANDREW TURNBULL

M. C. McCarthy, Esq.,
Department of Trade and Industry

CONFIDENTIAL

10 DOWNING STREET

Prime Minister (1)

Agree Mr Tebbit's proposals which Policy Unit reluctantly endorse, but about which Lord Cockfield has greater reservations?

Yes - but, AT 11/5

It is s 84 (1)(d)

(distributions of employment + industry)

that could give rise to trouble. I hope that DTI's statement will not be taken to rule out legislation later on

CONFIDENTIAL

10 May 1984
Policy Unit

PRIME MINISTER

MERGERS POLICY AND FOREIGN TAKEOVERS

Our mergers policy has come in for some criticism, following the series of decisions largely unrelated to competition matters - eg on bids for the Royal Bank of Scotland - which appeared to some observers to be somewhat singular. The root cause of the problem is the loosely defined "public interest" criterion: the MMC is instructed by Section 84 of the 1973 Fair Trading Act to "take into account all matters which appear to them to be relevant". Thus, in the 3 years 1981-83, two-thirds of the mergers references concerned competition, and one-third concerned other factors: for example, in the case of the Royal Bank, whether the Bank would be as susceptible to winks and nods from the Bank of England under foreign ownership; and in the case of Davy, whether it would become less effective in export markets under foreign ownership. The more important point is that the Commission found against more mergers on non-competition grounds (5) than on competition grounds (4) in these 3 years.

The most radical approach to mergers would be to abandon merger control altogether. If mergers prove unsuccessful, that is the parties' concern. If they result in monopoly abuses, these can be dealt with either by Orders to desist from the objectionable practice, or to divest. It is probably impossible to judge in advance whether a merger will prove either anti-competitive or successful. But given that merger control is probably required on political grounds, as a means of controlling - in a visible way - the growth of concentration in the economy, this option is not a realistic one.

The second most radical solution would be to confine "public interest" to the competition aspects, and catch foreign takeovers only to the extent that they threaten to reduce competition (an unlikely eventuality, since foreign takeovers are more likely to inject competition). If the Government wished to block foreign bids in order to keep British assets British, or Scottish, the appropriate place to do so would be the 1975 Industry Act, widened to include non-manufacturing sectors. This would place what are essentially political decisions squarely where they belong - with Ministers.

Norman Tebbit offers a way of making the existing interventionist apparatus less objectionable. The increase in the asset ceiling to £30 million is most welcome (why not £40 million?). The self-denying ordinance which he is setting himself, and the guidance he proposes to give to the

DASAAO

MMC will shift the emphasis towards competition. His handling of the Allianz bid demonstrated that this approach can be followed, and evidence of the last 3 years demonstrates that the MMC is likely to accept the guidance offered, rather than wandering as it pleases through the "public interest" catalogue (regional balance, employment, technology, etc). His successors may not be so successful in avoiding the special interest pressures which the present arrangements bring to bear on a Secretary of State; a different Government might not even wish to resist them.

Recommendation

Like Lord Cockfield, we would ideally favour the abolition of merger control. It involves god-like judgments on matters beyond the competence of government. However, given that Ministers probably wish to retain some control over mergers, and wish also to avoid legislation, the solution proposed by Norman Tebbit is the best available. If you agree, you might note in the reply that the possible grounds for concern about foreign takeovers identified in the DTI paper attached to Norman Tebbit's note seem rather slight, and that therefore you hope that, as far as possible, foreign takeovers can be treated on all-fours with domestic takeovers, on the basis of their likely effects on competition.

NICHOLAS OWEN

DASAAO

CC NO

Chancellor of the Duchy of Lancaster

PRIME MINISTER

MERGERS POLICY

In his minute of 8 May to you, the Secretary of State for Trade and Industry asked for comments in writing on the proposals on Mergers policy put forward in his ES Memorandum of 23 March.

1. The Mergers legislation is a product of the Wilson era. That was the heyday of interventionism. Today interventionism is very much on the retreat. Price control, pay control, exchange control have all gone. There is a case for saying that merger control should go the same way. Where a merger creates a monopoly it falls, and should fall, within the scope of the general monopolies legislation. But outside that field, there is little evidence that the mergers legislation has done any good: and some evidence that it has done harm. This is not to say that leaving matters to the free play of the market always produces the right result. But if it does not, the costs have to be borne primarily by the participants: while with intervention by Government the costs of wrong decisions tend to fall on the public at large.

2. Per contra, placing our reliance on the general legislation relating to monopolies has clear advantages. The criteria which bring a business within the scope of monopolies legislation are there for all to see; those who went ahead with mergers likely to trigger a reference would do so with their eyes open; those who decided not to, would do so on their own rather than the Government's responsibility; and any MMC investigation would have the benefit of evidence as to how the merger was in fact operating instead of being confined as at present to speculation as to how it might.

Bolting the stable door?

3. At one time it was thought that the ability to refer a merger for "impartial" examination by an "independent" body would defuse criticism. But this has not proved to be so. Where money is involved contestants will use any device to hand and the mergers legislation is as good as any. Indeed the effect of the legislation is to expose Government to far more attack than would be the case if there was no legislation at all.

4. To abolish merger control would reduce bureaucracy, reduce Government intervention in industry and distance Government from brawls in the stock markets. But it would require legislation and this may be a serious stumbling block. The proposals by the Secretary of State for Trade and Industry go a considerable way to moving merger control in the direction of a simple "anti-competitive" stance: and it has the advantage that it does so without the need for legislation. It may succeed for a time: but I doubt whether it would last for long. The law as it stands is very wide in its scope: quite apart from the general "public interest" criterion, it refers specifically to employment and the location of industry. It is not easy for Ministers to sustain a position where the law gives them specific powers and they say they will not use them or will use them in a way which does not correspond with what the law says. And there is always the risk of legal challenge. But my real reservations relate not so much to this as to the fact that the Secretary of State's proposals represent a way of keeping in being something it would be better to abolish.

5. I am sending copies of this minute to the other members of ES, to George Younger and to Sir Robert Armstrong.

A.C.

A C

10 May 1984

Govt Mach: Monopolies + Mergers
6/83

B/F with Policy Unit response AT 8/5 CC/NO

JF6464

CONFIDENTIAL

PRIME MINISTER

MERGERS POLICY : FOREIGN TAKEOVERS : ES(84)3 AND ES(84)4

I circulated the above papers on 23 March. A meeting of ES to discuss them arranged for 10 April had to be cancelled. I now understand that no discussion can be arranged before the beginning of June. This causes me considerable concern.

2 We have been known to be reviewing mergers policy for many months. Alex Fletcher and I are subject to frequent enquiries about the position; and there has been periodic press interest. The delay in making an authoritative statement risks speculation that we have in mind radical change (as you know I am recommending only modest changes within the existing legislative framework) or that we are vacillating (which is untrue) or that there are major differences to be resolved. I am very anxious that the general public and the corporate sector should know as soon as possible what our general approach is on an important subject. There is a demand to know the Government's mergers policy.

3 If you were content, I would greatly welcome it if colleagues could be invited to let me have their views in writing by 18 May. It may be that we shall find that the

papers can be cleared in correspondence, in which case I would circulate a draft statement for agreement. If there are substantial comments, it will at least be helpful to identify any difficulties seen by colleagues and possibly for me to have the opportunity to resolve them or to comment further before any meeting.

4 I am copying this minute to other members of E(S), to George Younger and to Sir Robert Armstrong.

NT

N T

8 May 1984

Department of Trade and Industry

Govt Machines June 83

Marcophiles & Meyes

B/F with meeting folder
E(S)

CC NO

Chancellor of the Duchy of Lancaster

PRIME MINISTER

MERGER POLICY - Memorandum by the Secretary of State for Trade and Industry - ES(84)3

1. I deal with the constraints imposed by the legislative programme at the end of this minute. The first thing is to decide what our policy ought to be. The legislative constraints then determine whether and how far we can implement that policy.

2. All is not reason and light as Norman Tebbit's memorandum would seem to suggest. At the moment we are passing through a period of quiescence. But experience shows that that could change very rapidly and unpredictably.

3. The heart of the problem lies in the nature of the present legislation. The Mergers legislation (as distinct from the Monopolies legislation) dates from the Wilson era in the mid 1960s. That was the heyday of interventionism: regional policy, the NEB, the white heat of technology, Wedgwood Benn and all that. The legislation was strengthened under Edward Heath who was also somewhat of an interventionist. The essential problem is how do you administer interventionist legislation in a non-interventionist way as Norman is now proposing.

4. Thus the present legislation specifies as some of the public interest factors to be taken into account employment and regional policy. With legislation as specific as this, can the Secretary of State say that he will ignore it? And save in the most exceptional cases regard the public interest as synonymous with competition? Where there is a clear employment or regional aspect, the pressures on the Secretary of State are very great: and they come not just from politicians and interested parties but even more insistently from colleagues.

5. The other major problem lies in the overlapping functions of the Secretary of State and the Director General of Fair Trading: and this is greatly accentuated by the attitude of the present Director General. He was undoubtedly involved in the campaign waged against the Government over the Stock Exchange Bill. Again in 1978 he launched a vigorous attack on the then Labour Government for spurning his advice. There may have been other incidents as well.

6. In law, the powers are vested in the Secretary of State - the Director General acts only in an advisory capacity. The Director General however has never seen it that way. His objective - in which he has largely been allowed to succeed - has been to exercise the power himself, relegating the Secretary of State to the position of Constitutional Monarch - someone with legal powers that he is expected never to exercise.

7. There is an interesting precedent for a very different approach in the present Telecommunications Bill. We have resolutely refused to allow the "public interest" to come into the Bill at all. References to the Monopolies Commission are made by the Director General: the Monopolies Commission reports to him: he takes whatever action is needed. Nowhere, in this area, does the Secretary of State come into the picture at all.

8. My own inclination would be to follow this precedent, to exclude the "public interest" criterion altogether and restrict intervention to competition. This incidentally is the approach in the United States.

9. Whenever we wish to abolish - or restrict - a control, special cases will always be pleaded. This happened when we abolished Exchange Control. It was argued that powers should be kept to prevent companies emigrating abroad, to control investment by foreign companies in UK companies and so on. We accepted none of this: and experience suggests that that was the right decision. Of course there will always be cases where one wishes one could have done something. But in the long run we are better without powers of intervention, leaving the ordinary economic forces to operate, even

if it does mean the occasional unfortunate incident, rather than to have and to have to operate powers which however convenient or even justifiable in the short run tend in the long run to obstruct much needed change.

10. The case which is likely to be argued most strenuously is that of employment. But even here it is well to remember that if a private sector company reduces its labour force by 1,000 or 5,000: if BSC reduces its labour force by 50,000 or BA by 20,000: it is accepted at least by our own supporters that we ought not to intervene. The argument that, because the reduction in the labour force is associated with a merger, therefore there ought to be special powers to refer to the Monopolies Commission is a tenuous one.

11. I would also want to keep the Secretary of State out of it altogether. This may seem odd in the light of the views I have already expressed as it would resolve the disputed powers in favour of the Director General. But it would be greater powers in a narrower and more closely defined field. And it would have the added advantage that the Director General would have to take public responsibility for his own acts. The only reservation I have is whether there ought not to be a reserve power enabling the Secretary of State by statutory instrument to permit a merger the Director General was trying to block much on the lines of the present provision relating to newspaper mergers. There are cases where a company is on the point of collapse and merger might be the only way of keeping it afloat. A Monopolies Commission investigation in such a case could do irreparable damage as the company could well collapse before the investigation was complete.

12. A change on these lines would require legislation. If that is ruled out, there is little alternative but to proceed on the rather muted lines Norman proposes.

A.C.

A C
30 March 1984

file

10 DOWNING STREET

Prime Minister (4)

To see the Policy Unit's views on the way forward on state monopolies, competition and regulation. The conclusions of the original CPRS report are attached

AT
1/2

MF

30 January 1984
Policy Unit

PRIME MINISTER

CENTRAL POLICY REVIEW STAFF STUDY OF STATE MONOPOLY AND REGULATION

CPRS Report

The CPRS Report gave a variety of ways in which monopolies could be limited and regulated in theory. It did not go on to tell you which of the numerous theories and methods was the best or the most likely to work in any given industry.

Competition: the Best Regulator

In dealing with monopolies, there is no substitute for introducing effective competition. Many commentators have been too timorous in assessing the opportunities for widening competition within the state monopoly sector. There are few natural monopolies, and they are never as large in their scope as the industry conglomerates which currently trade as nationalised industries.

First Step: Removing Entry Barriers

Where a monopoly is created or protected by a Statute, the law should be changed. This the Government has done in the case of gas purchasing from the North Sea, the generation of electricity for sale to third parties, and in the provision of certain telephone services to customers. It has not broken the statutory monopoly for the extraction of coal (though other considerations may apply here), it has not used the powers it has taken to suspend the postal monopoly, rules at British Rail are tantamount to a statutory protection of the train service monopoly, and the water authorities retain their monopoly powers.

Second Step: Split up and Sell Potentially Competitive Activities

The Government can split off those parts of a nationalised industry where competition can be injected by new entrants and/or by splitting the existing assets into competing groups. The best case is electricity generation. The main part of the cost in supplying electricity to the final customer is the cost of erecting,

maintaining and running expensive generating stations. The main errors of the CEGB have been in planning the number of stations they need (always building too many) and in allowing the costs of these stations to spiral out of control. The stations could be split into, say, four competing groups, and some or all of these groups sold to the private sector. Each company would have access to the grid and would be able to sell power to the grid operator. Power stations would be called on to provide electricity when they were the next cheapest supplier.

In the case of gas, the oil and natural resource companies are being slow in taking advantage of the freedom to route gas from the North Sea direct to end users. The Government, in denationalising British Gas, should retain the main gas grid as a common carrier, and allow competitors to route gas through the grid for a toll. The aim in both the case of electricity and gas would be to create a market and establish market prices. Government would then no longer have to fix the price of gas and electricity. There would no longer be shortages of gas because BGC was not prepared to pay the going price for it. Exploration for gas would no longer be held up because the monopoly buyer refused to pay the going rate. (Ten years passed from 1972 when no-one was prepared to prospect for southern sector North Sea gas because BGC would not pay a realistic price.) New power stations would not be built at high cost to add to the stock of unwanted capacity. As the market began to work, more entrants would come in, and competitive practices would replace monopoly. ICI and other large users might buy direct from a private power company, or generate its own and sell the surplus.

In the case of the postal service, the definition of a letter could be narrowed to allow greater competition and experimentation with new services by a range of new providers; or alternatively, the postal monopoly could be suspended in a trial area, preferably one where labour relations and practices were particularly bad and justified the action, to see what other services emerged. There might, of course, be problems with the interface between the new service operators and the rest of the mail system.

Third Step: Encourage Private rather than Public Sector Involvement in New Activities

Cellular radio phones and cable TV provide an opportunity for private companies to make dents in British Telecom's monopoly. Once Mercury has been established, other voice telephony services using new technology should be licensed. If in due course gas has to be generated from coal again, as North Sea supplies run out, private companies could put up the money: the public sector should not provide the funds. New coal mines could be paid for and run by private sector mining companies if and when the industrial climate in mining changes. New sewage treatment works can be financed and owned by private sector operators with suitable toll arrangements at the point of entry and exit into the main water system: their management contracts could be subject to periodic renewal to keep competitive pressure.

Fourth Step: Franchise Management

In the cases of the airports and the water authorities, there is considerable scope for franchising. The BAA already invites private contractors for baggage handling and some of the retail activities on the concourses. This practice could be widened so that the BAA becomes a management body for the property and services, ensuring fair competition between bidders for the franchises at stated periodic intervals. In the case of the water authorities, the present examples of contracting-out of sludge disposal could be extended to a wider range of activities.

Fifth Step: Set up Regional Distribution Boards for Gas and Electricity

The Regional Boards are already defined and are easily split off from the grids and from the generation and gas collection activities. There are three possible way of handling them once they have been set up as independent corporations.

Option 1 would be to retain the ownership of the pipes and wires in the public sector and to franchise the management. Managers would retain the contract for, say, a 7-year period. The contract would then be opened to competition, with the winner being one that would provide the best service for the least price.

Option 2 would be to sell the Regional Boards to private sector shareholders. There would then need to be regulation which should be modelled on OFTEL lines.

Option 3 would be to pioneer a new hybrid. The separate regional companies would be sold to private sector shareholders, but there would be a stipulation that the Government retained the right to let a management contract under a franchising system. When a new franchise was awarded, the management would change at the Regional Board, but the shareholders would not necessarily have to change. One of the defects of the present IBA system is that the unsuccessful company has difficulty in selling on its assets to the new entrant: in the case of the power boards, there has to be a mechanism by which the assets can pass to new managers. An alternative would be to allow transfer of the assets from one group of shareholders to another at the time of a new franchise being awarded, which would have to entail complex arbitration on price.

Option 3 is the best, but will need arguing through against the scepticism which always confronts relatively new ideas.

Residual Monopolies

Some smaller areas of monopoly will remain. The central gas grid and the electricity grid are natural monopolies. The water and sewerage systems, and real estate at Heathrow, and even at some of the regional airports, are also natural monopolies. These service grids and central properties can remain in public sector ownership and be operated by a small economical staff. The staff would be charged with ensuring that the use made of these monopolies was open to the widest range of competitive users. All of the activities on the residual public sector assets and of those operating under the franchises would be subject to the full panoply of UK competition law, and any given case could be subject to an MMC enquiry and to subsequent Government action.

OFTEL

The OFTEL model for regulating a privatised semi-monopoly is much better than the main suggestion of the CPRS; the idea that monopolies

should be subject to a control on the return on capital. A monopoly can, by definition, make its return on capital anything it likes by putting up or putting down its prices. A return on capital formula can hide enormous inefficiencies, the cost of which will be passed on to the customer and will not be revealed by the return on capital formula, whilst the capital base can be increased by gold-plating to lower the apparent return.

It is therefore a welcome departure that in the telecommunications regulation proposed, the emphasis is shifted away from return on capital to the important variable, the price to the customer. Under the OFTEL formula, BT will not be able to put its prices up by as much as the Retail Price Index. A deduction will be made from the RPI increase to take into account the natural increases in efficiency which should result from applying new technology and better working practices. If any more quasi-monopolies were to be privatised, the OFTEL route would be preferable as a means of controlling them. The formula applied should be clear to understand, and should bite on the important question of price, subject only to the proviso that the quality of service should not fall in such a way that it offset the price control.

Conclusions

The message is simple. The only effective way to regulate a monopoly is to break it up by introducing competition. Much more competition can be introduced into state monopolies than has been achieved to date, and this action should come up for early case-by-case review under your new competition initiative. Those who say it is not possible in the energy industries have forgotten that markets do work and can be fostered.

It would be a crowning irony if a Government wholeheartedly committed to removing the shackles from enterprise and to deregulation should leave as its monument to posterity a growing bureaucracy of complicated regulatory agencies. There is no need for this to happen. Competition can be increased and it will work.

It is probably best to leave the relatively small central monopoly grids owned in the public sector. If there is a wish to sell off activities where competition cannot flourish, regulation should always follow the route of controlling the price of the service to the customer rather than the return on capital route favoured by other commentators.

JOHN REDWOOD

IV - CONCLUSIONS AND RECOMMENDATIONS

80. We have examined in our study the development of state monopolies and shown that in many instances monopoly has been created and is not inevitable. The core of natural monopolies, where a second supplier would necessarily face prohibitively high costs, is narrower than is generally perceived. We have also examined the evidence available on the performance of the state monopolies, and have listed the adverse features which arise partly because they are monopolies and partly because they are in public ownership. The power of the unions stems mainly from the indispensable and monopoly nature of the products and services provided.

81. We suggest that the scope for change should be examined in detail for each industry. For various reasons the climate for change is right. The options discussed are not mutually exclusive; in many cases they are complementary. Not all are applicable to each industry. The overriding need is to break up the existing national monopolies.

A. Increase competition

82. The first objective should be to increase competition wherever possible. This means removing obstacles, and creating the right conditions for competition to develop -

a. remove the statutory bar on entry - necessary, but often not enough by itself;

b. regulate to ensure fair competition - we consider that an independent regulatory agency will provide the best assurance to potential competitors, against unreasonable pricing or regulatory actions by the state monopoly;

c. require industries to sell off parts where competition is possible - a quicker way to promote development of effective competition than waiting for new private sector entrants to appear;

d. as a step to privatisation under c, split industries into separate state companies, either by function (eg Sealink) or by region (eg regional electricity generating companies);

e. presumption against allowing state monopolies to expand - moving into new areas may sometimes increase efficiency or reduce dependence on another monopoly, and may increase competition short-term, but it increases market (and union) power.

B. Restructure and regulate

83. The process of stimulating effective competition will take time, and there will still be a core of natural monopolies. For the remaining monopolies, ways must be found to improve their performance. Last year's CPRS report made proposals within the existing framework of government/industry relations. This report reviews more radical options -

a. Privatise - this will remove the adverse features of state control, but not those of monopoly power (and union power); hence regulation and/or regionalisation should generally come first;

b. set up an independent regulatory agency - this should be an effective means of preventing monopoly abuse, but depends on Government willingness to hand over some of its powers to the agency (otherwise it merely adds another layer of supervision); hence we recommend that the experience of regulating British Telecom should be taken into account before regulatory agencies are established for other industries;

c. split the industry into regional corporations - in a natural monopoly these will not compete directly, but will enable management performance to be compared, so that a regulatory agency can be more effective; this will be strengthened if regional corporations borrow on their own credit without guarantee against bankruptcy, and if the possibility exists of a monopoly licence being withdrawn and the licence transferred ("competition for the field" as opposed to "competition in the field").

d. extend franchising and contracting out - much wider opportunities exist than have been considered so far, and should be pursued, even within the present framework, to promote efficiency by introducing private sector management and to reduce union power.

C. Reduce union power

84. There is a need to redress the imbalance of union power that currently exists. We believe that the options described above should all help to reduce monopoly power and therefore union power. Proposals for further general legislation on unions will be considered following a consultative period. The proposal for statutory cooling off periods may be useful in the state monopoly context. However we consider that other action might also be taken -

a. further studies should be undertaken where necessary to see how best to stand up to the ransom threat, for example by stockpiling;

b. union attitudes need to be changed; this should be tackled through management action;

c. where an industry is already structured on regional lines there may be advantages in developing decentralised wage bargaining;

d. linking wages more to performance will help to develop a relationship between effort and reward and hence lead to more responsible action.

D. Change the statutory and financial context

85. Other changes might also be made in order to change the context in which the state monopolies operate -

a. encourage private finance and joint ventures;

b. remove Government's guarantee against bankruptcy;

c. remove the statutory duty to supply;

d. make cross-subsidisation of classes of business including uneconomic social services more explicit.

Conclusions

86. The problems of monopoly power, and alternatives to state ownership, have baffled numbers of people for many years. We do not claim to have found any simple solution, for example in the model of a regionalised and regulated industry. In some industries or parts of industries where it proves impossible to introduce competition, the costs of splitting into regional organisations may turn out to be greater than the benefits, and Ministers may decide against handing over their powers to an independent regulatory agency. In such cases there may be no better course than the present system, with better business management along the lines proposed in last year's CPRS report. But we believe that the more radical options in this report need to be seriously and imaginatively examined in relation to the particular circumstances of each industry.

Recommendations

87. In order to effect changes wherever possible, we recommend that Sponsor Ministers should be invited to review the industries for which they are responsible and make detailed proposals, based on the general conclusions reached in this report and options put forward for change. Departments are already considering opportunities for privatisation and a separate exercise is being carried out to ascertain if nationalised industries could contract out more of their activities. A certain amount of ground will therefore already have been covered. We recommend that these efforts should now be extended to consider those more fundamental changes which might be made to break up the state monopolies and reduce their power.

88. We recommend that Treasury Ministers should be invited to consider the proposals for removing guarantees against bankruptcy and for encouraging joint ventures.

89. We further recommend that Sponsor Ministers should be invited to consider the proposals aimed at reducing the power of the unions in their industries.

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ANNEX

A REVIEW OF REGULATORY AGENCIES

1. As part of our study we have considered the experience of regulatory agencies in the United States where there is a long history of private sector ownership of monopoly industries and also of regulation. We have also examined regulation in the United Kingdom of broadcasting, air transport, local stage carriage bus services, private water companies and pharmaceutical companies. Where a monopoly exists, there is a need to regulate its activities in the interests of consumers, primarily in order to prevent excessive prices and therefore monopoly profits or excessive costs.

2. However in the United States in particular in the past it is competition as much as monopoly that has been restricted and regulated. In certain industries, mainly transport, monopolies and limited competition have been tolerated on the grounds that this best serves the public interest. A period of de-regulation of potentially competitive industries began under the Ford administration with some resistance from the operators who had previously been protected from competitive forces and effectively guaranteed a steady stream of profits. Experience has shown that regulation has had many unsatisfactory features, referred to further below, and we therefore recommend that regulatory agencies are only established where necessary. We consider that regulation is essential -

a. where, despite the introduction of competition, a created monopoly will exist for some time and there is a need to ensure that the monopolist competes fairly with new entrants to the market;

b. where natural monopoly cannot be avoided.

3. Regulation in the United States dates from the last quarter of the 19th Century where it was thought necessary in order to protect customers from exploitation by private monopolists. Regulators have been mainly concerned with ensuring a secure supply, at a fair price, and partly as a result of these and other considerations, mentioned below, regulatory agencies have suffered from the following defects -

a. they are too bureaucratic and legalistic. This is partly a reflection of the relative dominance of lawyers in United States commercial life and also of the difficulty the regulators and regulated have experienced in agreeing a "fair price" and "fair rate of return";

b. hearings are too formal and applications for price increases too burdensome;

c. the commissions have been too slow to respond. There have been delays in granting price increases, in periods of inflation. Such delays are referred to as the "regulatory lag";

d. many agencies have developed a cosy relationship with their industries and have failed to be sufficiently questioning and investigative in their approach. This is referred to as "agency capture".

e. economic efficiency has not been encouraged. Agencies have been more concerned with ensuring that a rate increase is reasonable;

f. they have responded too much to local political pressures and have tended to favour short term interests, and present rather than future consumers;

g. some commissions are underfunded and understaffed and lack good quality staff;

h. in order to increase their return, utilities have artificially expanded their "rate base" or capital employed;

i. agencies have condoned and even fostered unimaginative tariff structures and pricing policies.

Perhaps the most damaging effect has been the regulatory lag which, coupled with adherence to historic cost accounting, has resulted in low rates of return. This has affected bond and credit ratings. As a result regulated industries have had difficulty in expanding their funding at economic rates and have been loath to make new investments.

4. Despite these defects, the clamour for de-regulation has not extended to the monopoly industries such as telecommunications and electricity. Indeed in the former, the United States can claim, under the regulation of the Federal Communications Commission (FCC), to have developed one of the world's better telephone systems. The FCC has to some extent stimulated competition to AT and T and required that company to make interconnection facilities available. More recently it has been agreed with AT and T that it should divest itself of its local regional telephone operations in return for permitting it to retain its interests intelephone equipment.

5. Experience in the United Kingdom of regulation of private sector monopolies has not been encouraging. However as in the United States, this has mainly been the result of the methods of regulation used. Thus -

a. it is claimed that the Independent Broadcasting Authority (IBA) has failed to make the independent television companies operate more efficiently and economically. However the IBA has no direct responsibility for efficiency and the companies have little incentive to reduce costs, because monopoly profits are constrained by a levy which results in a marginal tax rate of 82 per cent above a certain level;

b. private water companies have had no incentive to improve their performance, other than from the threat of nationalisation, because profits earned in excess of a maximum rate of dividend must be ploughed back into the business or returned to water ratepayers.

6. Regulatory agencies can however claim certain advantages -

a. they act as a surrogate for market forces and aim to prevent abuse of monopoly power;

b. they are a better method of regulation than a Government Sponsor Department since they will not have the other conflicting responsibilities of manager of the economy, owner of the business, banker and subsidiser of social services;

c. they are likely to be more professional and can present a better method of highlighting inefficiency and promoting efficiency. Staffing is less likely to be constrained by Civil Service terms of employment and remuneration - they can more easily employ staff with expertise and knowledge of the industry concerned, accountants and economists;

d. there is greater transparency of decision making. The pricing mechanism will be divorced from Government and subsidies for loss-making and "social" activities are likely to become more explicit;

e. there is increased public accountability on the part of the industry being regulated;

f. they are essential if the monopoly is to be privatised, in order to reduce uncertainty and potential interference which would exist under Government regulation;

g. they will be able to assume the responsibility of the NICCs whose duties they will be able to carry out more effectively;

h. they offer the prospect of continuous regulation of monopoly.

7. We consider that regulatory agencies can be an effective method of reducing monopoly power and are essential if state monopolies are to be privatised and remain monopolies. They are likely to be most effective if accompanied by regionalisation, since this will facilitate comparison and is less likely to lead to agency capture. The deficiencies noted above are less likely to arise if the following conditions exist -

a. the agency should be divorced from Government in order to reduce the possibility of political intervention;

b. the agency should be managed by a small number of members who are full-time appointees of the Government. Terms of office should be at least 5 years, with cyclical rotation in order to minimise political interference. The members should be properly remunerated;

c. the agency should have statutory investigative and judicial powers. These will include rights of access to information and premises, to subpoena directors and staff, to conduct audits and reviews and to request the MMC to investigate the monopoly;

d. care should be taken to ensure that appellate arrangements will not result in political interference; we consider that the MMC should be able to fulfill this appellate function, with its experience of examining "public interest" questions;

e. uncertainties are created in the US system of regulation because agencies attempt to determine each year when approving price increases a fair rate of return based on the monopoly's relative efficiency. Major reviews of rates of return and of efficiency should only take place periodically, for example every 4 or 5 years. The results of efficiency reviews should represent a major input to the determination of permitted maximum rates of return, so that past effort and achievement are rewarded. However some flexibility should also be permitted to the agency in the intervening period as an added stimulus to efficiency;

f. permitted rates of return should be established by the agency (or the MMC as the appellate) rather than by Ministers, in order to reduce the possibility of political interference;

g. the agency should have powers to ensure that the monopoly is constrained and abuses are remedied. In the longer term the permitted maximum rate of return can be varied to meet this need. In the short term, price restraint could be used where maximum rates of return are likely to be exceeded;

h. the agency should be adequately funded and should be permitted to recruit those staff appropriate for the task, from outside the Civil Service where appropriate, at market rates of remuneration;

i. the agency should be permitted to examine all aspects of the business, including profits, efficiency, pricing, extent of market and services provided, standards of service, consumer protection, investment and possible abuses of monopoly power such as cross-subsidisation to keep out competitors and pressure on suppliers;

j. current cost accounts should be used primarily as the financial basis for regulation. However we would point out that for many industries there is a high degree of subjectivity involved in the preparation of CCA accounts. As a result we consider that for the time being at least it will be necessary for agencies to have regard to and even regulate by reference to historic cost accounts, as well as CCA accounts.

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FILE

B/C: N.O

10 DOWNING STREET

From the Private Secretary

5 January, 1984

MERGERS POLICY

The Prime Minister has seen your Secretary of State's minute of 23 December and its attachments. She feels that the papers leave a number of difficult questions unanswered. While she agrees that it is right to give greater weight to competition as the main element of "the public interest" the papers do not make clear precisely how such a change of emphasis could be made successfully. In this field it is the exceptions, rather than the run of the mill cases, that cause the difficulty and the papers do not resolve in a satisfactory way how cases which involve not just competition but also foreign takeover, conglomeracy or a regional dimension would be dealt with. How, for example, could the MMC be prevented, when dealing with a case referred to it principally on competition grounds, be prevented from giving substantial weight to these other aspects?

The Prime Minister feels that it would be inadvisable to make a statement, which would be best made orally rather than as a written answer, without having first resolved these questions. The Government would soon be asked how it intended to deal with foreign takeovers and it would not be satisfactory to reply merely that this was going to be reviewed.

The Prime Minister therefore suggests that these outstanding questions be considered further and that a new paper, incorporating the options on foreign takeovers, should be put to a meeting of E(S), to which the Secretary of State for Scotland would be invited. The section dealing with foreign takeovers will need to pay particular attention to the financial sector where merger activity could well be substantial in the near future and where difficult issues of prudential supervision are raised.

I am sending a copy of this letter to Margaret O'Mara (HM Treasury) and Richard Hatfield (Cabinet Office).

(A. Turnbull)

C. McCarthy, Esq.
Department of Trade & Industry

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PRIME MINISTER

MERGERS POLICY

Of these documents I suggest you read:-

(i) Mr. Tebbit's minute of 23 December - Annex A;

(ii) DTI's short paper - Annex B;

(iii) paragraphs 20-44 of DTI's longer paper which spells out some of the arguments more fully - Annex C;

(iv) the key section of the Fair Trading Act 1973 - Annex D;

(v) the list of recent merger references - Annex B.

These documents are rather unsatisfactory. The main thrust seems laudible, i.e. giving greater emphasis to competition as the main component of "the public interest". This would reduce the extent to which the Government was seen to be pronouncing on the relative merits of different managements as in the Lonhro/House of Fraser case where the Government was essentially usurping the function of the market. In principle, it would also reduce the extent to which foreign takeovers and the Scottish dimension would be cited as cause for reference. At the same time a number of minor changes would be made, e.g. raising the assets size limit, which would improve administration of the policy.

The problem with these proposals is that they underestimate the difficulty of achieving such a shift of emphasis. Mr. Tebbit was successful in standing aside in the Allianz/BAT/Eagle Star battle, but next time it may not prove so easy to do so. It seems to me somewhat naive, given recent controversy over MMC cases, to expect this subject to go through as a written answer. Similarly, it seems to me inadvisable to make a statement on the subject without having first worked out the

/Government's

Government's approach on foreign takeovers or how it would deal with territorial interests.

I have spoken to Mr. Gregson and we recommend that Mr. Tebbit be asked to bring this subject to E(S) plus the Secretary of State for Scotland. This would take a revised paper (eliminating the enormous duplication of the present papers, plus additional material setting out the current powers on foreign takeovers and the options for further action). This section would need to pay special attention to the financial sector where there is likely to be a great deal of merger activity in the near future and where difficult issues of prudential supervision arise. While this discussion is going on it would be reasonable to announce an increase in the assets size limit as a piece of administrative tightening up.

Agree this approach?

AT

4 January 1984

cc: Mr. Owen

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cc NO (part to follow)

PRIME MINISTER

MERGERS POLICY

I am now able to respond to your request of 5 July for a review of mergers policy, on which Cecil Parkinson sent you a note on 1 August.

2 My Department has reviewed the operation of mergers policy over recent years. I enclose the review paper. It considers the criticisms which have been made, but finds - so far as the public interest criterion is concerned - that these could better be met by a shift of policy in decisions about references to the Monopolies and Mergers Commission, rather than alterations in the criteria to be applied by the Commission, or other institutional adaptations. It therefore comes down against primary legislation which would make fundamental changes. These are conclusions which I am convinced are right. Our present system has merits. I do not believe that a new system is needed, and I see no call for the Government to embark on the public debate which would inevitably go with proposals for legislative change.

3 But the review rightly concludes that it is essential for the Government's policy on mergers to be more clearly articulated and better understood. It makes a number of proposals summarised in paragraph 22 of the Note below. I intend to act on these; and I believe that, taken together, they will be

welcomed as a measured response to recent pressures for greater clarity of direction within our system.

4 The review's proposals cover twin objectives. The first is to have fewer mergers within the ambit of control. This is to be achieved by doubling the assets threshold for mergers qualifying for investigation, and by confining Government intervention almost exclusively to mergers with potential for seriously restricting competition in the UK economy. These can then be weighed up, with any offsetting merits, by the Commission, against the public interest criterion. With this goes the objective of making clear to industry that the Government is concerned not to be a stumbling block to worthwhile merger activity, both by making our policy better known in public statements and by improving the scope for giving confidential guidance to merging companies. It is part and parcel of both of these that appropriate weight should be given to the international dimension which increasingly affects mergers between UK companies, as regards both competition with imports in the UK market and the need for UK firms to be internationally competitive in scale and scope.

5 Gearing our merger policy more closely to competition questions may leave other issues for decision. Foreign takeovers are one such issue. Hitherto a reference to the Monopolies and Mergers Commission has sometimes been a convenient recourse where

a controversial foreign bid provokes unease. It is rarely that such a merger restricts competition, and the logic of my proposals is that Government should not normally intervene in such cases as a matter of competition policy. As a result, I may need to review the wider question of whether new powers need be taken in relation to foreign takeovers.

Sort out note

6 I am copying this minute to Nigel Lawson and Sir Robert Armstrong.

NT

N T

23 December 1983

Department of Trade & Industry

H 229

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(1) NBPM
(2) BF to MCS on 2/9

CSP 2/8

PRIME MINISTER

MONOPOLIES AND MERGERS

Your Private Secretary wrote to mine on 5 July about the criteria against which mergers and monopolies are considered.

2 One of my first acts on becoming Secretary of State for Trade and Industry was to set in hand a review of our present policy on monopolies and mergers. Alex Fletcher has this well in hand. I would hope to bring forward a paper to colleagues, as you suggest, on the outcome of this review in the Autumn.

C P

1 August 1983

Department of Trade and Industry

GOV MACH: Monopolies and Mergers: July 83

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MERGER POLICY

NOTE BY THE

DEPARTMENT OF TRADE AND INDUSTRY

Merger Control: The Institutional Framework

1. Government control of mergers is the Fair Trading Act of 1973. Only newspaper mergers require the prior consent of Government. For all other mergers the Act merely gives the Government a discretionary power to intervene to have proposals referred to the Monopolies and Mergers Commission (MMC) for investigation. The MMC originated in the 1948 Monopolies and Restrictive Practices legislation. They are an independent, quasi-judicial body, appointed by the Secretary of State.

2. The duty of the MMC is to satisfy themselves that any merger referred to them qualifies for investigation and thereafter to investigate and report whether it is likely to operate against the public interest. The MMC are not constrained as to the matters they look at when judging the public interest but some aspects are set out in general terms in the Act (Section 84 of the Act is reproduced at Annex 1).

3. The Government's discretionary power is circumscribed in three ways:-

a) Only mergers which create or intensify a monopoly (above a 25% share of the UK market) or which are of a certain size (the assets to be taken over exceed £15 million) can be referred for investigation;

b) The Director General of Fair Trading (the independent head of a non-Ministerial Government Department created by the Act) has a statutory duty to keep merger activity under review and to advise the Secretary of State whether a merger should be referred to the MMC for investigation;

c) Only if the MMC find that a merger is against the public interest, can the Secretary of State take steps to prevent it.

4. Apart from these three points, the Secretary of State has a free hand. He does not have to heed the advice of the Director General about what to refer - although in practice he has tended to do so (and since the 1983 Election, this Government has reaffirmed to Parliament that it will generally seek to do so, or give reasons publicly when it decides not to). If the MMC say that a merger is against the public interest, he is not bound to exercise his powers to prevent it.

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5. Thus the framework is one which:

- leaves the competition institutions with freedom to look at the relevant issues objectively and independently;

- leaves with Ministers full responsibility, answerable to Parliament, for final decision and executive power;

- starts from the assumption that mergers are generally beneficial unless they seem likely to obstruct competitive forces or impede efficiency.

Policy Objectives

6. The objectives of competition policy have to be set within the context of the Government's overall strategy for industrial efficiency, growth and the elimination of inflation. Competition is a valuable instrument for achieving that strategy through downward pressure on prices and costs. At a time of particularly rapid change in the United Kingdom economy competition assumes even greater importance because of its power to facilitate the free shift of resources into expanding areas of activity.

7. Most mergers result from competitive forces: they are one means by which assets, through changing hands, are put to better use. Many will enhance competition eg by strengthening smaller firms competing with larger firms. Sometimes a merger will involve a reduction in competition as a necessary step for achieving an improvement in efficiency eg economies of scale, rationalisation of excess capacity or ability to compete in world markets. To the extent that Government does not wish to intervene in the operatio of market forces it is right to have a policy towards mergers which lets these proceed without hindrance.

8. But sometimes the motive to merge is to reduce uncertainty or to increase market power with no offsetting benefits to efficiency. As the paper at Annex 2 shows, mergers have not generally produced the efficiency gains forecast for them. Successive studies show that UK industry is more concentrated than in competing countries - partly the result of prolonged merger activity. Thus a Government which sees competition as necessary for wider strategic objectives will see a need to intervene to ensure that competition is not impeded, though if there is evidence of clear efficiency gains these will have to be weighed against the loss of competition.

Merits of the Present System

9. The merits of the present system are:

- the powers conferred by the Act are adaptable to changing economic circumstances;

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- it permits a flexible and pragmatic approach and allows policy to be lightly administered (of the several hundred mergers which take place each year, fewer than 200 qualify for scrutiny by the Office of Fair Trading and of these only 5% on average have been referred to the MMC);

- ultimate power rests with the Secretary of State but he has the help of independent assessment in the exercise of that power;

- intervention before a merger takes place ensures that anti-competitive practices are forestalled. It is difficult to enforce the break up of a merger which subsequently works against the public interest;

- a balance can be struck in every case between the detriments to competition and the benefits of rationalisation, efficiency or enhanced world competitiveness.

Criticisms of the Present System

10. The main criticisms of the system stem from the very flexibility which is one of its merits:

- it is said that the Secretary of State has too much discretion, used inconsistently or unpredictably, or that he has too little because he is constrained by the views of independent institutions;

- it is said that in their investigations the MMC have either too little or too much discretion. And companies complain at the delays inevitably caused by the investigation procedure and the costs involved in complying with it - financial and management time.

11. Just as the criticisms are varied, so are the proposals for change made by the critics. At one extreme a judicial system, removed from politics and based on a narrower test than public interest , is favoured. At the other extreme the suggestion is that public interest judgements should be entirely removed from independent institutions and reserved for Government. All such proposals would need new legislation and give rise to fresh uncertainty. The price of increased predictability could well be increased rigidity.

12. The criticisms and the proposals for change essentially concern three issues: the public interest criterion, the definition of what mergers qualify for investigation, and the need for guidance to companies.

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The Public Interest Criterion

13. Critics have suggested that the criterion is meaningless and that its breadth has been abused to permit references which are politically motivated and unrelated to competition, or unfounded value judgements by the MMC on non-economic factors. The facts are analysed in Annex 3.

14. The conclusion to be drawn from the analysis is that competition-orientated references rightly form the backbone of cases referred. But, because so many of these cases were abandoned by the parties subsequent to the reference, greater prominence has been given to the controversial cases based on issues such as foreign takeover, conglomeracy or regional policy. If undesirable controversy is to be avoided in the future the answer is not to change the criterion (which would make the policy rigid and narrow) but to ensure as a matter of policy that references are confined - with the very rarest of exceptions - to cases where a putative detriment to competition is the central factor. This has implications for cases which involve conglomerates and foreign takeovers but where competition issues may not be important. These are considered in paragraphs 19-20 below.

What Mergers Qualify for Investigation

15. As indicated in paragraph 3(a) above, there are two tests in the Act: the market share test and the size of assets test.

a) Market Share - the figure of 25% is set in the Act and can be changed only by primary legislation. Under the previous Act (1965) it was 33%. Any figure is bound to be arbitary. There is no evidence to suggest that the move from 33% to 25% in 1973 was mistaken. True, the increasing need to take account of international markets has reduced the relevance of market shares confined to the UK market; and the wider international dimension needs to be recognised in two respects. First, with our EEC membership, tariff barriers have gone, leading to a rise in imports from our European competitors. A high share of the UK output may therefore not confer real market power. Secondly, in many sectors of manufacturing industry, particularly where a significant proportion of the business is in large capital investment projects worldwide for which the competition is international only big companies can survive. This may mean only one or two UK-based companies based in any one sector. Although there is no need to take powers to change the current 25% figure, there is a need to ensure that the Director General and the MMC continue to take full account, wherever appropriate, of the overseas dimension in both its aspects.

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b) Size of Assets - the figure can be changed by Order. It was increased in 1980 from £5m to the present figure of £15m. A further rise would take more mergers out of the control system. But as Annex 4 explains too big an increase cound bring difficulties - some mergers which should be "caught" would be free of control unless they could be referred under the market share test, but the problems of defining markets in some cases could make that test unreliable. An increase to £30m would act as a signal of the Government's desire to limit intervention (it is more than an adjustment of the present figure). Without real risk it would have the advantage of removing some 40-80 mergers a year from control leaving some 110-120 subject to the Act (but, of course, only a small proportion of these would be referred).

The need for Guidance

16. There are two aspects; confidential guidance to companies contemplating merger and public guidance about the objectives and intentions of Government policy.

17. Greater use by companies of the procedure for giving confidential guidance about the likelihood of a merger reference could help to reduce the uncertainties which give rise to some of the criticisms of the present system. The issues are examined in detail in Annex 5. The conclusion is that the procedure should be both more widely publicised and modified to enable guidance to be given in a greater number of cases.

18. As to general guidance, firms would find it helpful (and so would the Director General because he would reflect it in the advice he gives) if the Government gave a clear and public indication of the criteria likely to be used in reference decisions together with a statement that references would be confined - with the very rarest of exceptions - to mergers raising important competition issues.

Foreign aids

Foreign Takeovers

19. Reference of a foreign merger bid has on occasion been seen as a convenient method of opposing an unwelcome take-over. A policy which sought to confine the use of the Fair Trading Act to genuine competition issues would mean that the Government would have to rely on the power available in the 1975 Industry Act for manufacturing companies (or expressly take them in the case of service industries) if it wished to frustrate foreign takeovers. In any event the Fair Trading Act may not always be a possible or convenient instrument.

Also the Government's stated position is that inward investment is welcome and that there is no policy of seeking to deter the operation of market forces or of assuming that foreign ownership is harmful to the national interes (save perhaps in relation to defence-related manufacturing, which could be covered by the Industry Act).

Conglomerate Mergers

20. The Department has carried out a number of studies, taking account of MMC findings on specific cases, to assess whether conglomerate mergers give rise to concerns for competition policy. The conclusion has so far been that no special action in the competition context would be justified. The Government has already taken steps to facilitate demergers so that there are no fiscal or institutional impediments to slimming down a large conglomerate. But it could help to reinforce the objectives of competition policy if action were taken to increase the availability of information about the performance and financial position of the constituent parts of a conglomerate. Further consideration is being given to this. Any action that seems appropriate is likely to be best taken outside the merger control system.

Conclusions and Main Recommendations

21. The present system for control of mergers fits reasonably well with the Government's objectives for competition policy, in a way that permits that policy to reinforce wider Government economic objectives. The system has many merits, not least that of flexibility. But some valid criticisms exist and a number of changes need to be made to meet those criticisms. Together the changes set out below make a significant package. They have the added merit of not requiring any primary legislation now (although in the longer term legislation to improve some technical aspects of the Fair Trading Act would be desirable). Apart from the change in the size of assets test, which requires an Order, administrative action should suffice. The whole package needs to be presented in a statement to Parliament, perhaps in answer to an Arranged Question.

22. The proposals for action are:

a) fewer mergers should be within the ambit of control;

b) the size of assets test governing the system should therefore be raised from £15m to £30m;

c) greater determination should also be stated and shown to confine merger references to cases raising important competition issues (but some limited scope for having other cases referred should be retained);

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d) the confidential guidance procedure should be improved so that more companies can be given an indication whether or not a merger is likely to be referred;

e) at all stages of assessing mergers, appropriate weight should be given to the international dimension;

f) policy on foreign takeovers will be the subject of a separate review

g) the possibility of getting conglomerate companies to disclose more information about their constituent parts should be pursued.

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MERGERS

UK MERGER CONTROL

1. The main instrument of Government control of takeovers of UK companies is the Fair Trading Act 1973. The Industry Act 1975 contains a separate and special power for Government in the national interest to prevent a foreign takeover of an important manufacturing undertaking (but not a service industry undertaking) carried out in the UK. That latter power, which does not involve any reference to the MMC, enables Government by Order to prohibit a change of control and, if satisfied that the national interest cannot be protected in any other way, to vest the share capital, on payment of compensation, in the Government. That special power has never been used, even under the previous Labour administration which introduced it.

2. Apart from newspaper mergers which are treated specially and are not the subject of this review, under the Fair Trading Act mergers do not require any prior consent or approval of Government. The Act merely gives a power, which is not in any way fettered, to refer qualifying mergers to the MMC for investigation and report. The qualifying mergers which may be so referred are those which create or intensify a monopoly situation (above a 25% share of the UK market) or which are above a certain size determined by reference to the value of the assets to be taken over (currently £15m but which may be varied by Order). Once referred to the MMC it is then their duty to satisfy themselves that the merger qualifies for investigation and thereafter to investigate and report as to whether the merger operates or may be expected to operate against the public interest, and in doing so the Act provides that apart from having regard to certain specified matters the Commission should take into account all matters which appear to them in the particular circumstances to be relevant. The MMC are thus not constrained in what they may take into account in determining whether a merger is against the public interest. The relevant provisions (Section 84 of the Act) are at Annex 1.

3. If the MMC report that the merger is likely to be against the public interest, then the Secretary of State has a power by Order to prevent the merger, but is not bound to do so. If, on the other hand, the MMC find that the merger is not against the public interest, then the Act gives no power to do anything to prevent the merger from taking place.

4. The function of the Director General of Fair Trading is that he has a statutory duty to make recommendations to the Secretary of State as to whether qualifying mergers should or should not be referred to the MMC. The Secretary of State, however, is not bound by such recommendations.

COMPETITION POLICY OBJECTIVES

5. This framework needs to be considered against competition policy objectives as part of the Government's overall strategy for industrial efficiency, growth and the elimination of inflation. The United Kingdom economy is undergoing great change with particularly rapid adjustment at present. For the economy to meet pressures to adapt, resources need to shift freely to expanding areas of activity.

6. The key objective is to use resources more efficiently and to increase the competitiveness of the trading sector of the UK economy. The Government's policy towards industry is to work with the grain of market forces: this involves improving the efficiency with which markets operate and maintaining and promoting competition in those markets. In the private sector of the economy, mergers are a significant element in the competitive process - one means by which assets, through change of ownership, are put to different or better use.

7. Most mergers result from competition; many will enhance competition eg by strengthening smaller firms which are in competition with large firms; such mergers are therefore likely to be desirable. But some mergers will reduce competition. Sometimes a reduction in competition is necessary to achieve an improvement in efficiency to exploit economies of scale or to carry through necessary rationalisation. Sometimes however the motive is to reduce uncertainty or to increase market power with no benefits to efficiency.

8. The basic mechanism of merger policy is the discretionary power to intervene where the merger seems likely to run counter to either of the objectives of promoting competition and efficiency or where there are conflicting effects on competition and efficiency The importance of such a mechanism being available is suggested by the evidence on the contribution of mergers to concentration in UK industry and on the effects of mergers on efficiency. The UK market is highly concentrated. Successive studies show that concentration seems higher in the UK than in many major competitors. The present degree of concentration and hence of potential for monopoly abuse is to a significant extent the result of prolonged merger activity. Particularly given the severe political and practical difficulties of divestiture and the unsatisfactory nature of alternative solutions such as price and profit controls, mergers policy is an important means of limiting avoidable future monopoly problems. Furthermore, economic studies have also pointed to the generally disappointing performance of mergers. As the paper at Annex 2 shows, mergers have not generally produced the efficiency gains forecast for them. Any presumption that mergers are generally beneficial

is not necessarily valid. This conclusion is not easily reconciled with a policy of non-intervention in the market. But intervention can be limited if there is a case by case approach weighing the particular effects of individual mergers on competition and the effects on efficiency in its many dimensions. A flexible pragmatic approach is best suited to this task.

9. Cases justifying intervention ought to be few in a smoothly operating market economy. They will also be highly varied. Markets for different goods and services may be international, UK-wide, or regional and local; and in each case they may also be growing, static or declining. This gives a matrix of market types, which will in turn have other features, such as ease of market entry, ease of product substitution, or scope for economies through large-scale production or vertical intergration. A range of these features may be present in any case for Government intervention, so that an individual balance will need to be struck, trading off possible efficiency gains against possible detriments.

THE INSTITUTIONAL FRAMEWORK

10. The UK approach to mergers developed since the War has taken the public interest as its yardstick. The discretionary framework within which the Monopolies and Mergers Commission (MMC) works originated in the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948, under which the MMC was established and given the task of reporting on monopoly situations referred to it. Restrictive Trade Practices (RTP) legislation grew out of the work of the Commission established by the 1948 Act when it became evident that certain practices were consistently held to be against the public interest. The discretionary features of the 1948 Act were reflected in all subsequent legislation affecting the MMC: the Monopolies and Mergers Act 1965 put mergers within the MMC's scope; the Fair Trading Act 1973 reaffirmed and consolidated the MMC's role in this respect, as well as establishing the Office of Fair Trading (OFT); and the Competition Act 1980 extended the discretionary pattern previously established to the examination of anti-competitive practices and the efficiency of public sector bodies.

11. The machinery created for considering monopoly and merger cases has been designed to be independent, and capable of examining a wide range of issues. The Monopolies and Mergers Commission is an independent quasi-judicial body its role deriving from its status as a body of indepedent figures; and, like a court, attaches importance to its indepedent status. It examines all relevant issues; and makes findings on the merits of each case. The Director General of Fair Trading is indepedent head of a non-Ministerial Government Department, with statutory responsibilities. The system contains checks and balances,

ensuring that important decisions affecting competition in the economy are taken only after advice has been received from that independent statutory person, or findings made on the public interest by a quasi-judicial body. This can pose problems, particularly where the MMC or the Director take a different view from the Government of the day. On the other hand, this institutional indepedence is seen by industry and commerce as a bulwark against political interference.

12. The freedom enjoyed by the competition institutions to assss leaves Ministers with responsibility for executive decision-taking. The decision whether to refer a merger lies with the Secretary of State, as does the decision whether and to what extent to act on an adverse finding by the MMC on a merger. The Secretary of State therefore has the main responsibility; and he must take - and later defend - the decision which seems to him right. In most cases Secretaries of State have chosen to follow the Director General's advice. But Parliament has left the final decision to the Secretary of State; and ultimately the Secretary of State has no option but to weigh the issues for himself.

13. Officials see no compelling reason for changing the law to make the Secretary of State the sole judge of the public interest unaided by any indepedent advice.

MERITS OF THE PRESENT SYSTEM

14. The present system allows a selective approach in the small margin of cases where a merger may be expected to produce results meriting examination, so that monopoly or anti-competitive practices can be anticipated and forestalled, without recourse to the difficult divestment measures which might be necessary for a monopoly, once created to be broken up.

15. The merit of the system is its flexibility. It combines institutional checks and balances within a framework which enables a balance to be struck in every case between such factors as possible detriments to competition, on the one hand, and the benefits of rationalisation, efficiency, and enhanced world competitiveness, on the other. The powers to intervene are discretionary: they enable the Government to intervene only as occasion arises. The powers are moreover adaptable to changes of economic policy. The system also allows merger control to be administered lightly: although several hundred mergers take place annually (particularly between very small concerns) less than 200 mergers a year qualify for scrutiny by OFT. Of these, less than 5% on average have been referred to the Monopolies and Mergers Commission in recent years. True, there are costs to the parties involved in a reference; but these costs are not high in relation to the total value of a bid,

and arise only in a very small margin of cases. In the other 95% of qualifying merger cases, the merger parties are able to proceed after no more than a relatively light scrutiny by OFT. Raising the threshhold for qualifying mergers (paras 28-34 below) will underline this feature.

CRITICISMS OF THE SYSTEM

16. Apart from such features as delay and distraction of top management (which tend to be common to all forms of merger control), most criticisms of the system are based on the contention that it leads to the small margin of important cases being subjected to the public interest criterion inconsistently, abribrarily or unpredictably. There are two broad arguments, involving both Ministers and the MMC, concerning:

a) The Reference Stage: What are the precise criteria for the Ministerial decision whether to refer?

b) The Intervention Stage: What weight does the Commission give to different factors in assessing the public interest?

c) General: The need for guidance to companies.

17. These criticisms have in turn led to a wide range of proposals for change, most of them aiming at forms of

- Judicial procedure, removed from politics;
- Minimum Ministerial involvement;
- Definitive criterion, with specified competition factors.

Corresponding proposals for insitutional change are sometimes canvassed. At one extreme would be a judicial system, based on a narrower test than the public interest. Another alternative would be to retain the present system, either with a reversal of the burden of proof, (so that mergers leading to dominent positions were prohibited unless there were proven offsetting benefits) with automatic reference of mergers meeting quantified criteria (size or market share). At the other extreme there have been occasional suggestions that public interest judgements should be removed entirely from independent institutions, and left as a matter for the Government of the day to rule upon in individual cases.

18. Common to all such proposals would be the need for major legislative change, with industry having to adapt to fresh circumstances. There might be the benefit of increased

predictability. But this cannot be certain: some form of assessment of individual cases would be necessary under any system, with its attendent uncertainties.

19. Within this general range of criticisms two questions have been intermittently highlighted:

a) Foreign Takeovers: There are the twin questions of the general policy towards foreign takeovers, and the extent of powers to prevent them. Certain aspects of the desirability of foreign takeovers can be considered within the frameowrk of the general public interest criterion under the Act, which allows the merits of a foreign takeover to be examined. But other aspects - such as the periodic debate on the range of powers which are or ought to be available to Government to prevent overseas bids - fall outside the Fair Trading Act and need to be examined separately.

b) Conglomeracy: Conglomeracy, and conglomerate mergers, remain a difficult area of policy.

20. Criticisms can be taken under five broad heads

a) The public interest criterion

b) Mergers qualifying for investigation

c) The need for guidance

d) Foreign takeovers

e) Conglomeracy and conglomerate mergers

Each is taken in turn.

THE PUBLIC INTEREST CRITERION

21. The breadth of criterion has proved controversial. There has been dispute over the weight which should be given to its various aspects, both by Ministers at the reference stage, and by the Commission in an investigation. This has arisen particularly over the non-competition issues which have arisen in certain mergers (Annex 3) and over conglomerate mergers (Annex 4).

22. But the record is far from pointing to major institutional change as a solution. The data suggest that criticisms of the "public interest" criterion are exaggerated. Critics have suggested that the criterion is meaningless, and that, both

at the reference and investigation stages, its breadth has been abused to provide justification for politically motivated merger references, unrelated to competition, or value judgements by the Comission on non-economic factors which could be little more than matters of opinion. The record (summarised in the table at Annex 3) shows a different picture. In 1981 to 1983, 27 merger references were made. Of these, the vast majority (nineteen) were made on account of various concerns over accretion of horizontal market share - the classic competition-orientated merger reference. But there were eight other references. Five of these were motivated by concern over various aspects of overseas control (in two cases with an additional Scottish economic element), one involved conglomeracy and management efficiency, another concerned conglomeracy and the Scottish economy and the last involved management efficiency closely linked to the questions about the acquirer. All in all the record clearly shows that while horizontal market share was the preponderant factor at the reference stage, there was a substantial minority of non-competition cases.

23. The picture emerging from the Commission's investigations is different. The preponderance of horizontal market share factors in the Commission's findings is less marked. This is partly because the number of cases in which adverse effects were found by the Commission is itself small: adverse effects were found in only nine of the 27 cases. The remainder were judged to have no adverse effects (eight cases), laid aside (five cases) or still under consideration by the Commission (five cases). Of the nine cases in which adverse effects were found four related to horizontal market power, while five related to other factors.

24. Taken crudely, these figures might suggest that where references have been motivated by competition considerations, the Commission have chosen to range more widely, finding against the mergers in question on non-competition grounds. In fact that is not the case. Over the last three years, as the table shcws, if the Commission have found against a merger they have found against it broadly on the grounds which gave rise to the reference. There is not a single instance in which a merger has been referred on competition gorunds, but the Commission has found against it on some other grounds. By the same token, where concern about a merger has involved some other issue (eg foreign takeover or conglomeracy) that issue has been at the centre of the resultant report. The reason why the Commission have not made adverse public interest findings on horizontal competition grounds in a greater number of cases is either that they have not shared the concern which led to such mergers being referred, or else the mergers themselves have been abandoned by the parties, with the references being laid aside.

25. The overall effect is that competition-orientated references rightly form the backbone of all references. But the abandonment of a significant number of the mergers so referred dilutes the significance of the competition-orientated cases, giving greater prominence to the controversial cases based on issues of divergent opinion such as foreign takeover, conglomeracy or regional factors. It is the prominence of these issues which has led to criticisms of the policy and its machinery.

26. The general lesson is that controversy can best be avoided, and the machinery made to work, if references are - with the very rarest of exceptions - confined to mergers raising important competition issues.

27. This is not to say that the public interest criterion should be narrowed to detriments to competition alone: it is clearly useful for both Ministers (in considering references) and the Commission (in making findings) to be able to weigh detriments to competition against other factors, such as rationalisation, greater efficiency, or adaptation to a wider market. But a putative detriment to competition must normally be central ground for a reference. Where mergers raise other possible detriments (management efficiency, overseas control, regional effects) it is arguable that these issues (which do not arise only from mergers) should be tackled via specific Government policies, rather than remitted to the Commission when a merger is fortuitously involved.

MERGERS QUALIFYING FOR INVESTIGATION

28. Although merger control is already administered lightly, there are strong arguments for making it lighter still, through changing the tests for qualifying mergers set out in the Act.

a) The Market Share Test

29. The market share test is set in S.64 of the Act, and could be altered only by primary legislation. It is currently 25% having been reduced in the Fair Trading Act 1973 from the 33% level set in the Monopolies and Mergers Act 1965.

30. Although the setting of the test must always be somewhat arbitrary, officials see no grounds for serious doubt about the present level. The relationship between market share and economic performance is not simple and straightforward. Nonetheless there is no evidence to suggest that lowering the market share test from 33% to 25% was a mistake; and indeed, in some markets such as retailing, it could be argued that 25% is itself on the high side.

31. It has been argued that the increasing need to take account of international markets has made irrelevant a market share test confined to the UK market. There are certainly cases in which the wider international dimension needs to be recognised:

i) EEC Membership: EC membership has significant implications. Tariff barriers have gone, imports have risen substantially, and the UK market is far more open to our European competitors than it was say, 20 years ago. A high share of the UK market may therefore not confer real market power.

ii) International Competition: In many sectors of manufacturing industry, particularly where a significant proportion of the business is in large capital investment projects worldwide for which the competition is international, only big companies can survive. This may mean only one or two companies based in the UK in any one sector.

However, given the many non-tariff barriers to international trade which still exist, it would be unwise to argue that the current market share test should be adjusted to reflect the overseas dimension. As the Director General and the MMC are well aware, what is needed is the careful application of common sense to interpretation of the market share test in such instances.

32. Declining sectors of manufacturing industry present a diferent problem in relation to the market share test. They need to restructure to remain competitive. This will almost certainly involve a reduction in the number of UK companies operating in such sectors; and the policy needs to take account of this.

b) The Size of Assets Test

33. While the market share criterion can only be varied by primary legislation, the assets criterion could be raised by order. There was one increase (1980) from £5m to £15m. This did little more than take account of inflation. A further rise would take further mergers out of merger control. But, as Annex 4 explains, any significant rise could bring difficulties as well as benefits. Some mergers qualifying for investigation might then do so only on the market share test. A reference on this basis - and indeed prior discussion with the companies concerned - would involve complex problems of market definition, in which not only the Government, but also the companies themselves, might have difficulty in gaining a clear picture of market share, and through it, of the application of merger control in a particular case. A large increase in the assets test would extend the area in which these uncertainties could lead to undesirable problems, with criticisms that the tests

for qualifying mergers had become cumbersome and time-taking.

34. An inflation-linked increase (taking account of inflation since the original level was set in 1965) would take the size of assets test to £25m. For the reasons explained in Annex 4, an increase above this level could be taken to £30m or (with some of the risks set out above) as far as £40m, while an increase to more than £40m is not recommended. Doubling the present level to £30m would remove some 40-80 mergers per year from control, leaving only some 110-120 per year subject to the Fair Trading Act, while at £40m the corresponding figures would be 60-90 and 100-110.

THE NEED FOR GUIDANCE

35. There are two aspects, confidential guidance to companies contemplating merger, and public guidance about the objectives and intentions of Government policy.

36. As regards confidential guidance (ie guidance to companies contemplating merger, as to the likely decision on a reference) we believe that limited steps could be taken to make the procedure more widely known. It is currently used in just over one-tenth of qualifying merger cases. Clear guidance is given in three-quarters of such cases, being withheld in the remaining quarter. However difficult it may be to give guidance, withholding it is clearly unhelpful to the ocmpanies concerned. For the reasons given at Annex 5, it sems unlikely that guidance will prove possible in all cases. But it might be possible to reduce the cases in which guidance is withheld. This, together with slightly greater recourse to the procedure as a whole, would be helpful.

37. As to general guidance it would be helpful to the market as a whole if guidance could be given as to the criteria likely to be used in reference decisions. As has been made clear (paragraph 21) references of cases raising clear competition issues are likely to be best understood and raise least controversy and a statement that references would be confined to such cases might well be welcomed. But such a statement, to be clear, would need to represent an unambiguous self-denying ordinance, clearly stating that references on other - more controversial - grounds would not be considered. Whether to make such a statement is a matter to be decided after taking account of this review.

FOREIGN TAKEOVERS

38. A statement that competition policy would aim at confining references to mergers with genuine competition issues would no doubt provoke questions about foreign takeovers. There

is already some criticism of competition policy as unclear on this issue; and there could be wider debate as to whether additional measures were needed.

39. The present powers to prevent foreign takeovers derive from the Fair Trading Act 1973 and the Industry Act 1975.

a) The Fair Trading Act 1973

40. The powers under the Fair Trading Act 1973 to prevent a merger may be used whatever the nationality of the bidder, provided that the MMC has reached an appropriate adverse finding. The provisions in the Act are not discriminatory on grounds of nationality. For them to be invoked in relation to a takeover by a company from another EEC member-state of a UK company would not in itself involve any breach of the EC Treaty provisions. The point may arise, however, that if a merger were referred to the MMC solely on the stated ground of nationality of a prospective purchaser this would be contrary to Article 221 of the EEC Treaty which requires Member States to accord nationals of other Member States the same treatment as their own nationals as regards participation in the capital of companies. The same point may also arise if the MMC in their report concluded that the only relevant factor that made the merger against the public interest was the EC nationality of the bidder. In both these cases if the stated reason for preventing the merger was solely the matter of EC nationality, then there could be a breach of Article 221. It is not entirely clear, but the better view is that Article 221 has direct applicability so that in such cases any prohibition of a merger could be challenged in the English Courts apart from any action that might be taken by the European Commission.

b) The Industry Act 1975

41. The Industry Act 1975 contains a separate and special power for Government, in the national interest, to prevent a foreign takeover of an important manufacturing undertaking carried on in the UK. It does not involve any reference to the MMC. The power relates only to undertakings engaged in the manufacturing industry which appear to the Secretary of State to be "of special importance to the United Kingdom or to any substantial part of the United Kingdom". If the Secretary of State thinks it would be contrary ot the interests of the UK for a change of control to take place, he may, by Affirmative Resolution Order, prohibit the change of control. (There are detailed provisions about what is a change of control, but essentially it is where a foreigner gets control of 30% or more votes of a company). In addition to a Prohibition Order, if the Secretary of State is satisfied that the national interest cannot be protected in any other way, he may make

a Vesting Order, vesting the share capital, on payment of compensation, in the Government. None of these powers under the 1975 Act have ever been used.

42. Since the Act is solely about foreign takeovers, the use of these powers in relation to acquisitions by EC nationals would clearly be contrary to Article 221. That would not, however, apply in all cases, because Article 223 does allow Member States to take measures necessary to protect the essential interests of its security in connection with the production of war materials. Reliance could be placed on Article 223 to prevent EC nationals gaining control of UK manufacturing undertakings with a defence role such as Plessey or Ferranti.

43. Whilst in general the term "EC nationals" includes companies or firms established in accordance with the law of a Member State, for the purposes of Article 221 a distinction can be drawn for EC companies which are controlled by non-EC nationals. Thus the powers under the 1975 Industry Act could probably be used to prevent takeover of a UK manufacturing undertaking by a US company (owned by US nationals) even though the bid is channelled through a French or German subsidiary.

44. The broad conclusion to be drawn is that if merger references to the MMC were almost wholly confined to mergers raising competition issues new legislation might be necessary if comprehensive powers to prevent foreign takeovers were wanted, since the powers under the 1975 Act only apply to changes of control in important manufacturing industries. Taking such powers would no doubt be controversial, not only domestically but also with OECD and EEC partners, themore so given the long-standing UK policy of welcoming inward investment.

CONGLOMERATE MERGERS

45. A policy confined to mergers raising competition issues might also provoke questions on the approach to conglomerate mergers, where such issues are not always present. The Department has carried out a number of studies, taking account of MMC findings on specific cases to assess whether conglomerate mergers give rise to concerns for competition policy. The conclusion has so far been that no special action in the competition context would be justified. The Government has already taken steps to facilitate demergers so that there are no fiscal or institutional impediments to slimming down a alrge conglomerate. But it could help to reinforce the objectives of competition policy if action were taken to increase the availability of information about the performance and financial position of the consitutent parts of a conglomerate. Further consideration is being given to this. Any action

that seems appropriate is likely to be best taken outside the merger control system, in the framework of company accounting. The Department's work is summarised at Annex 6.

CONCLUSIONS AND MAIN RECOMMENDATIONS

46. The present system for control of mergers fits reasonably well with the Government's objectives for competition policy, in a way that permits that policy to reinforce wider Government economic objectives. The system has many merits, not least that of flexibility. But some valid criticisms exist and a number of changes need to be made to meet those criticisms. Together the changes set out below make a significant package, with the added merit of not requiring any primary legislation. Apart from the change in the size of assets test which requires an Order, administrative action should suffice. The whole package needs to be presented in a statement to Parliament, perhaps in answer to an Arranged Question.

47. The proposals for action are:

a) fewer references should be made and fewer mergers should be within the ambit of control;

b) the size of assets test governing the system should be raised from £15m to £30m or £40m;

c) greater determination should be stated and shown to confine merger references to cases raising important competition issues (but some limited scope for having other cases referred should be retained);

d) the confidential guidance procedure should be improved so that more companies can be given an indication whether or not a merger is likely to be referred;

e) at all stages of assessing mergers, greater weight should be given to the internaitonal dimension;

f) policy on foreign takeovers should be reviewed;

g) the possiblity of getting conglomerate companies to disclose more information about their constituent parts should be pursued.

DEPARTMENT OF TRADE AND INDUSTRY
30 November 1983

LIST OF ANNEXES

1. Fair Trading Act 1983: S.84

2. Analysis of Mergers: Evidence since the White Paper 1978

3. The Public Interest Criterion

4. The Size of Assets Test

5. Confidential Guidance

6. Conglomeracy and Conglomerate Mergers

EXTRACT FROM FAIR TRADING ACT 1973

PART VIII

ADDITIONAL PROVISIONS RELATING TO REFERENCES TO COMMISSION

Public interest.

84.—(1) In determining for any purposes to which this section applies whether any particular matter operates, or may be expected to operate, against the public interest, the Commission shall take into account all matters which appear to them in the particular circumstances to be relevant and, among other things, shall have 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.

(2) This section applies to the purposes of any functions of the Commission under this Act other than functions to which section 59(3) of this Act applies.

CONFIDENTIAL

ANALYSIS OF MERGERS: EVIDENCE SINCE THE GREEN PAPER 1978

1 Nearly 5 years have passed since the review of monopolies and mergers policy which was published as a Green Paper (Cmnd 7198, 1978). With such an interval there is a need in the current discussion of mergers policy to ask what evidence has emerged since, and to assess whether the Liesner analysis would have been materially different if this evidence had been available to the Group. Such is the purpose of this note. The first section gives the essential background to the Green Paper and summarises its principal findings. The second contains a brief account of subsequent evidence in two key areas - concentration and the performance of mergers. The function of the final section is to establish whether the conclusions of the Green Paper are challenged by subsequent evidence or supported by it.

A THE GREEN PAPER

Essential background

2 The UK mergers policy which the Green Paper reviewed was based - and is arguably still based - on a presumption that mergers are on balance beneficial. This reflects the response of successive governments to the large increase in mergers which, for much of the last three decades, have replaced liquidation as the main cause of the disappearance of quoted companies, and in so doing have been largely responsible for the radical changes in the structure of industry. In part the response may have been a defensive reaction to the large post-war increase in international trade and capital movements, and particularly to a perceived competitive threat from American multinational corporations. On occasion UK governments have actively promoted mergers and generally have looked to them to provide

better management or genuine economies of scale; although powers to prohibit mergers were taken in 1965 these powers have been benignly used. The position including governmental response has been very similar in other European countries.

3 In the Green Paper as elsewhere, analysis commonly starts from the premise that the structure of markets as shown by the number and size of competitors and customers has important implications first for the policies of the enterprises concerned and hence for their performance. Good performance in this context means the provision of goods and services of the type and quality which customers want, at the lowest cost permissible given current technology and input prices. To begin with extremes, where it is technically feasible the presence of a considerable number of independent competing suppliers is considered to be a better insurance of corporate policies conducive to good performance in the above sense than overwhelming dominance (say, 90% market share) by one company. If, as is now the case in very many markets, no more than half a dozen suppliers have survived, a more equal size distribution seems more likely to ensure adequate performance than a structure under which, say, two leaders have over 30% each and the remaining suppliers are all very small. Again, markets are likely to perform better where large shares by individual UK firms are subjected to active import competition or to the countervailing influence of large clients. These three examples illustrate the nature of the underlying premise. Because it is quite impossible to summarise the detailed and immensely varied experience of thousands of individual markets at national and regional level, the relationship between structure and performance is represented by consideration of different measures of concentration.

4 Underlying the mergers analysis of the Green Paper is the central importance of competition. In this the Report was a natural further step in the development of policy since the end of the second world war. Then restraint of competition had been identified as one of the factors holding back British industry, particularly through extensive cartels which had developed throughout industry in the inter-war years, often with Government encouragement. A series of measures had been taken to strengthen competition, notably the Restrictive Trade Practices Act 1956 and the banning in 1964 of individual enforcement of resale price maintenance. Procedures for the assessment of mergers were introduced in the Monopolies and Mergers Act of 1965 and the essential question before the Liesner Group was whether, in the light of experience since 1965 and of current economic circumstances, a change of Governmental stance was desirable; was the benign attitude towards mergers still the right one?

Conclusions of Green Paper

5 (a) On structure:

Concentration in the UK had increased rapidly in the post-war period and from data then available (to 1972) might well increase further. Mergers had been responsible for a large part of the increase.

Concentration had already reached a high level which exceeded that of many of our international competitors.

Although growing international trade had tended to some extent to offset effects on competition and although in some cases further mergers might raise efficiency, the high relative level of concentration and the possibility of further increase gave cause for concern.

(b) On performance:

Several academic studies had produced the surprising conclusion that in roughly half of cases examined the merger had produced an unfavourable effect on the profitability of the companies concerned. It was fully recognised at the time that the profit test itself cannot be interpreted unambiguously. For even if profitability in the generality of merging firms were to rise (that is profits were higher post-merger than pre-merger) the test itself would not indicate whether this reflected increased market power or improved efficiency. The failure of the tests generally to show improved profits post-merger was interpretted as strong evidence that mergers were failing to generate the improved performance which had been presumed under the post-war policy stance.

(c) On mergers policy

Since in individual cases benefits from mergers are entirely conceivable and this possibility is not invalidated by empirical evidence on the performance of mergers in general, the Paper concluded that a case-by-case approach should be retained but a more critical policy towards mergers should be adopted.

Instead of mergers being presumed generally to be beneficial policy should be shifted to a neutral approach, within the existing institutional framework; this would recognise the dangers of increased concentration and reduced competition but also give due weight to the benefits which particular merger proposals might be expected to deliver. The proposal for a shift in presumption was not implemented but a more critical assessment of merger proposals was signalled in a keynote speech by Mr Nott.

B SUBSEQUENT EVIDENCE

6 No attempt has been made to repeat in its entirety the work of the Liesner Group, much of it highly detailed involving many people. The research reported here is limited to the two central issues of concentration and the performance of mergers.

Concentration

7 Two different measures of concentration are commonly used: aggregate concentration and industry concentration. Aggregate concentration shows to what extent the 100 largest firms dominate the manufacturing sector as a whole. Industry concentration shows in terms of output or employment how much of a particular manufacturing or extractive industry (e.g. agricultural machinery) is accounted for by the largest concerns in that industry. The latter is a rough approximation to concentration in specific markets for which data are not available on a comprehensive scale.

8 The Green Paper showed that aggregate concentration increased rapidly in the post-war years from the pre-war figure of around 20%, reaching a peak of approximately 40% in the late sixties. There were signs that the increase might be levelling out but at that stage one could not be sure. Table 1 which carries the data forward from 1972 to 1979 confirms that a plateau in aggregate concentration has been reached in manufacturing.

TABLE 1: SHARE OF THE 100 LARGEST FIRMS IN UK MANUFACTURING NET OUTPUT

Year	1970	1971	1972	1979
Share (%)	39	40	41	42

Source: Business Monitor PA 1002

9 The Green Paper also reported that aggregate concentration was higher in the UK than in the USA or Germany. This may be partly due to the larger overall size of total manufacturing industry in these countries. The fact remains however, that of the 349 industrial companies in Western Europe with a turnover of more than £500 million in 1980 (some of which extended to non-manufacturing activities), over a third were based in the UK. This is a much higher proportion than the UK share of industrial production and reflects the relatively high level of aggregate concentration. Both German and French companies accounted for about a fifth of the total.

10 The aggregate measure gives a broad view of the growth in overall concentration, but in practice mergers policy operates within specific markets. A first and rather crude approximation to this is given by the five firm employment concentration ratio which represents the share of total employment in a particular

industry accounted for by the five largest employers. Paragraph 3.6 of the Green Paper contained an analysis based on 116 manufacturing and extractive industries in 1972. This is repeated below for the 114 industries on which comparable data were available for 1972 and 1979. Note that the concentration ratios given are the averages of industries in each group or Order. For example it is not the top 5 firms in Food, drink and tobacco but the top 5 in each of the 12 industries of this Order which are represented by the ratios.

TABLE 2: FIVE FIRM EMPLOYMENT CONCENTRATION RATIOS

Industrial Order	No. of Industries in each order	Weighted average percentage of employment in the five largest firms in each industry	
		1972	1979
Mining & quarrying	2	38	41
Food, drink & tobacco	12	56	53
Coal & petroleum products	1	45	43
Chemical & allied industries	13	56	57
Metal manufacture	5	64	58
Mechanical engineering	17	35	33
Instrument engineering	3	38	36
Electrical engineering	9	62	58
Shipbuilding & marine engineering	1	51	76
Vehicles	5	68	69
Other metal goods	7	41	45
Textiles	8	34	34
Leather and Fur	2	19	20
Clothing and Footwear	7	21	24
Bricks Pottery etc.	6	44	45
Timber, Furniture etc.	4	15	15
Paper, Printing etc.	6	25	25
Other Manufacturing	6	46	47
Total Manufacturing & Extractive	114	48	48

Source: Business Monitor PA1002

11 The table shows that, comparing 1979 with 1972, average industry concentration increased in 9 orders, decreased in 6 and was unchanged in 3. The overall average was 48% in both years. International comparisons show that the same industries tend to be highly concentrated in different countries, though not necessarily to the same degree. The Green Paper (para 3.7) found concentration in manufacturing to be higher in the UK than in other major European countries. No further information on this is available but the position is unlikely to have changed.

12 Since the Green Paper was prepared data have become available for a finer disaggregation of manufacturing and extractive industries. On this basis the output of an industry segment is relatively homogeneous so that the resulting statistics provide a somewhat closer approximation to individual markets than any previously available. Concentration ratios have been calculated for each of 222 industry segments which can be commonly iientified from 1963 to 1977, and then weighted together.

TABLE 3: FIVE FIRM SALES CONCENTRATION RATIOS

Year	1963	1968	1975	1976	1977
Weighted average percentage of sales by five largest firms in each of 222 segments of industries	59.2	64.3	65.5	65.8	64.0

Source: OFT

These ratios are much higher than the average figure of 48% in Table 2 simply because of the lower level of disaggregation. Taken together the three tables are mutually supportive. They show convincingly that the post-war increase in concentration in UK manufacturing levelled off, broadly during the seventies. Data are not available to reveal whether the same holds good for the remainder of the economy.

13 The above figures ignore imports which in recent decades have provided an increasingly important dimension of competition in the UK, as in other major markets. For several statistical reasons concentration ratios cannot be properly adjusted to take account of international trade. In particular it is not possible to identify the imports and exports of the 5 largest UK producers which are significant in some instances. However some broad brush adjusted data were included in the Green Paper; not surprisingly, in general this data indicated rather lower concentration ratios. These calculations have not been repeated but an overall judgement can safely be made. During the 1970s when, as shown above, concentration levels remained broadly constant in British industry further increases occurred in the proportion of home sales accounted for by imports, implying a reduction in adjusted concentration figures although the position varied widely from one market to another. In some industries the threat of imports may also have contributed to a strengthening of competition; clearly such an effect cannot be picked up by the data. On the other hand it is likely that the adjusted concentration figures would still be higher than comparable statistics for other major European countries.

14 Since most individual product markets are characterised by a small number of suppliers even when allowance is made for imports academic attention has during the last few years been focussing on the identification of conditions under which concentrated markets can be expected to function effectively. An absence of barriers to entry is one condition which has long been recognised; another, more recently identified and perhaps harder to find in the real world, is that a company should be able to leave an industry without serious financial loss. Under these conditions the policies and performance of current suppliers, even if few in number, must be conditioned by the constant threat of potential entrants. This work reinforces the view set out in the Green Paper that each merger proposal should be considered separately in the context of the nature and degree of competition existing in the relevant market.

The performance of mergers

15 The results of a major empirical investigation of mergers were published in 1980. (The Determinants and Effects of Mergers, edit. D C Mueller) This study represents a significant advance in a number of ways. It was from its inception designed as an international comparison covering seven countries - UK, USA, Germany, France, Belgium, Holland and Sweden. The findings for separate countries, in part reflecting national conditions and institutions and in part showing the common impact of external influences, tend to cross-check, adding authority to the overall results. One of the objectives of the programme was to ascertain whether mergers tend to increase efficiency in the companies concerned. The inadequacy of a profit test, noted above at para 5(b), was well appreciated. A three-stage testing procedure was devised, based on the idea that if efficiency were improved, it would show up in at least one of the following ways:

(1) increased profitability

(2) increased growth following the passing on to customers, in the form of lower prices, of some or all of the benefits from increased efficiency.

(3) increased share prices reflecting future efficiency gains not yet through by the end of the study period (3/5 years after the merger).

All tests were based on comparisons of the merged companies with companies in a size-matched control group.

16 In four of the seven countries (UK, USA, Germany and Belgium) merging firms realised a slightly superior performance in terms of after-tax profits than companies in the size-matched control group. In the remaining three countries there was evidence of a relative decline in profitability of the merging firms following merger. This result is broadly consistent with earlier studies although for reasons stated earlier it cannot in itself be regarded strictly as definitive.

17 The tests on growth were uniformly negative. Under the hypothesis examined, if mergers result in economic efficiency, costs should fall leading to a fall in prices and an expansion of sales - all relative to the control group. In no country did the tests show sales of merged companies growing relatively quickly post-merger.

18 In four countries (UK, USA, France and Holland) holders of shares in acquiring companies experienced a significantly higher improvement in the rate of return on their shares between the pre-merger period and the immediate post-merger period than the shareholders of size-matched control group companies. However, the difference disappeared within three years. For the UK the non-acquiring control group companies exhibited a significantly higher rate of return performance on this test than did the acquiring firms and this superior performance was still in evidence after five years.

19 This study is the most comprehensive so far attempted. Its results are bound to emphasise the doubts already felt about mergers as generators of improvements in company performance.

C MERGERS ANALYSIS RE-ASSESSED

20 Evidence which has emerged since 1978 on two issues central to the analysis of mergers - concentration and the performance of merged companies - challenges the findings of the Green Paper in one minor respect: fears that the relatively high level of concentration in the UK might be increasing further have not been fulfilled. Data now available down to 1979 show that both aggregate and industry concentration measures covering manufacturing remained broadly stable during the seventies. During the same decade further increases in import penetration are likely to have moderated some of the effects of high concentration, creating overall some strengthening of competitive pressures in the UK. Of course renewed protectionist pressures, if successful, will tend to reverse this process and could remove the only effective source of competition in some highly concentrated markets.

21 In other respects the findings of the Green Paper are confirmed by subsequent evidence. Concentration appears still to be higher in the UK than in many of our major competitors. The disappointing performance of mergers which was strongly suggested by earlier studies in spite of the inadequacy of the profitability test has now been confirmed by further research covering seven countries and employing a wider set of tests. Any presumption that mergers are in general beneficial has been yet more seriously undermined. Had these results been available to the Liesner Group they would have reinforced the conclusion that a more critical policy towards mergers should be adopted.

THE PUBLIC INTEREST CRITERION

1. Under the present system, mergers have to be considered against the broad criterion of the public interest. At the MMC investigation stage, the criterion is set out in the Act (Annex 1) which also includes an illustrative list comprising of both competition and non-competition factors, comprising: monitoring and promoting competition in the UK; the interests of consumers; the promotion through competition of efficiency and innovation, and of market entry by ew competition; regional policy and exports. At the reference stage, there is no similar statutory criterion. But in practice the Secretary of State, when considering a reference, needs to have regard to the public interest issues which the MMC would examine in their investigation.

Scope of the Criterion

2. The wide scope of the public interest criterion has always been recognised as a problem at both the reference and investigation stages. This has prompted a series of public statements by Ministers on their approach to mergers, including statements by Sir Geoffrey Howe (Minister for Trade and Consumer Affairs) in 1973, and Sir John Nott in 1980.

3. Dispute on the public interest criterion centres on the elements which ought to be included in it, and their treatment by Ministers at the reference stage, and by the MMC in any subsequent investigation.

Narrowing the Scope: Limited References

4. The potential problem of scope was recognised in 1973, when a power was introduced (S.69(4) of the Act) to make limited references, as follows:

> "A merger reference may require the Commission, if they find that a merger situation qualifying for investigation has been created, to limit their consideration thereafter to such elements in, or possible consequences of, the creation of that situation as may be specified in the reference and to consider whether, in respect only of those elements or possible consequences, the situation operates, or may be expected to operate, against the public interest."

5. The power has never been used. It was intended to give a measure of flexibility in cases where there might be no need to call into question the merger itself even where a particular aspect of a merger was found to be against the public interest.

The intention was that the merger would be allowed to proceed, restricted in particular ways either by undertakings or an Order. The power would be used in situations in which the Secretary of State felt that the basic purpose and objectives were acceptable or even desirable but there were one or more aspects of a merger which gave rise to doubt and needed further investigation.

6. In practice the power of limited reference may well be more difficult to use than it appears., for two reasons:

- Effectiveness: The Act requires specification of the aspects to be considered; and it is doubtful whether it could be used simply to exclude one or two aspects leaving what is to be considered unspecified. In any event, it might not be easy to limit the Commission's scope with any certainty, because issues within the reference could relate to those outside it. For example, had the Lonrho/House of Fraser reference been restricted to (say) the impact of the merger on competition in the retail trade the Commission might nonetheless have thought it appropriate to look at management compatibility (as an aspect of underlying competitiveness).

- Technical: References have to be made at speed: since 1973 changes in the City Takeover Code have led to a growing number of cases where, because of offer closing dates, a reference decision has to be taken by the deadline. With the present (unlimited) type of reference the only decision is whether or not there are issues of public interest which merit full examination; and this type of reference allows the use of interim powers if there is any risk of the merger proceeding despite the reference. A limited reference might be less versatile: it would be necessary to identify the issues and define clearly those for consideration by the MMC and those not, and the interim powers would not be available

7. All in all, the limited reference power is not a clear solution to the general problem of scope. True, it has been intermittently considered, and may yet prove useful. But it does not seem in itself to point a way to settling controversy over the scope of the public interest.

Constituent Elements of the Public Interest

8. There is no dispute that any assessment of the public interest issues in a merger must include an assessment of its effects on competition. It is clear that a merger producing significant accretion of market share (a horizontal merger) or involving the takeover of a current, or potential, supplier or customer (a vertical merger) could lead to detrimental market dominance and may require scrutiny. Within this framework, care needs to be taken over the relevant market. It is clear that for some internationally traded products, the UK market alone may

no longer be the relevant market, and the question of whether a particular firm is market dominant needs to be considered in relation to its competitive position in international markets. The Fair Trading Act does not preclude this being taken into account by the Commission at the investigation stage, as Section 84(1)(e) (Annex 1) makes clear. Nor is there any barrier to its being taken into account by Ministers or the Director-General at the reference stage.

9. On the other hand, there has been dispute over the weight to be given, whether at the reference or the investigation stages, to factors less clearly related to market dominance. There are

a) Conglomeracy (see Annex 4);

b) Management efficiency;

c) Wider "non-competition" factors, including

- Regional Policy
- Overseas Control
- Balance of Payments
- Sectoral Regulation
- Wider Economic Policy.

These are taken in turn.

10. Management efficiency appears in Section 84 as a potential by-product of competition rather than as a free-standing consideration. The issue has been at the core of two recent decisions to refer (Lonrho/House of Fraser, and Lewis/Illingworth, Morris) and was present in a third (Knoll/Sotheby's). The Commission have also considered the issue in a number of reports, both where prospective efficiency gains have offset criticism of a merger on, for example, anti-competitive grounds (BTR/Serck, Nabisco/Huntley & Palmer); and in the opposite sense where, in a few cases (most recently Lonrho/House of Fraser and Charter/Anderson Strathclyde) possible detriments to efficiency have been prominent in the public interest finding against a merger. It is a confusing element that the cases where prospective detriments to efficiency have weighed particularly heavily have frequently been opposed mergers with vocal opposition from the target company board and the prospect of management upheaval, and they have sometimes involved particularly controversial individuals. It is arguable whether merger control should try the business conduct of individuals, which falls to be considered if necessary under the general criminal law or company and other regulatory law. But short of this, it is inevitably difficult to assess the effects of a powerful and idiosyncratic manager on an organisation which he takes over.

11. Critics have suggested that the Commission is not well placed to make judgements about efficiency of business and that, in the absence of anti-competitive effects from the merger, efficiency judgements should be left ot the-market, both in judging whether the merger should proceed, and (if ineffiicnecy thereby occurs or persists) in correcting its through the working of competition; the critics consider that it is arbitrary for these aspects of efficiency to become the basis for investigating and perhaps prohibiting a merger when efficiency is so much a matter of management - and management can if necessary be changed.

12. The wider non-competition factors are certainly matters of Government interest. But critics argue that since they are, or should be if state intervention is necessary, within specific Governement policies or legislation, they should not form part of merger control, since this will have arbitrary effects as between companies which happen to be merging and those which are not. These factors include

(a) Regional Policy: regional disparities of economic prospects are addressed by many public policies, but Governmenet policy towards company decisions other than mergers (eg new investment diversification or plant closure) is based on persuasion and regional incentives and it is arguable that the draconian measure of stopping a merger on these grounds is inappropriate There is now a strong political element where the regional factors are Scottish (or perhaps Welsh, though this has not so far occurred). Convenient as it can seem to have these examined by an impartial body, drawbacks have begun to appear. The recent cases have now created some expectation of reference in any case where there is vocal concern, and may indeed intensify expression of that concern. The Commission itself was divided even in the most recent controve sial cases (the Royal Bank and Charter/Anderson Strathclyde) where the 'Scottish' consideration arguably took the strongest form. And the minority views against stopping themerger for 'Scottish' reasons received support from critics of merger control.

(b) Overseas Control: since the war, successive Governments have pursued and worked internationally for liberal policies towards inward and (subject to balance of payments problems) outward investment, based on the view that (whatever the balance in individual cases) this best meets the public interest. These policies are reflected in our international obligations, within the EEC and (in more general form) within the OECD. It is questionable how far merger control can prudently introduce exceptions to these policies, without leading to emulation or retaliation which would put the policies themselves under pressure. Mergers cannot be stopped

on the ground of overseas control per se, where the acquiring company is sufficiently established in another EEC country. There also is an argument that since the Industry Act 1975 provides specific powers to prevent overseas takeovers in the national interest and confines these to the manufacturing sector this is the proper framework to consider issues of overseas control. At the same time, certain cases have raised concern about specific consequences of overseas control, notably Allianz/Eagle Star (not referred) Enserch/Davy, and the rival bids for the Royal Bank and Sotheby's. While the Commission have shown some sensitivity to the international policy considerations, their findings in the two major cases (Davy/Enserch and the Royal Bank) did not escape criticism from the US Government. This was echoed in the US Congress when the Knoll/Sotheby's merger was referred.

(c) Balance of Payments: in the past the balance of payments has been an important factor in the Commission's consideration of some mergers and it still seems to weigh with them. But with floating exchange rates it has lost at any rate some of its relevance. And effects on the balance of pyaments principally reflect, and are as hard to judge as, effects on efficiency and competitive output.

(d) Sectoral Regulations: in a number of sectors (eg banking, insurance, gaming) the Government has not merely a policy but also a duty under legislation to administer detailed measures of prudential regulation and control. Mergers in these sectors may raise competition issues in the ordinary way. But it has been argued that the regulatory consideration which could also arise should be addressed only within the statutory regulatory framework (eg the tests of fitness of a bidder in terms of competence, probity, and financial standing) and should not be considered by the Commission. This issue arose in the Royal Bank case, in which the Bank of England, while apprehensive about the Hong Kong and Shanghai Banking Corporation's offer, took the view that the Banking Act powers in relation to changes of control did not extend to preventing the takeover, since the bidder could not be held to be objectionable on banking supervision grounds. This left undecided the question whether banking supervisi issues could nevertheless enter into the MMC's consideration of the case. The Allianz/Eagle Star case (not referred) raised some similar issues.

(e) Wider economic policy considerations: the Royal Bank also showed the Bank of England's concern that foreign control of a clearing bank might lead to erosion of the Bank's ability to achieve effective influence over monetary policy without the rigidity of statutory controls. Arguably this was not an issue which could properly - and effectively - be left to the MMC.

Ministers decided not to legislate for new powers on bank takeovers either on this or the prudential regulation ground. The underlying issues about the scope of merger control were left unresolved.

13. It has been argued that all these wider non-competition factors lead to unpredictability in merger control. So far as reference decisions are concerned, some recent cases may lend some truth to this. But critics have gone further suggesting that the criterion is meaningless, and that its breadth has been abused to provide justification for politically motivated merger references, unrelated to competition, or value judgements by the Commission on non-economic factors which could be little more than matters of opinion. The record (summarised in the attached table) shows a different picture. In 1981 to 1983, 27 merger references were made. Of these, the vast majority (nineteen) were made on account of various concerns over accretion of horizontal market share - the classic competition-orientated merger reference. Of the remaining eight references five were motivated by concern over various aspects of overseas control (the dual reference of bids for the Royal Bank by Scotland, the reference of Enserch/Davy, and the two references involving Sotheby's). Of the three remaining cases. one (Lonrho/House of Fraser) involved conglomeracy and efficiency, another (Charter Consolidated/Anderson Strathclyde) involved conglomeracy and the Scottish economy and the last (Lewis/Illingworth, Morris, referred against the advice of the Director General) involved management efficiency issues, arising from disparity of size, closely linked to the questions about the acquirer (Mr Lewis). All in all the record clearly shows that, at the reference stage, horizontal market share was the preponderant factor.

14. The picture emerging from the Commission's investigations is different; and the preponderance of horizontal market share factors is less marked. This is partly because the number of cases in which adverse effects were found by the Commission is itself small: adverse effects were found in only eleven of the 27 cases, the remainder being judged to have no adverse effects (eight cases), laid aside (five cases) or still under consideration by the Commission (three cases). Of the eleven cases in which adverse effects were found six related to horizontal market power, while five related to other factors.

15. Taken crudely, these figures might be taken as suggesting that where references have been motivated by competition considera tions, the Commission have chosen to range more widely, finding against the mergers in question on non-competition grounds. In fact that is not the case. Over the last three years, as the table shows. if the Commission have found against a merger they have found against it broadly on the grounds which have rise to the reference. There is not a single instance in which a merger has been referred to the Commission because of fears over competition and market share, and the Commission has found against it not on those grounds but on some other factor.

By the same token, where concern about a merger has involved some other issue (eg foreign takeover) that issue has been at the centre of the resultant report. The reason why the Commission have not made adverse public interest findings on horizontal competition grounds in a greater number of cases is either that they have not shared the concern which led to such mergers being referrred, or else the mergers themselves have been abandoned by their promoters, with the references being laid aside.

Conclusions

16. Two conclusions emerge. First, competition-orientated references rightly form the backbone of all references, but a significar number of the mergers so referred are abandoned. This dilutes the significance of the competition orientated cases, giving greater prominence to the controversial cases based on issues of divergent opinion such as foreign takeover, management efficien or regional factors. This effect can only be avoided by a policy of keeping a high proportion of references competition orientated. The record suggests that the proportion should be well over three-quarters if controversy over the role of non-competition issues is to be minimal.

17. The second conclusion is that there must be doubt whether references involving non-competition issues ought to be made other than extremely rarely (a few times a decade). Where they are made, the Commission will do their best to reach a verdict, as the record shows. But they are bound to be matters of controversy, on which the MMC's conclusions will not necessarily be regarded as authoritative. There is therefore a strong argument that the non-competition issues itemised above should be regarded as falling outside merger control for practical purposes and should either be left to be dealt with by other Government policies, or, where the Government needs to have a positive power of control for public interest reasons, to specific powers for this purpose.

Annex 3 : Table 1

MERGER CASES 1981-1983: THE PUBLIC INTEREST

Merger Reference	Public Interest Issues Identified at Reference Stage	MMC Finding Adverse (A) or Non-Adverse(NA)	Main Public Interest Effects Identified Commission
1981			
Lonrho/House of Fraser	Conglomeracy: Managementefficiency	A	Detriments to efficiency, disparate management style
Enserch/Davy	Overseas control	A	Overseas control: Detriments in export markets
European Ferries/Sealink UK	Competition - Horizontal	A	Competition - Horizontal market power
Hoverlloyd/BR Hovercraft	Competition - Horizontal	NA	No market dominance: Some remedy to over capacity
Standard Chartered/Royal Bank	Overseas control: Scottish economy	A	Overseas control: Effect on Scottish economy
HKSBC/Royal Bank	Overseas control: Scottish economy	A	
BTR/Serck	Competition - Horizontal: Conglomeracy	NA	Market shares relatively low. Some efficiency benefit:
Argyll/Linfood	Competition - Horizontal	-	(Laid aside)
1982			
Rowntree/Huntley & Palmer	Competition - Horizontal	-	(Laid aside)
Nabisco/Huntley & Palmer	Competition - Horizontal	NA	No adverse effects: Beneficial rejuvenation of H&P
ICI/Arthur Holden	Competition - Horizontal	NA	Market share too low to have adverse effect
GUS/Empire Stores	Competition - Horizontal	A	Competition - Horizontal market power
Charter Consol/Anderson Strath	Scottish economy: Conglomeracy	A	Efficiency, labour relations, Scottish economy
Sunlight/Johnson	Competition - Horizontal	A	Competition - Horizontal market power
Initial/Johnson	Competition - Horizontal	A	Competition - Horizontal market power
Prosper de Mulder/MCP	Competition - Horizontal	-	(Laid aside)
Linfood/Fitch Lovell	Competition - Horizontal	NA	Adverse effects on food retailing insufficient
A J Lewis/Illingworth, Morris	Management efficiency, employment	NA	Some benefits (and no adverse effects) from change of control
1983			
Redland/London Brick	Competition - Horizontal	-	(Laid aside)
Ibstock Johnson/London Brick	Competition - Horizontal	NA	Separate markets: No adverse effect on competition
Knoll International/Sotheby's	Overseas control/Management efficiency	-	(Laid aside)
Taubman/Sotheby's	Overseas control	NA	Some benefits: No adverse effect to offset
Hepworth Ceramic/Steetley	Competition - Horizontal		Report awaited
Pleasurama/Trident	Competition - Horizontal	A	Competition - Horizontal market power
Grand Met/Trident	Competition - Horizontal	A	Competition - Horizontal market power
P&O/Trafalgar House	Competition - Horizontal		Report awaited
GKN/AE	Competition - Horizontal		Report awaited

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THE SIZE OF ASSETS TEST

1. Whereas the market share criterion in Section 64 of the Fair Trading Act could be increased only by primary legislation, the assets criterion for merger references could be raised by order under Section 64(7) of the Act. There has already been one increase in the assets criterion, from £5m to £15m, in April 1980. This mitigated, but did not wholly dispose of, the problem of inflation since the original £5m asset criterion was set in the Monopolies and Mergers Act 1965 (re-enacted in the Fair Trading Act 1973). If changes in the Wholesale Prices Index (WPI) since 1973 are allowed for, the then £5m asset test should now be £19m. However, simple indexation from 1965 on the WPI gives a current figure of the order of £25m.

2. A variety of increases in the assets criterion have been considered, examining the effects of increases to £20m, £25m, £30m, £40m and £50m. Table 1 sets out the number of mergers which would have qualified for investigation at these different levels in 1981 and 1982, compared with the number of qualifying mergers at the then assets test of £15m.

3. Depending on which asset level were chosen, a number of mergers which under the present law would have been open to reference would not have been caught (on the assets test) in 1981 and 1982. These are listed in Tables 2-6. Tables 2 and 3 (covering mergers involving assets between £15m and £25m) include few mergers of significance. There is only one merger which was referred to the Commission (BRHL/Hoverlloyd) but this could have been caught by the market share test. Similarly, another case (Tarmac/Ruberoid) would not have been caught by the assets test, but could have been referred on the market share test had it proceeded in the face of confidential guidance by OFT that it was likely to be referred. There is only one merger on the list which the Director General advised should be investigated and which would have fallen out under a £25m asset test. This is Woolworth/Northcott. In that case the then Secretary of State decided not to refer after a plea that Northcott would not be able to survive financially if the merger were delayed or prevented by a reference.

4. Generally, Tables 2 and 3 show that mergers involving assets between £15m and £25m fall into a variety of categories:

(a) Mergers between smaller firms in the same market;

(b) Acquisition by large conglomerates of small independents either in an unrelated business or in a related business where the market shares are above 25%;

(c) Acquisition of small United Kingdom concerns by foreign companies;

(d) Small foreign acquisitions by United Kingdom companies.

5. Tables 4, 5 and 6 (showing mergers involving assets between £25m and £30m, £30m and £40m, and £40m and £50m) reveal an only slightly greater range of significant cases. Table 4 includes the Blue Circle/Aberthaw case, where the Director General recommended a reference, which the then Secretary of State decided against. Table 5 includes two cases (Initial/Johnson and Sunlight/Johnson) which were referred, as well as a number of other important cases such as the exchange of plastics business between ICI and BP and the simultaneous acquisition by Acatos and Hutcheson of three competitors in the edible oil business. Table 6 includes only one further case (BSC/Road Oak).

6. The general lesson of the data in Tables 1-6 is that, at any level of assets there is a small margin of cases in which a merger reference would have to be made on the basis of the market share criterion, rather than the assets criterion. This need not be a matter of great concern if only a small margin of cases is affected. But it has attendant difficulties which do not arise in the case of references based on the assets test.

7. These difficulties centre on the increased uncertainty - both for the merging companies and the Government - which is inherent in reliance on the market share criterion. The market share criterion is more complex, both conceptially and in practice, than the assets criterion, since assets are ultimately reducible to an absolute figure in every case, while market-share may be open-ended (depending on the market chosen) and rarely so clear cut. This has consequences at the pre-reference consideration stage (when the merging companies consult OFT) the refernece stage (when a reference has to be considered by the Secretary of State, and the relevant text drafted by the Department) and the investigation stage (when the MMC have to find whether the merger qualifies on the market-share test). At each stage the same problems may recur.

8. At the pre-reference stage, the authorities (the OFT, in consultation with other Departments via the Mergers Panel) have to take a view as to what appears to them to be a merger situation qualifying for investigation. By virtue of Section 68, different forms of supply of the goods or services in question can be selected eg a market could be viewed as separate according to the purpose concerned (such as paints for use of coating) or according to the types of customers. A view can also be taken that a market is limited to a "substantial part of the

UK" by virtue of Section 68(2). Bidders will often not know their own share in sectors of the market, let alone that of the target company. Bidders would therefore still generally find that they need to approach OFT for clearance. It is possible that OFT would frequently have to say that they are uncertain whether the bid gives rise to a merger situation qualifying for investigation This would be burdensome , the more so since OFT might take longer to consider whether a merger was referable under the Act, with resulting uncertainty for the parties.

9. At the reference stage the same problems may recur. When making a reference based on the market share test the Secretary of State msut specify the market in which it appears to him that the merged enterprise may have a qualifying share. This is a matter of exact definition which is bound to prove more complex than simple recourse to the assets criterion. Market definition is rarely clear-cut. It will be much more dififcult to establish whether a merger entails the creation or strenghening of a monopoly because of the need to reach a sustainable view of the market taking account of the degree to which there are substitutes for the goods or services concerned and the estimates of market share of firms concerned, commonly in the absence of published statistics. All in all, there would be additional work for the Department, involving hard assessments of technical market characteristics - made harder because conducted confidentially without further help from the parties - during the (usually very short) period before the first closing date of an offer.

10. There are related problems at the investigation stage. The definition in the reference is binding on the Commission. If, for instance, the reference directs the Commission to a particular market, the MMC cannot look at a sub-market only, and vice versa. The Commission would however have a limited discretion to look at different "forms of supply". These problems were present in the only two recent references in which the market share criterion was used. In the first case (ICI/Arthur Holden) the reference relied on both the assets and market share criterion. The market share criterion proved adequate, but not before it had become clear to the MMC that a finding based on market share would be disputed by ICI, who would have required satisfaction on the point as a pre-requisite for enquiry into the substantive issues raised by the merger. In the second (Prosper de Mulder/MCP) it became clear that different forms of supply of the reference products could prove a problem; but the reference was laid aside before this became acute. All these factors point to the dififculties faced by the Comission in finding that a referred merger is indeed a qualifying merger by reference to the market share test. It would certainly be a costlier process of investigation. It could also take longer for the Commission to investigate a merger, if the parties withheld their cooperation unless and until they were satisfied that the Commission had established that the merger qualified on themarket share test.

11. It would therefore be unwise to rely heavily on the market share criterion as a basis for merger references. True, where a merger appears to give rise to serious concern on market share grounds the market at issue ought, in most cases, to be reasonably clear. If it is not, and if the reference (and subsequent investigation) could only be framed in terms of a narrowly defined sub-market, that must beg the question whether concern over market share in a significant sector can really be a major factor. Nonetheless, size of assets test raises far fewer problems as a basis for quickly determining a qualifying merger, and ought to remain the principal test used.

12. Against this background officials have considered the following levels for the assets test.

a) £25m: the figure could certainly be set at this level, since this would be no more than a simple indexation from the asset test set in 1965.

b) £30m: there is no real obstacle to this figure. But the problems inherent in references based on market share could begin to arise, the more so when account is taken of mergers in the services sector (eg stock-broking or computer software) where the assets may be quite small in relation to the significance of the business in question.

c) £40m: raising the assets test to this level would undoubtedly bring in some mergers which have been referred on the assets criterion in the immediate past. Examples are Initial/Johnson and Sunlight/Johnson - both references made because of concern over the implications for competition, with adverse findings by the Coomission on the same grounds. There were also a number of significant cases involving assets between £30m and £40m which were not referred, but which involved significant market shares, close enough to the makret share test to invite dispute if a reference had been in question. Examples are Norsk Hydro/BIP Vinyles, ICI/Ugine Kuhlmann, Plate Glass and Shatterprufe IND/Doulton Glass Industries, Caparo/Barton and Norton Opax/John Waddington. In these cases, the joint market shares of 23, 22, 24, 20-25 and 25 per cent respectively were all close to the qualifying 25%.

d) £50m: the data do not suggest that the problem would necessarily be much greater at £50m than at £40m. But in view of the problems which could arise at £40m, an increase to £50m cannot be recommended.

13. It is difficult to draw a firm conclusion. Doubling the assets test to £30m would be a safe option. Raising it further, to £40m, would be a riskier option. But it is difficult to assess the extent of the risk given the difficulty of predicting the balance of future cases. There is one general point to be repeated. Whatever the attraction of raising the assets test to a high figure (£40m or £50m) it is doubtful how far it would lead to significant gains in practice. True, it would make a reduction in the number of mergers qualifying for a reference (as Table 1 shows) but this might not mean that a significant extra number of mergers would escape examination. In each case, it would still be necessary for OFT, on becoming aware of the merger, to confirm the asset position and market shares with the companies concerned (who might themselves seek reassurance from OFT as to its likely treatment). A merger involving assets of up to £50m is a significant merger by any standards; and OFT would be obliged to establish the market share position with some care.

14. As the level is rasied there is also an increasing risk of excluding from examination significant acquisitions by large conglomerates diversifying into previously unconcentrated markets. It would be wrong, for example, if a bid by (say) Imperial Tobacco for a company with a share of (say) 17% in a small but unconcentrated market could not be investigated even if the target company were the market leader. German experience suggests that such bids can give rise to concern, being often followed by a rapid increase in concentration in previously unconcentrated markets as existing competitors find themselves unable to compete with a market dominant conglomerate off-shoot.

QUALIFYING MERGERS AT DIFFERENT ASSET LEVELS

Year	No of Industrial and Commercial Mergers*	Mergers qualifying for Reference at:					
		£15m	£20m	£25m	£30m	£40m	£50m
1981	452	164	139	129	122	108	94
1982	463	190	168	145	112	108	100
1983 (Jan-Sept)	299	132	116	109	108	98	95

*Source: Business Monitor: The number of mergers in the Financial Sector is unknown.

Table 2

MERGERS INVOLVING ASSETS BETWEEN £15&£20m

(1) 1981

MP NO	Companies	value assets acquired (£m)	Joint Market Share (if over 25%)
005/81	British Rail Hovercraft Ltd/Hoverlloyd Ltd*	18.4	33%
007/81	Guthrie Corp Ltd/Stoddard Holdings Ltd	18.5	
031/81	Grand Met Ltd/Warner Holidays Ltd	15.8	
032/81	Hawley Leisure Ltd/Provincial Ltd	17.10	
035/81	Brown Shipley Holdings Ltd/Medens Trust Ltd	19.66	
036/81	Hanson Trust Ltd/G H Downing & Co Ltd	18.80	
040/81	Steetley Co Ltd/G H Downing & Co Ltd	19.0	34%
041/81	London Trust Co Ltd/Barrow Hepburn Ltd	17.50	
041/81	Charter Consolidated Ltd/Beralt Tin & Wolfram Ltd	16.29	
041/81	Jones Stroud (Holdings) Ltd/Fothergill & Harvey Ltd	16.22	
046/81	Standard Brands Ltd/Nabisco Ltd	16.40	
052/81	London & South of England Building Society/ Kingston B.S.	20.0	
057/81	Edmundson Electrical Ltd/Electrical & Radio Distributor	15.9	
057/81	Bass Ltd/Yorkshire Television Ltd	18.45	
057/81	Pearson Longman Ltd/Yorkshire Television Ltd	18.45	
060/81	Tarmac Ltd/Ruberoid Ltd	19.76	45%
066/81	George Oliver (Footwear) Ltd/Hiltons Footwear Ltd	15.10	
069/81	Rohm & Haas Co/Certain assets of Borg Warner Co	15.6	52%
072/81	Marsh & McLennan Companies Inc	17.35	
075/81	FJC Lilley Ltd/MDW Holdings Ltd	19.9	
075/81	Courtaulds Ltd Pensions Comm./Grange Trust	16.61	
075/81	Aarque Office Systems/GAF Corp. - Reprographic P.	17.0	
076/81	BICC Ltd/Sealectro Corp.	16.20	
080/81	European Ferries Ltd/Southern Television	18.0	
080/81	London Trust Ltd/Southern Television	18.0	

(2) 1982

006/82	Suter Electrical Ltd/Appleyard Group of Cos.Ltd	19.6	
006/82	BP Co Ltd/Brascan Recursas Naturais	15.4	
009/82	Initial Services Ltd/Consolidated Laundries	19.29	
009/82	Assurances du Groupe de Paris Vi./London & Hull Maritime Insurance	15.4	

* Referred to MMC: No adverse finding.

029/82	Quaker Oats Ltd/C Shippam Ltd & Diablitos Venezo	19.88	
030/82	John Menzies (Holdings) PLC/Lonsdale Universal PLC	17.50	
030/82	Harrisons & Crosfield Ltd/Australian Chemicals	18.34	
038/82	Sketchley PLC/Rentex Services Corp	15.9	
041/82	Electronic Rentals Gp/London & Montrose Investment Trust	16.0	
041/82	ICI PLC/Lonza Ltd	20.0	34%
045/82	Seryis Holdings Ltd/Wilkins & Mitchell PLC	18.30	
046/82	Hongkong & Shanghai Banking Corp/Tozer Kemsley & Millbourne	19.0	
046/82	St Pauls Co's Inc/Seaboard Surety Co	15.0	
057/82	William Press Group PLC/Fisk Electric Co	18.30	
064/82	Locks Heath Properties Twenty-one/Brent Walker PLC	18.40	
067/82	Amey Roadstone Corp Limited/Westminster Gravels Ltd	16.30	
073/82	Anglo Nordic Holdings PLC/Braby Leslie PLC	16.50	
078/82	Marchwiel PLC/Finlas PLC	16.0	
081/82	Cheshire Building Soc/Chorley & District Building Soc	15.4	
081/82	W Williams & Sons PLC/Ley's Foundries & Engineering	18.5	
081/82	Mills & Allen International PLC/Edinburgh General Ins. Serv.	19.5	
084/82	Flather Bright Steels Ltd/Exors of James Mills Ltd	16.0	

007/83	Alco Standard Corp/Henry Sykes PLC	17.3	
016/83	Dobson Park Industries PLC/Fletcher Sutcliffe Wild Ltd	15.3	35%
020/83	Pakhoed Holding NV/Pandair Freight Ltd	15.8	
020/83	Standard Telephone & Cables PLC/Certain businesses of ITT	17.2	
030/83	Favor Parker Ltd/Fitch Lovell Poultry Ltd	15.18	
036/83	Ruberoid PLC/Camrex (Holdings) PLC	16.2	
036/83	Lex Service PLC/Jermyn Holdings Ltd	15.8	
039/83	Hestair PLC/Duple International PLC	17.2	
043/83	Senior Engineering Group PLC/Greens Economiser Gp PLC	19.5	
046/83	Int. Signal & Control Gp/Marquardt Co (US)	19.2	
002/83	C H Beazer (Holdings) PLC/R Green Properties PLC	20.0	

P No	Companies	Value assets acquired (£m)
007/83	Throgmorton Trust Ltd/R Green Properties Ltd	16.47
010/83	Security Centre Holdings/Jewellers Protection Services (US)	17.2
31/83	Brittania Arrow Holdings/Nat Employers Life Assurance Co Ltd	19.8
49/83	International Investment Trust Co/Crosby House Group PLC	19.15
49/83	Finning Tractor & Equipment Co Ltd/Bowmaker	15.24

Table 3

b) ASSETS BETWEEN £20&£25m

1981

002/81	Morinyest Ltd/Planned Sayings Life Assurance Co	23.19	
002/81	Bahco Ltd/Record Ridgway Ltd	21.90	
013/81	Harrisons & Crosfield Ltd/London Sumatra Plantations Ltd	21.08	
015/81	Kangra Holdings Ltd/Renwick Group Ltd	20.05	
030/81	Cape Gate Group/Johnson & Nephew Ltd	20.40	
035/81	Aberdeen Investments Ltd/Hume Corporation Ltd	25.0	
041/81	The 600 Group Ltd/F Pratt Engineering Corporation	22.86	
065/81	F W Woolworth/F R Northcott Ltd	22.0	
072/81	Unigate Ltd/Casa Barita Inc	21.23	
077/81	J Lyons & Co Ltd/Tenco Division of the Cola Cola Gp	22.70	27%

1982

016/82	Johnson Controls Inc/European Controls	21.40	
017/82	Federated Land Ltd/Estate & General Investments PLC	24.84	
022/82	Dundonnin PLC/Planned Savings Life Assurance	23.19	
030/82	Mercantile Credit Co Ltd/Appleyard Gp	21.3	
030/82	Conagra/Country Pride Foods	22.0	
030/82	Wedge International Holdings/Capacitor businesses of the ples.	21.0	
045/82	Security Pacific Corp/Hoare Govett Ltd	25.0	
053/82	St Pauls Co's Inc/Minet Holdings PLC	23.1	
054/82	Anglo-Indonesian Corp PLC/Eva Industries PLC	22.1	
055/82	F J C Lilley PLC/Mallerstang Holdings Ltd	22.6	
056/82	Pioneer Concrete (Holdings) Ltd/Mixconcrete (Holdings) PLC	22.8	
057/82	Tioxide Group Ltd/Titanic SA	21.4	
057/82	Kao Corp/Kao Atlas	22.5	
057/82	Australian Consolidated Ind./Plascoat International Ltd	20.9	
061/82	Skipton Building Society/Otley Building Society	23.5	
064/82	Espley-Tyas Property Group PLC/Howard Tenens Services PLC	23.1	
064/82	Hambro Life Assurance PLC/Dunbar Group PLC	22.0	
072/82	Pergamon Press Ltd/Hollis Bros & Esa PLC	20.80	
074/82	Redland PLC/Boston Industries Corp	22.6	
074/82	Groyewood Securities Ltd/Gresham Investment Trust PLC	20.6	
079/82	Bernard Wardle Gp Ltd/Storeys Industrial Products Ltd	25.0	45%
081/82	Orient Overseas Container (Holdings) Scottish Lion Insurance Co Ltd	24.2	
081/82	Brittania Building Soc/Colne Building Soc	22.2	

014/83		Lin Pac Containers Ltd/Arthur Guinness Sons & Co Ltd	21.6	
017/83	*	Lucas Industries PLC/Certain assets of Smiths Ind PLC	21.1	50%
003/83		Kohler Bros/DRG's South African Subsidiary	23.9	
003/83		Rowntree Mackintosh PLC/Laura Secord	20.1	
003/83		Marley PLC/Hyde Products Ltd	21.9	
012/83		C H Beazer (Holdings) PLC/Second City Properties PLC	25.9	
64/83		Mount Charlotte Investments/Assets of Grand Metropolitan	21.5	

Table 4

Mergers Involving Assets Between £25 and £30 million

Mergers Panel Paper No	Companies	Value Assets Acquired (£m)	Joint Market Share (i over 25%
1981			
002/81	Ferguson Industrial Holdings Ltd/ Gosforth Industrial Holdings Ltd	25.7	
046/81	Arab Asian Bank/United City Merchants Ltd	27.99	
056/81	American Brands Inc/Ofrex Group Ltd	27.4	66%
072/81	Grand Metropolitan Ltd/ Southern Health Services of Kent	25.31	
076/81	Mondi Paper Company Ltd/ Usutu Pulp Company Ltd	27.0	
080/81	Messrs Michael & Graves/ United Engineering Industries	26.7	
	Gasco Investments Ltd/Saint Piran Ltd	27.84	
1982			
003/82	Beaumont Properties Ltd/London Shop Property Trust Ltd	28.71	
008/82	United Biscuits (Holdings) Ltd/ Joseph Terry & Sons Ltd	27.59	31%
035/82	Imperial Chemical Industries PLC/ PVC Business of BP Chemicals Ltd	25.1	45%
045/82	Global Natural Resources/McFarlane Oil	26.6	
049/82	Hays Group Limited/Autobar Group Limited	29.8	
053/82	Allstate Insurance Holdings Ltd/ Federated Insurance Group Ltd	28.8	
054/82	Wolsley-Hughes PLC/Ferguson Enterprises Inc	26.3	
055/82	Warner-Lambert Company/Imed International Corpn	26.3	
058/82	Hanson Trust PLC/United Gas Industries PLC	27.6	
061/82	Tricentrol PLC/Coral Petroleum Development	25.4	
069/82	English China Clays/Watts Blake Bearne PLC	28.7	90%
071/82	Acatos and Hutcheson Limited/ Liverpool Central Oil Ltd	26.7	29%
072/82	Beecham Group PLC/J B Williams Companies	26.8	
073/82	Standard Oil Company /Pfaudler Division of Sybron Corp.	26.9	

Mergers Involving Assets Between £25 and £30 million (cont'd)

Mergers Panel Paper No	Companies	Value Assets Acquired (£m)	Joint Market Share (if over 25%)
075/82	Blue Circle Industries PLC/ Aberthaw and Bristol Channel Portland Cement *	25.7	60%
083/82	Siebe-Gorman Holdings PLC/ The Safety Products Division of Norton Co	27.6	61%
1983			
021/83	Wolverhampton & Dudley Breweries PLC/ Davenports Brewery (Holdings) PLC	27.5	

* DGFT's recommendation for reference rejected.

Table 5

1981

a) ASSETS BETWEEN £30 and £40m

Mergers Panel Paper No	Companies	Value Assets Acquired (£m)	Joint Market Share (if over 25%)
07/81	Argyll Foods Ltd/Oriel Foods Ltd	32.3	
12/81	Avana Group Ltd/Robertson Foods Ltd	38.84	36%
13/81	Anglo-Indonesian Corporation Ltd/ Eva Industries Ltd	31.5	
13/81	Suter Electrical Ltd/Prestcold Holdings Ltd	39.96	
19/81	Charter Consolidated/Alexander Shand (Holdings) Ltd	34.2	
25/81	Trusthouse Forte/The Savoy Hotel Ltd	31.6	50%
32/81	Dunfermline Building Society Ltd/ Edinburgh and Paisley Building Society	37.0	
33/81	Lloyds and Scottish Ltd/Raleigh Industries (Gradual Payment)	39.7	
33/81	SA Sipef/Warren Plantation Holdings Limited	39.3	
58/81	Lloyds and Scottish Ltd/Hamilton Leasing Ltd	34.4	
72/81	McCleod Russel PLC/Warren Plantalion Holdings Ltd	39.3	
72/81	Bremar Holdings Ltd/Bank of Long Island	34.17	
76/81	Burnett and Hallams Hire Holdings/ Anglo International Mining Corporation	35.9	
76/81	Greycoat Estates Ltd/The City Offices Company Limited	31.5	

1982 (assets between £30 and£40m cont)

06/82	IMI Ltd/Cornelius Company	32.0	
07/82	Trafalgar House Ltd/Redpath Dorman Long Ltd	37.6	

Table 6

1981 TO SEPTEMBER 1983 - MERGERS INVOLVING ASSETS BETWEEN £40m and £50m

MP No	Companies	Value Assets Acquired(£m)	Joint market Share(if over 25%)
1981			
1/81	C & J Clark Ltd/K Shoes Ltd	41.4	
8/81	Georgia Pacific Corporation/Inveresk Group Ltd	46.5	
13/81	Caparo Group Ltd/CMT	44.6	
16/81	TKM Foods Ltd/Smedley-HP Foods Ltd	45.4	
33/81	Bowater Corporation/Escor	50	
39/81	Cargill Inc/Assets of Bowater Corp	49.8	
46/81	Multi Purpose Holdings Berhad/ Guthrie Berhad	50	
47/81	United Scientific Holdings/Alvis	45.2	
68/81	Esselte/Letraset	46.6	
70/81	Perlis Plantations Berhad/Assets of Berhad Holdings	49.8	
70/81	Permodalan National Berhad/Assets of Berhad Holdings	49.8	
76/81	Anglo International Mining Corp/Rand London Corporation	49.1	
76/81	RIT Ltd/Esperanza Ltd	40.9	
No panel Paper	Stemash/Coventry Climax	44.7	
1982			
19/82	British Steel Corporation/Round Oak Steel Works	46.1	64%
20/82	Norsk Hydro/assets of Fisons	50.0	
21/82	Enoxy Inc/International Synthetic Rubber	45.5	
23/82	British Aerospace/Sperry Gyrosoope	41.2	
28/82	Cadbury Schweppes/Rio Blanco	45.6	
30/82	European Ferries/Denver Technology Centre	47.5	
42/82	Glynwed International/Ductile Steels	43.9	
73/82	Amalgamated Distilled Products/Barton Brands	41.4	
1983			
22/83	Knoll International Holdings/Sotheby Parke Bernet	45.7	
No panel Paper	Alfred Taubman/Sotheby Parke Bernet	45.7	
55/83	Hawley Group/Security Corporation of America	48.8	

19 (cont)

Mergers Panel Paper No		Companies	Value Assets Acquired (£m)	Joint Market Share (if over 25%)
09/82		Sejati Motors SDN BHD/ certain assets of Inchcape Berhad	31.0	
16/82		Cadbury Schweppes Ltd/Duffy-Mott Company Inc	37.7	
16/82		Sketchley PLC/Means Service Inc	37.08	
22/82		Saatchi and Saatchi Co Ltd/Compton Communications Inc	38.8	
22/82		John D Hollingsworth/Assets of Stone Platt	40.0	
25/82		British Steel Corporation Pension Funds/Federated Land PLC	37.13	
25/82		MP Kent PLC/Federated Land PLC	37.13	
25/82		Queens Moat Houses PLC/County Hotels	35.2	
26/82		Northern Foods PLC/Avana Group PLC 20.5%	30.1	
40/82		Bunzl PLC/Bemrose Corporation PLC	34.51	
44/82		INA Merger Corporation and North American General Company/Insurance Company of North America	36.14	
00/00	C	Initial PLC/Johnson Group Cleaners PLC*	34.2	55%
48/82		Norsk Hydro AS/BIP Vinyls Limited	34.92	
52/82		Sunlight Services Group PLC/Johnson Group Cleaners PLC*	34.2	36%
57/82		Imperial Chemical Industries PLC/ Products Chemiques Ugine Kuhlmann	36.6	
61/82		Barclays Bank International Ltd/ Commercial Banking Company Ltd	34.8	
64/82		Plate Glass and Shatterprufe IND/ Doulton Glass Industries (Holdings)	31.9	
74/82		BOC Group PLC/Glasrock Medical Services Corporation	30.8	
74/82		The Plessey Company PLC/Strongberg Carlson	33.0	

* Referred to MMC: adverse finding.

1983 Assets between £30 and £40m

03/83	Duracell/Assets of Ever Ready	37.0	
07/83	Beecham Group/DAP Inc	33.0	
18/83	Booker McConnell/IBEC Inc	38.9	
34/83	Caparo Ltd/Barton Group PLC	30.3	
37/83	Norton Opax/John Waddington PLC	30.7	25%
40/83	ESAB AB/Assets of BOC Group PLC	34.0	37%
43a/83	British Printing and Communications Corporation PLC (BPCC)/John Waddington PLC (Waddington)	30.4	
62/83	Pritchard Services Group PLC/Spring Grove PLC	37.3	
62/83	Sunlight Services Group PLC/Spring Grove PLC	37.3	28%
64/83	Simon Engineering PLC/Drake and Scull Holdings PLC	39.5	

CONFIDENTIAL GUIDANCE

1. The Office of Fair Trading gives confidential guidance to a company contemplating a merger who approaches the Office for a view as to whether or not it is likely to be referred. Guidance is sought in just over a tenth of all qualifying merger cases: in three-quarters of the cases where it is sought, clear guidance is given as to whether or not a reference is likely. In the remaining quarter, guidance is withheld because a proposal is not public and its likely effects are difficult to guage. Statistics for confidential guidance (1979-1983) are in the attached table. The terms in which it is given are also appended.

2. It is noteworthy that guidance, oncegiven, has never been overturned by the subsequent decision at the reference stage. It is therefore viewed as a strong indicator of the authorities' views.

3. Although increased use of the confidential might help individual companies, it does not necessarily follow that an extension of the use of confidential guidance, and a refinement of the types of guidance, will remove or materially diminish the number of complaints about the unpredictability of merger control as a whole. A major cause of this criticism is the difficulty of seeing a"pattern" in reference and non-reference decisions. Differences of treatment of apparently similar cases can arise because of the various financial circumstances of some companies, or the Government's commitment to certain industrial restructuring prosposals. Factors such as these cannot conveniently be explained publicly or in confidential guidance.Because of these and other variations in circumstances, there will always be an element of apparent inconsistency in reference decisions when they are examined comparatively. Moreover, confidential guidance can never be of help to the market generally before the public announcement of a decision on reference. The parties receiving it can be reasonably confident of their own position, but, after they announce their proposal, interested third parties - shareholders, competitors, customers, suppliers, potential counterbidders etc - remain just as uncertain about the Secretary of State's eventual decisions as they would be if no guidance had been given. In short, the benefits of guidance accrue only to the parties receiving it and an extension of the practice will do little to make the overall logic of the mergers control system more transparent.

4. There are also inherent problems about giving confidential guidance. The information and range of views avialable to the Director General and the Secretary of State are far narrower than in the case of a publicly known merger. There is also the possibility of a subsequent change in the circumstances which could bear on the decision. With greater use of guidance the Secretary of State's actual decision on the announced merger proposal could come to be regarded as no more than a formality.

He might then find it embarrassing to have to deal with representations from Members of Parliament, trade unions and other third parties which assume that the decision is genuinely open when in practice (short of a radical change of circumstances) it has already been taken. Confidentiality has on the whole been well preserved, but there could well have been complaints if it had been generally known that the parties in some recent high profile mergers had obtained favourable guidance before they made their plans public.

5. Any such embarrassment would be political, and is not a reason for urging a more cautious policy than has been followed in the past. Indeed, in borderline cases it might be possible to be rather more forthcoming than in the past. On a few occasions confidential guidance has been withheld from an applicant not because of any genuine belief that a full-scale reference to the MMC was a serious likelihood but because the merger entailed a substantial reduction of competition and there was reluctance to give it what might be regarded as the stamp of official approval. Here the approach should rather be one of giving favourable guidance in cases where there is no reason on present information to propose a reference, or to expect that the public announcement of the merger proposal will evoke further relevant information. Unfavourable guidance should be given where reference seems more likely than not. "No guidance" should be an indication that further information is needed before the Secretary of State can make a decision.

6. These three possible outcomes in principle cover all the likely circumstances that confron the competition authorities. But they can be too bald to give maximum help to parties to a merger, particularly in the cases where the decision on the guidance to be given is finely balanced. We have accordingly considered means of improving confidential guidance, so that confidential guidance, while remaining in a standard form of phraseology, should be more closely attuned to the circumstances of a particular case. This would mean that, instead of the present three forms of confidential guidance (favourable, unfavourable, or guidance withheld), there might be five graded forms of guidance,

(a) Unfavourable

(b) Probably unfavourable, subject to assessment when the merger becomes public

(c) Guidance withheld

(d) Probably favourable, subject to assessment when the merger becomes public

(e) Favourable

7. The argument in favour of such a scheme is that it ought to reduce the number of cases in which guidance is simply withheld, thus giving industry a more exact idea of the Secretary of State's likely attitude to a reference, so far as it could be predicted.

8. There are however cogent counter-arguments that the three present basic types of guidance are sufficient, and that industry will be unlikely to be helped by more finely-graded nuances, particularly when account is taken of the need to retain the key proviso that the Secretary of State might take a different view if additiona information coming to light later pointed that way. Only by droppin that proviso could the guidance become more helpful. But the consequences of that would be:

(i) if the Secretary of State were later to take a different view that could give rise to unfavourable publicity which would be damaging to the system;

(ii) a commitment (to eventual clearance or reference of the case) would make a charade of any later consideration of representations following announcement of the proposal;

(iii) where definitely favourable guidance had been given, the companies could consummate the merger before a public announcement, and the likely difficulty of separating them could itself become an argument against reference.

9. The room for manoeuvre is not great. Perhaps the greatest area of difficulty currently arises where guidance is simply withheld, since this is conspicuously unhelpful to the companies concerned. One possibility would be to adopt a policy of never withholding guidance, instead relying on the alternatives at (b) and (d) above, on the view that, if the view given had later to be changed, the dangers would be minimal if good reasons were given. Against this, it has to be said that such a procedure might sharply increase the probabilities of guidance being overturned because the Secretary of State would be denying himself the opportunity to reserve judgement in the small core of cases of serious doubt.

10. All in all, it seems best to retain the present three forms of guidance (favourable/unfavourable/withheld). But the unhelpfulness of withholding guidance should be recognised and every attempt should be made to reduce to a minimum the number of cases in which it is withheld. This slight shift of emphasis, together with increased recourse to the confidential guidance procedure, should produce a small but useful move towards helping companies contemplating merger.

FORMS OF CONFIDENTIAL GUIDANCE

Confidential Guidance by OFT at present takes three forms, contained in a letter to the applicant:

(a) Favourable Guidance (that a merger is unlikely to be referred):

"As you will understand, while a proposed merger remains confidential, we cannot be sure that we know enough about it to ask the Secretary of State to make a final decision. In particular, we cannot take account of the views of those other than the parties involved who may have an interest in the proposal. We cannot, therefore, express a formal view on the question of reference to the MMC at this stage. However, I can tell you that, on the information at present available, it seems unlikely that the Secretary of State would want to refer the transaction to the Commission for investigation. I am able to tell you this only on the understanding that the information remains strictly confidential to the parties and their advisers.

"After the proposal has been announced we shall allow about three weeks to enable representations to be made. If any new factors emerge which we believe would be of interest to the Secretary of State we shall invite you to comment on them before the Director General's final recommendation goes forward. Otherwise we shall seek confirmation that the Secretary of State does not intend to make any reference in this case."

Notes

(i) The Takeover Panel have suggested that favourable guidance should be qualified by a statement to the effect that the guidance would cease to be valid if a second bidder were to come forward, and that this should become a standard part of guidance in future. OFT are considering this.

(ii) Occasionally the final sentence is omitted when OFT have wished to be a shade less encouraging.

(b) Unfavourable Guidance (that a merger is likely to be referred):

"As you know, it is not the practice of the Secretary of State to make a final decision about reference to the MMC of a proposed merger while the proposal remains confidential. We cannot therefore express a formal view on the question of reference at this stage. I can however tell you that, on the information at present available, the Secretary of State would be likely to wish to refer the transaction to the Commission for investigation."

Notes

OFT intend to add a reminder about confidentiality similar to that used now in favourable guidance.

(c) Guidance Withheld:

"We have examined this proposal carefully, and I am sorry to have to tell you that we are unable to give confidential guidance on the question of reference to the MMC. This does not mean that a reference is more likely than not. It means only that, without being able to assess the reactions of customers, competitors and others who may have an interest, the Secretary of State is not prepared to authorise us to predict what his decision will be."

CONFIDENTIAL

ANNEX 5: TABLE

REQUESTS FOR CONFIDENTIAL GUIDANCE AND OUTCOME

	Requests	Response			Zage Guidance
	Dealt with	Unlikely to refer	Likely to refer	No guid.	(Cols 2 & 3)
1979	28	19	2	7	75
1980	18	16	2	-	100
1981	18	11	2	5	72
1982	29	21	-	8	72
1983 (to date)	16	11	1	4	75
Total	109	78	7	24	78

October 1983

Annex 6

CONFIDENTIAL

CONGLOMERACY & CONGLOMERATE MERGERS

The Department has undertaken a good deal of work on conglomeracy, in the context of mergers policy. No clear conclusions emerge: but there are some arguments for greater disaggreation of accounts.

Conglomeracy in UK Industry

2. Particular attention was given to discernible patterns within conglomeracy, and their lessons for competition. A paper was completed in mid-1982. This shows that few firm statements can be made about conglomeracy in a competition policy context. Conventional analysis points neither to clear advantages springing from conglomerate organisation nor to evident detriments. There is very little by way of clear-cut empirical evidence on the perform ance of conglomerates or on any abuses of the power which a big conglomerate enjoys. Moreover, there is nothing to answer the specific question whether "concentric" (or "narrow spectrum") conglomerates tend to prove more successful than "pure" (or "wide spectrum") conglomerates.

3. Recently the conventional analysis of conglomerates has been supplemented by enquiries centering on management structure and organisation, and on the way in which these inter-relate with conglomerate policies and performance. As a result the consideratio of conglomeracy has put increased stress on matters such as the efficiency with which a conglomerate allocates funds to its various activities. However, it seems fair to say that whilst there may be a better appreciation of the range of issues to be examined, there is little progress in the assessment of the strengths and weaknesses of conglomeracy. There is clearly need for further research, difficult though it would be. In addition the experience of other countries as well as inquiries by UK competition authoritie in merger cases and in the course of monopoly and Competition Act investigations should throw light on the issues. However, it seems unlikely that progress towards the evolution of clear cut criteria and policy guidelines which reflect economic factors and experience will be at all rapid.

4. If this leaves a feeling of uncertainly and indeed impotenc it is perhaps salutary to remember that much the same situation - signposts blurred by weak and ambiguous evidence - applies also in the assessment of the structure of industry generally and the way this affects the behaviour and performance of business. It is probably fair to say that much of British industry now operate under conditions of oligopoly and that there is a general impression that oligopolists too often opt for a quiet life. However, these impreoise notions are no guide to action.

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Demergers

5. There remains the question what, if any, specific policy initiatives might be taken with regard to conglomerates. There are two specific issues. The first relates to demergers. If conglomerates (or, for that matter, other large companies) consider that a slimming down of the organisation would on balance be advantageous by, say "hiving-off" one or more of its businesses or operations, it is desirable that they should not be discouraged from doing so by fiscal considerations or institutional factors. The Companies Act 1981 contained relevant provisions, as did the Finance Act 1982. There is little evidence of the need for further action at present.

Disaggregation of Accounts

6. Secondly, there is the question of the extent to which a conglomerate should be required to publish information about the performance of its constituent parts, and the degree to which firms contemplating entry into one or other of the markets in which the conglomerate operates are handicapped in their assessment of the opportunities open to them.

7. In its merger report on Blue Circle/Armitage Shanks (1980) the MMC commenting on the general treatment of disclosure of information in conglomerate merger viewed the availablity of information about performance and financial position of a company as being very important in determining the competitive situation in which it operates. Any loss of information resulting from a merger wuold have several adverse effects: the reduction in publicly available knowledge relevant to the evaluation of the behaviour of the market and its constituent parts would make more difficult if not impossible any comparisons between the acquired company's performance and its competitor's, and knowledge of the comparative success of failure of parts of the group. The MMC saw this loss of information as impairing the working of the markets and proposed that the present legal requirements should be strengthened in two respects -

(a) by replacing the directors' discretion to determine the basis for disaggregation with objective definition of classes eg by reference to the Standard Industrial Classificati (SIC), at least 3-digit level

(b) by requiring additionally an analysis of capital employed.

8. The MMC gave prominence to this matter as an issue in conglomerate mergers but in principle it applies equally to a company which has diversified through internal growth. The wider argument on disclosue on competition policy grounds runs as follows.

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Market entry opportunities are harder to identify because with the emergence and growth of large diversified companies the publishe profit figures which had been obtainable in the annual reports of smaller specialist firms have been obscured in aggregate accounts In these markets entry becomes more hazardous for the newcomer and the competitive process is thereby impeded. The reduction in profit data through diversification and aggregation of accounts makes it harder for competition authorities to identify situations in which intervention should beconsidered.

9. The information issue is about the degree of disaggregation in published company accounts and the extent to which magagerial discretion should be permitted in the identification of different classes of business. The information disclosed by many widely diversified companies in their accounts appears to be of limited value from the competition point of view.

Research on Disaggregation

10. Some empirical assessment was considered essential both to test the validity of the view that the information available is adequate and also to ascertain whether a reasonable extension of disclosure would remedy the situation to a substantial degree.

11. The latest annual reports and accounts of 20 major UK conglomerates and 10 of the largest UK non-conglomerate companies were analysed by DTI economists. Their research showed that all of the companies published turnover and pre-tax profit figures in some degree of disaggregation. Virtually 80% of published accounting segments for conglomerates (75% for non-conglomerates) could be classified under the SIC no more precisely than divisional level which is a very broad grouping (the whole economy is encompassed in 10 divisions). The only information typically available at a level relevant to competition issues (SIC activity or group) is the name of the product range or servies with no figures whatever The information problem was found not to be particular to congomerates; it is a function of diversification of which conglomeracy is the most extended form. Only 6 of the 30 companies provided information on capital employed.

12. Work has also been done on the US disclosure rules. These differ from those of the UK in a number of respects and it appeared that they might represent a half-way house between leaving it to directors' discretion to identify reporting segments and requirin companies to disaggregate using the SIC. This is mainly because ofterminology; the Companies Act refers to "classes of business" whereas US regulations are written in terms of "industry segments". It was accordingly decided to embark on a small exercise designed to indicate whether the US disclosure requirements do lead to disaggregation more relevant to competition policy (nearer to markets) than our own. The results suggest - one could

say no more on the basis of such a small sample - that disclosure in the United States is no more helpful to competition policy than disclosure in this country.

Assessment

13. There is already a degree of disaggregation in company accounts but in the study by our economists of a sample of 30 large conglomerates/non-conglomerate companies the figures being published under the provisions of the Companies Act related typically to groupings of activities too diverse to make a significant contribution to the flow of information necessary to sustain competitive forces in the market. The introduction of greater objectivity and definition in the application of existing requirements by requiring business segments to be defined in SIC terms could therefore provide a useful competition policy tool. The differences between the amount of information provided by the conglomerates and non-conglomerates was found to be only one of degree.

14. Any decision to introduce a requirement to publish at SIC activity or group level (as proposed by the MMC) would involve the companies affected in a large increase in the number of categori disclosed and an internal reorganisation of data to put their accounting categories on an SIC basis. It would be purely coincidental if the divisional organisation were to coincide with the SIC structure. Almost certainly, any attempt by statute to produce strict comparability in published accounts via the SIC could involve most affected companies in setting up two parallel internal accounting systems - a very costly process and one which would not be likely to be conducive to efficiency.

15. Industry would certainly be hostile to such a degree of disclosu and would complain about the cost in compiling the figures and paying for audit and about the loss of confidentiality to competitors particularly from abroad where no such requirements were imposed. It is not possible to assess what the compliance costs would be to companies. Some companies already provide more information than required, others only the barest minimum.

16. The Government's overall stance to company accounting and reporting has hitherto been to impose minimum new burdens on companies and provide maximum flexibility to directors and the accounting profession to develop appropriate accounting practices. The law has been viewed as providing merely the framework for company accounts and directors reports; the flesh by way of greater elaboration or of detailed guidance on how statutory requirements might be implemented comes from non-statutory accounting standards.

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17. While it might be possible to justify on competition policy grounds the introduction of additional accounting requirements, in the company law context such action would be viewed as an about-turn from the stance taken during the passage of the Companies Acts 1980 and 1981. New proposals would be viewed as controversial - adding the requirement for capital employed would be fairly straightforward, but much more difficult would be the devising of any objective criteria for determining segments and allocating resources - and likely to be seen by companies as untimely as they get to grips with the new regime flowing from the 1981 Act.

Conclusion

18. The UK level of aggregate concentration continues at a relatively high level with at least half the increase in a concentration being attributable to mergers or takeovers. Some of these mergers have brought together unrelated lines of business and have created conglomerate companies, of which the UK economy has a large number.

19. The introduction of greater objectivity and definition in the application of existing requirements by requiring business segments to be defined in SIC terms could provide a useful tool in the context of competition policy. But it is difficult to make a full assessment in advance. There would certainly be some benefits but these would be balanced by costs.

20. The decision on whether to proceed to disaggregated accounting is essentially a judgement of the comparative merits of obtaining greater information to ensure the competitive process works more efficiently and of imposing greater burdens on business in order to do so. If a decision were taken to proceed, a consultative document would probably need to be issued.

DEPARTMENT OF TRADE AND INDUSTRY
22 November 1983

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FILE

10 DOWNING STREET

From the Private Secretary

5 July, 1983

MONOPOLIES AND MERGERS

The Prime Minister would be grateful if your Secretary of State would bring forward a paper to colleagues on the framework within which the Monopolies and Mergers Commission works at present, and the criteria against which mergers and monopolies are deemed objectionable or otherwise.

It is the Prime Minister's impression that the present arrangements allow too much room for personal and political judgements on the part of the Monopolies Commission. Mrs. Thatcher wonders whether the "public interest" criterion could and should be dispensed with, so that the Commission would concern itself solely with competition matters (togetner, perhaps, with an interest in the effect of a merger on Britain's overseas trade). The Prime Minister, too, would be grateful for an analysis of whether, if the area of intervention were cut down in this way, the role of the Director General of Fair Trading should also be reduced.

M. C. SCHOLAR

J. Spencer, Esq.,
Department of Trade and Industry

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10 DOWNING STREET

PRIME MINISTER

MONOPOLIES AND MERGERS

In the light of your comments on Arthur Cockfield's minute (attached), does the attached draft letter to Cecil Parkinson's Office set them off on their review of monopolies and mergers policy in the direction, and in the way, you wish?

MCS

4 July, 1983

GR
Pl type f.m.s.

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MCS 5/7

DRAFT LETTER TO J. SPENCER, DTI FROM M. SCHOLAR

MONOPOLIES AND MERGERS

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CC. PW

CHANCELLOR OF THE DUCHY OF LANCASTER

Prime Minister (1)

If you will tick the views to which you are sympathetic, I will prepare a draft letter for your approval, which would invite Mr Parkinson's views on this subject and at the same time indicate your initial ideas about it.

MLS 1/7

SECRET AND PERSONAL

PRIME MINISTER

MONOPOLIES AND MERGERS

1. Most of this relates to Mergers because that is the field which has given rise to most of the trouble. But much of what is said is equally applicable to Monopolies.

2. There are two principal areas to be considered -

   1. The criteria
   2. The procedures

The Criteria

3. The sole criterion for mergers and monopolies laid down in the present Acts is the "public interest". The 1973 Act tried to define this more precisely by laying down for mergers five tests - four of these related to competition, the remaining one to location of industry and employment. But these were simply specified as examples of the "public interest". While they may have been intended to limit the scope of the "public interest" neither in law nor in fact have they done so.

4. The "public interest" is wholly unsatisfactory as a test. It is subjective: often a highly political judgment: a cloak for what at times is little more than personal prejudice.

5. It is always argued that you cannot define "the public interest". The argument is irrelevant. You need not define the "public interest" because the test ought not to be the "public interest". Instead of being vague and wide: it should be narrow and specific. The law forbids you to steal: to receive stolen property: and so forth. It does not forbid you to handle another's property in a way that is contrary to "the public interest". Nearly all the highly contentious decisions in this field - for example the Royal Bank of Scotland and the Lonrho/House of Fraser case - have arisen out of personal views of members of the Monopolies Commission reflecting what they liked and what they disliked. A test of "the national interest" not only invites this sort of judgment, it is arguable that the law compels it.

6. We need to list those things we don't like, want to stop and are prepared publicly to defend stopping. There are in my view only three such -

   ✓ 1. Seriously adverse effects on competition - this is what "monopoly" is supposed to be about.

2. Seriously adverse effects on employment. – in short-run in long run? These two are often contradictory

✓ 3. Seriously adverse effects on our overseas trade.

7. We should specify these in the law: these and no others. The function of the Monopolies Commission would simply be to find the facts: say whether the merger offended the criteria. If it did that would be the end of it. The element of judgment in such an approach is very limited. Consequently the area of dispute once the verdict was delivered would be equally limited.

The Procedures

8. There are three "bodies" involved: the Secretary of State, the Director General of Fair Trading, and the Monopolies Commission. In law the Director General stands merely in an advisory position - both on references to and reports from the Monopolies Commission. Over the years however he has manoeuvred himself into pole position: the Secretary of State merely being regarded as the custodian of the rubber stamp. If we redefined the criteria in the way suggested it ✓ would, by reducing the area of intervention, also cut down the role of the Director General.

9. There is a lot to be said for cutting down the role of the Secretary of State as well. The present situation under which in law he has not only the right but the duty to take the decisions is not sustainable and is not desirable. Mergers have now become so contentious and so bitterly fought that the pressures on the Secretary of State are not tolerable: and the law is such that the protagonists can and do now carry their battles into the Courts and onto the floor of the House of Commons. The only escape from this situation is to ensure that the system is largely automatic in operation and that the right - or duty - of the Secretary of State to intervene is narrowly circumscribed.

10. What I have in mind therefore is that a decision to refer (or not to refer) should be taken by the Director General without any right of appeal to the Secretary of State. With the criteria strictly defined in the Act, the Director General would be amenable to action in the Courts if he stepped out of line.

Doubtful

Doubt whether we could define them tightly enough.

11. Similarly when the Monopolies Commission reported, that would normally be the end of the matter. Subject to one reservation, neither the Director General nor the Secretary of State would come into the matter at all. In effect one would be elevating the Monopolies Commission to the position of a Court of law. It would be delivering judgment and that would be the end of the matter unless the parties appealed. On this analogy, provision would be made for a right of appeal to the Secretary of State. Here the Secretary of State would be acting in a judicial capacity and the right of appeal would relate only to the question whether on the facts the Monopolies Commission had come to the right decision on the basis of the criteria laid down in the Act. Circumscribed in this way, one would expect the right of appeal to be exercised only rarely: and very rarely to succeed.

Doubtful

It is not a Court of Appeal.

12. I had set in train work on these lines while I was at the Department.

13. There is one further observation I would make. The mergers legislation is of comparatively recent origin. It dates back only to the Wilson era. I seriously wonder whether we really need it at all. The Industry Act contains a parallel power to prevent a foreign takeover of a UK company. It is arguable, now that Exchange Control has gone, that the Treasury should have similar powers in relation to Banks. Subject to this I really do wonder whether we need the Mergers legislation at all.

14. This in turn leads to a further observation. The Office of Fair Trading is - or soon will be - the sole remaining relic of the Great Bureaucracy created by the Heath Government. I seriously doubt whether it still serves any useful purpose.

15. Both these points I put to Sir Anthony Rawlinson in my last few weeks at Trade. I have no doubt he is pursuing them.

A.C.

COCKFIELD

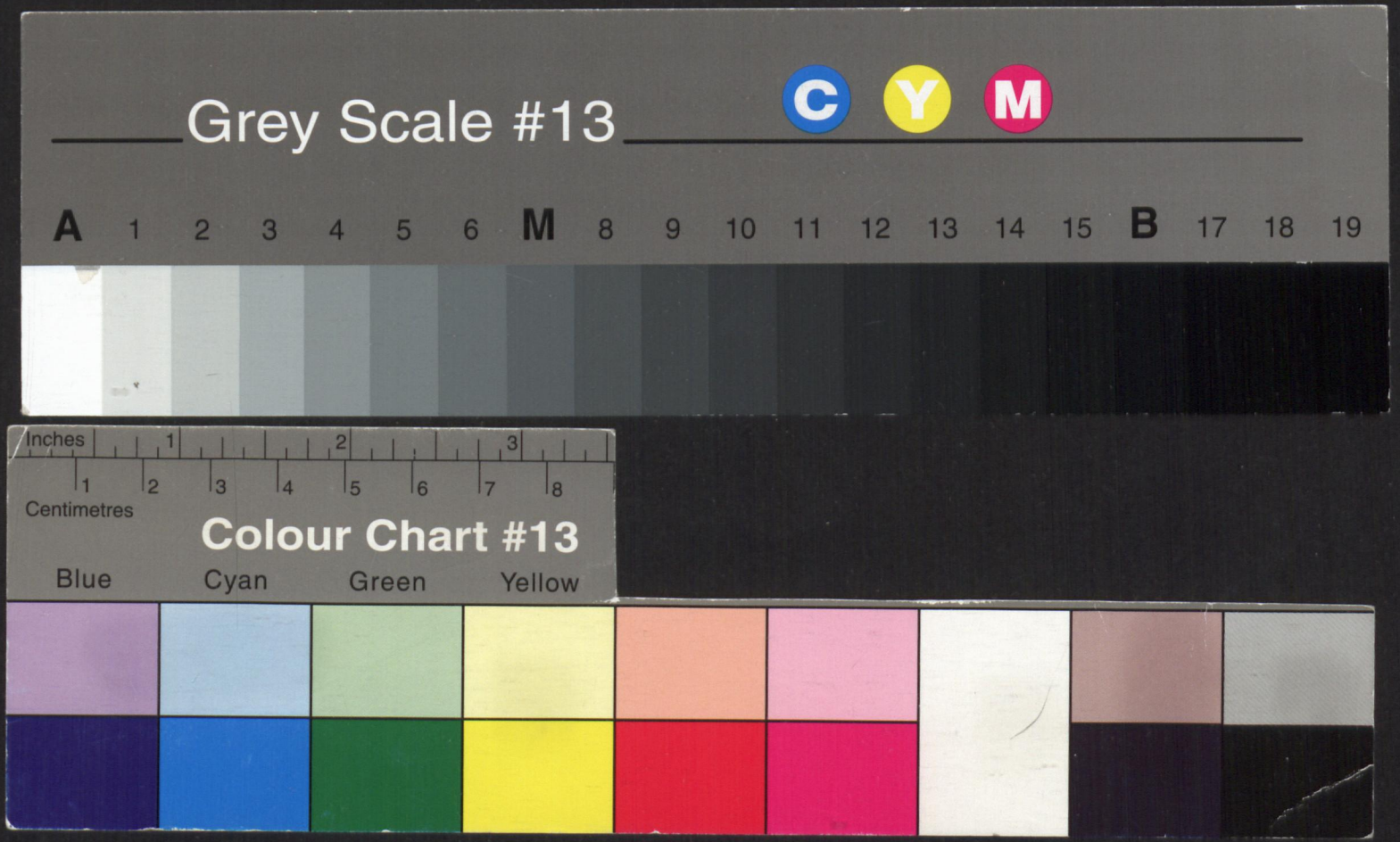
1 July 1983

PRIME MINISTER

The Monopolies and Mergers Commission

David Wolfson has been asking me what changes the DTI are proposing in the framework within which the Monopolies and Mergers Commission are currently operating. I know that you have been very dissatisfied with recent developments on this front, and wondered whether you would like me to enquire what Cecil Parkinson has in mind. Would it be a good idea to ask Lord Cockfield whether he would let you have an entirely personal note on what changes he thinks ought to be made?

30 June 1983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