PREM 19/2703

PART 3

BOX 459 MI

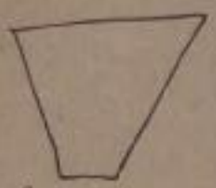
CONFIDENTIAL FILING

Monopolies and Mergers

GOVERNMENT MACHINERY

PT1: June 1983

PT3 March 1988

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
7.3.88		19.12.88					
21.3.88		12.1.89					
29.4.88		17.1.89					
5.5.88		21.2.89					
12.5.88		28.2.89					
16.5.88		28.2.89					
19.5.88		28.2.89					
20.5.88							
7.6.88							
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9.9.88							
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30.11.88							
8.12.88							
12.12.88							

PREM 19/2703

PART 3 ends:-

MAFF & DTI 28.2.89

PART 4 begins:-

DTI Press Notice 8.3.89

CCPU.

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

NKPM
PRG
1/3

Mr Neil Thornton
Principal Private Secretary to the
Secretary of State for Trade and Industry
Department of Trade & Industry
1-19 Victoria Street
LONDON
SW1H OET

28 February 1989

Dear Neil.

MONOPOLY REPORT ON THE SUPPLY OF BEER IN THE UNITED KINGDOM

Thank you for your letter of 21 February.

As you say, the recent report by the MMC on the beer industry is highly sensitive, and in the period between now and the publication of the Government's response to it, we will of course deal with any queries in the way you have suggested. I should add that the nature of the report and its recommendations are such that my Minister will certainly wish to discuss them with your Secretary of State in due course, once he has had a chance to digest properly the very full analysis which it provides and before decisions are taken.

I am copying this to the Private Secretaries to all Cabinet Ministers and to Trevor Woolley (Cabinet Office).

Sincerely

SHIRLEY STAGG (MRS)
Principal Private Secretary

GONTMACH: Monopolies + Mergers Pts

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Ms Shirley Stagg
PS/to the Secretary of State
for Agriculture, Fisheries and Food
Whitehall Place
LONDON
SW1A 2HG

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard
01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref MM2ACW
Your ref
Date 21 February 1989

Dear Shirley.

MONOPOLY REPORT ON THE SUPPLY OF BEER IN THE UNITED KINGDOM

You will no doubt be aware that the MMC has recent submitted to my Secretary of State their Monopoly Report on the beer industry.

This report is politically most sensitive, especially as the brewers appear to have mounted a publicity campaign to secure public - and, of course, Ministers' - support for the industry as it is now structured. In particular, a brochure 'The Brewing Industry - a Special Report' is being widely distributed. It would be helpful if in any reply your Minister were to make, he were to refrain from making any comment that might be interpreted as support for the status quo. In reply, it might suffice to say:

> "As you will know, the Government are considering the Monopolies and Mergers Commission's report on the supply of beer. You will understand that it would not be appropriate for Ministers to comment on areas which may relate to the report until it is published and the Secretary of State for Trade and Industry has announced his response to it."

I am copying this to the Private Secretaries to all Cabinet Ministers with a request that they advise others as

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the department for Enterprise

necessary in their departments of the sensitivity involved. A copy goes also to Trevor Woolley (Cabinet Office).

Yours ever,

Neil

NEIL THORNTON
Principal Private Secretary

the Enterprise initiative

Prime Minister (3) cap 4
To note
AT 17/1

dti
the department for Enterprise

Sir Brian Hayes GCB
Permanent Secretary

Andrew Turnbull Esq
Principal Private Secretary
to the Prime Minister
10 Downing Street
Whitehall
LONDON SW1

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

MF

Direct line 215 4439
Our ref
Your ref
Date 17 January 1989

Dear Andrew,

MERGERS

When we spoke last week about mergers I explained that the Secretary of State for Trade and Industry has statutory functions in relation to mergers which only he can exercise. I thought that it might be helpful if I described the background in a little more detail, so that if either you or I receive further enquiries on the subject an authoritative letter setting out the position would be available. This letter has accordingly been drafted in consultation with our Solicitor.

There are two key points. First, under the legislation the decision whether or not a particular merger should be referred to the Monopolies and Mergers Commission for investigation must be my Secretary of State's, and his alone.

The second point concerns the role of the Director General of Fair Trading. The statute prescribes that he should keep himself informed of mergers, and should make recommendations to the Secretary of State on what action should be taken - which means essentially whether or not the merger should be referred to the Monopolies and Mergers Commission. In practice, this means that the Director General is the Secretary of State's key adviser on mergers. The Secretary of State would almost certainly face an application for judicial review were he to take a reference decision without

having received the Director General's advice. In addition, successive Secretaries of State have stressed the weight which they place on this advice, by saying that they would normally expect to follow it. Practice has been very much in line with this; over the last four years there have been over a thousand qualifying mergers but in only three cases has the Director General's advice been overturned. Lord Young himself has never yet gone against Sir Gordon Borrie's recommendations.

The Director General can be expected to consult all the principal parties to a proposed merger. He will have discussions with them and their representatives and a range of other parties likely to be affected by the merger proposal - for instance, principal customers - but any one who wishes to make submissions to him will be free to do so. In addition, any difficult and/or controversial cases will be discussed in the Mergers Panel before the Director General advises the Secretary of State. All interested departments are normally represented on the Mergers Panel. This body thus constitutes, and is generally acknowledged to constitute, the channel whereby the Secretary of State's colleagues express their views on a particular merger.

The Secretary of State himself may also receive material representations on the issues raised, including representations from Cabinet colleagues. It is his invariable practice to pass on such representations to the Director General so that the Director General can consider all points before he tenders his advice. It would not be legally safe for the Secretary of State to take his decision - after he has received the Director General's recommendations - if he had been in possession of relevant information which had not been available to the Director General when the Director General framed his advice.

The Director General's submission, especially in a complex and controversial case, will constitute a full statement of the case; it always summarises the views which departments have put forward at the Mergers Panel. The Secretary of State, when taking his decision, will therefore know the views expressed by colleagues, even if they have not approached him personally.

It has always been accepted (and it has been recently confirmed by the Law Officers) that, once Lord Young has received the Director General's advice, it would be dangerous for him to solicit or be sent additional material from colleagues. Again, with judicial review particularly in mind, he might have to refer such material to the Director General, who might feel obliged to undertake a further round of consultations before offering advice again. Inordinate delay (which could impinge on the City Code

Since it could be held that the DG did not all be material information

dti

the department for Enterprise

timetable), confusion and unnecessary expense could result. The only safe procedure therefore is for the Departments concerned to express their views and submit papers to the Director General while he is pursuing his research and before he tenders his advice to the Secretary of State.

I hope that this sets out the position clearly. There is an obligation to comply with the statutory provisions. There is also a need to observe all the proper procedures in order to reduce the risk of a successful application for judicial review against the Secretary of State. With such large sums of money at stake companies involved in takeover bids naturally adopt every possible means of achieving their objectives, and recourse to judicial review is becoming increasingly common. We want to minimise our chances of losing!

I am sending a copy of this letter to Robin Butler.

Yours ever,

Brian

BRIAN HAYES

PROFESSOR GRIFFITHS

TAKEOVERS AND MERGERS: ROLE OF POLICY UNIT

After our discussion I spoke, as promised, to George Guise. In the light of that I identified two advantages and one disadvantage from Policy Unit membership of the Director General's Panel. First, by taking part in the consideration of individual cases, the Policy Unit see competition policy at work and are thereby better able to comment on general competition issues. To an extent this could be achieved by receiving the papers but the benefit would not be as great as attending the meetings.

Secondly, there is a benefit to the Director General in having advice from the Policy Unit who are somewhat outside the normal departmental positions.

The disadvantage is that the Prime Minister has made it clear that she does not become involved in the consideration of individual takeover cases; indeed to do so would be inconsistent with the legislation. Whether official, socially or in the course of charity she frequently comes across most of the players likely to be involved in takeovers of major British companies. Despite the line she takes, such people persist in trying to influence her, and do so no matter what the nature of the gathering. These takeovers are often bitterly fought, and losers do not do so gracefully. They are not above complaining about the manner in which they lost or even above going to Court. In the process, allegations about the Prime Minister's involvement can easily be made.

In these circumstances, it is essential that the Prime Minister's non-involvement is not only actual but is perceived as well. If the Policy Unit ceases to attend meetings of a Panel, she would be able to give that assurance without any qualification whatsoever. The difficulty is that someone may seek to misconstrue the Policy Unit's role and try to argue

that she had used her influence thorugh the back door. There may be no substance in this but the accusation could be made.

At your suggestion, I spoke to Sir Gordon Borrie about the value he saw in Policy Unit participation in the Panel. He said he was pleased to have a representative of the Policy Unit; they often brought a wider outlook and the people involved were often able to draw on wider experience. He would regret losing this.

I also sought his view on where the balance of advantage lay. He took the view that people attending the Panel did so in a personal capacity at his invitation, and were there to assist him. The Panel was not a decision-making body, and no votes were taken. He felt that the Policy Unit's role was consistant with the legislative framework, though he acknowledged that, in a highly charged dispute, that might not be fully believed.

In view of this, I decided to put the matter to the Prime Minister. I said that, as regards substance, I was satisfied that there was nothing improper in the Policy Unit's role. The issue for her was how much importance she attached to having that last degree of protection which comes from being able to say, without qualification, that neither she nor No. 10 are involved. I therefore asked her whether she was content to allow the Policy Unit to continue attending the Mergers Panel, or whether she wished them to withdraw, receiving only the papers.

Her response was that she would much rather that the Policy Unit were not involved. In the light of this I must ask you to disengage.

ANDREW TURNBULL

12 January 1989

PRIME MINISTER

TAKEOVERS AND MERGERS: ROLE OF POLICY UNIT

Before he left, Nigel took up with Brian Griffiths the role of the Policy Unit in the process of considering takeovers and mergers. For some time now, someone from the Policy Unit has attended the Director General's Panel. This comprises representatives from a number of Whitehall Departments. Through it, the Director General gathers together views and information to enable him to make recommendations on MMC referrals to the Secretary of State.

The attendance of someone from the Policy Unit (currently usually George Guise) has two advantages and one disadvantage.

First, by taking part in the consideration of individual cases, the Policy Unit see competition policy at work, and are thereby better able to comment on general competition policy questions. To a degree, this could be achieved by receiving the papers instead of attending the meetings.

Secondly, there is a benefit to the Director General in having advice from the Policy Unit who are somewhat outside the normal Departmental position. I consulted Sir Gordon Borrie about the importance he attached to this. He said he was pleased to have a representative of the Policy Unit. They often brought a wider outlook, and the people involved were often able to draw on wider experience.

The disadvantage is that you have made it clear that you do not become involved in the consideration of individual takeover cases; indeed to do so would be inconsistent with the legislation. Whether officially, socially, or in the cause of a charity, you frequently come across those most likely to be involved in takeovers of major British companies. Despite the line you take, such people persist in trying to influence you, and will try to do so no matter what the nature of the gathering. These takeovers are often bitterly fought, and the

losers are not above complaining about the manner in which they lose, or even above going to court. (Or, as in the Guinness case, they may end up being taken to court.) In such circumstances, allegations about involvement by you can easily be made.

In these circumstances, it is essential that your non-involvement is not only actual but is perceived as well. If the Policy Unit ceased to attend meetings of the Panel, you would be able to give that assurance without any qualification whatsoever. The difficulty is that someone may seek to misconstrue the Policy Unit role and try to argue that you had used your influence through the back door. There is no substance in this, but the accusation could be made.

I put this to Sir Gordon as well. He took the view that people attending the Panel did so in a personal capacity at his invitation, and were there to assist him. The Panel was not a decision-making body, and no votes were taken. He was satisfied that the Policy Unit role was consistent with the legislative framework. The only difficulty is whether, in a highly charged dispute, that would be fully believed.

I am satisfied that provided we make sure that whoever represents the Policy Unit is not involved in a conflict of interest (as George Guise would have been had he not withdrawn in the Minorco/Consolidated Goldfields case) there is nothing improper in the Policy Unit role. The issue for you is how much importance you attach to having that last degree of protection which comes from your being able to say, without qualification, that neither you nor No.10 are involved.

Content to allow Policy Unit to continue attending the Mergers Panel?
Or
Do you wish them to withdraw, receiving only the papers?

AT AT

May we have a word?

11 January, 1989.

CONFIDENTIAL

Note - Spoke to PH. She said "I would much rather they didn't"
AT 12/1

dti

press notice

RA

89/5

5 January 1989

CLEARANCE OF MERGER PROPOSALS

The 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 following merger to the Monopolies and Mergers Commission under the provisions of the Fair Trading Act 1973:-

Proposed acquisition by News International plc of William Collins PLC

Press Enquiries: 01-215 4475/4472/4471
Public Enquiries: 01-215 4751/9

ENDS

Department of Trade and Industry 1 Victoria Street London SW1H 0ET Fax 01-222 4382

dti

the department for Enterprise

GCPU

Npm.

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Paul Channon MP
Secretary of State for Transport
2 Marsham Street
LONDON
SW1P 3EB

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 19 December 1988

Dear Paul.

NATIONALISED INDUSTRY REFERENCES TO THE MONOPOLIES AND MERGERS COMMISSION UNDER SECTION 11 OF THE COMPETITION ACT, 1980: LONDON UNDERGROUND

Thank you for your letter of 29 November seeking a further deferral of the London Underground reference. I have also seen Nicholas Ridley's letter of 12 December.

I can understand that it would not now be helpful to proceed with the London Underground reference planned for the Spring and that we should review the situation towards the end of next year so that an MMC inquiry could be focussed to look at the Board's response to Pennell and any areas where you think further improvements might be achieved. On Nicholas Ridley's specific suggestion for the LUL's inquiry, I should explain that within the legislative framework set by Section 11 of the Competition Act (and also the monopoly provisions in the Fair Trading Act) it is not open to me to ask the MMC to report on whether continuation of the monopoly is the right approach. Both sets of provisions enable the MMC broadly to look only at the

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activities of monopolists and to see whether their activities are against the public interest. An MMC report would establish the facts and might be a useful basis for a Government decision on the future of the monopoly but it could not address whether alternatives to the continuation of the monopoly provided a better way forward.

The withdrawal of both the London Underground and UKAEA inquiries highlights the need for us to draw up urgently a further programme of references for the MMC to undertake in the coming year and I shall be putting forward proposals shortly.

I am copying this letter to other Members of E(NI) and to Sir Robin Butler.

Yours ever.
Tony.

TONY NEWTON

EM9AAK

Govt. MACH: Monopdiy
+ Meyer P+J

CONFIDENTIAL

GOPU

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

12 December 1988

NBtm
RecG
13/12

Dear Tony

NATIONALISED INDUSTRY REFERENCES TO THE MONOPOLIES AND MERGERS COMMISSION: LONDON UNDERGROUND

Paul Channon's letter of 29 November puts to you the case for delaying the MMC reference on the London Underground for at least a further year. There is obviously a strong case for giving London Underground a little more time. However, the management shortcomings revealed by the Fennell Report would seem to make it more not less important to have an MMC reference.

From my own Department's viewpoint I am conscious of the need for efficient mass transport to service growth and new development in London. I think we need to look carefully at whether the London Underground monopoly is the right continuing approach to providing this service. It would be particularly useful to have the MMC's views before we become committed to any major new rail transport developments in London. That may not be completely practicable, but I hope you will keep the London Underground in the list of references for as earlier date as is practicable.

Copies of this letter go to other members of E(NI) and to Sir Robin Butler.

Yours ever
Nicholas

NICHOLAS RIDLEY

Gov + mach: Monopolies
+ mergers

FG
SEW

cc PJC.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

8 December 1988

Dear Jeremy,

AMENDMENTS TO THE FAIR TRADING ACT: ORDER MAKING POWERS

Thank you for your letter of 7 December which the Prime Minister has seen. She is grateful for the further consideration your Secretary of State has given to this issue and is now content to agree the power to require information to be published if it is limited to the categories you have described.

I am copying this letter to the Private Secretaries to members of E(A), and to Trevor Woolley and First Parliamentary Counsel.

Yours,
Paul

(PAUL GRAY)

Jeremy Godfrey, Esq.,
Department of Trade and Industry.

EA

CCPS

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the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Prime Minister

This is the last outstanding point on these powers. Lord Young has now responded to your concern. Content with the proposed limitation on information powers at X below?

PRCG
5/12

Yes not

Paul Gray Esq
Private Secretary to the
Prime Minister
10 Downing Street
London
SW1A 2AA

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard
01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5424
Our ref JW1ABI
Your ref
Date 7 December 1988

Dear Paul

AMENDMENTS TO THE FAIR TRADING ACT: ORDER-MAKING POWERS

In your letter of 21 November, you said that the Prime Minister would like further consideration to be given to whether there could be any limit put on the categories of information which the Secretary of State can require to be published following an adverse MMC report.

The reason for requiring the publication of information is that a company which dominates the market often controls the information which potential competitors need and which customers can use to make an effective choice. In some cases of monopoly abuse, therefore, publishing information can improve the working of the market making it unnecessary for there to be any direct intervention (such as ordering a divestment or limiting the prices a monopolist can charge).

The main limitation on the use of a power to require publication of information will be the nature of the MMC's findings. Any firm required to disclose information unnecessarily could challenge this in the courts.

However, we recognise that there could be concern about such a power and have concluded that it could be explicitly limited to:

X

- accounting information on the goods or services in question; and
- information on the quantities and geographical areas supplied.

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the department for Enterprise

This would exclude matters such as trade secrets about the products or processes themselves.

I would be grateful if you could seek the Prime Minister's approval of the power to require information to be published if it is limited to the categories I have described.

I am copying this letter to Private Secretaries to other members of E(A) and to Trevor Woolley and First Parliamentary Counsel.

Yours

Jeremy Godby

COUT MACH : Monopoles + Mesons

PT3

FILE EL

PROFESSOR GRIFFITHS

POLICY UNIT ATTENDANCE AT THE MERGERS PANEL

As you know, I have some concern about the attendance of a member of the Policy Unit at the Mergers Panel. Briefly, my concern is as follows:

1. The Prime Minister takes the line in public that mergers and associated Monopolies Commission work are issues on which she does not become involved. They are for the Secretary of State for Trade and Industry.

2. Officials, other than those from the OFT, attend the Mergers Panel as representatives of their Departments so that the Chairman of the Panel can be aware of Departmental views before making his recommendation to the Secretary of State. I would expect that an official would consult his Minister about his line before speaking at the Panel where a major issue arises.

3. Policy Unit members can only attend the Panel as a representative of the Prime Minister. The concept of attendance "in a personal capacity" has no meaning in this context. The Director General of Fair Trading is not able to take account of "personal" views when giving his recommendation to the Secretary of State.

My concern is that there is an inconsistency between our saying in public that the Prime Minister does not involve herself in mergers matters and a Policy Unit member speaking at the meeting of the Panel.

There seem to me to be the following ways forward:

(i) the Policy Unit does not go to meetings of the Panel;

KK

(ii) the Policy Unit attends as observers but does not speak;

(iii) the Policy Unit seeks the Prime Minister's explicit authority before attending for what they might say at a meeting of the Panel.

I have to say that (iii) seems to me to be difficult, to say the least, in that it is not reconcilable with the Prime Minister's basic public stance.

I should be grateful for your views.

N.L.W

N.L. WICKS
7 December 1988

EL3DEH

BANK OF ENGLAND

With the Governor's Compliments

Bank of England
London EC2R 8AH

The Governor

6 December 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade & Industry
1-19 Victoria Street
London
SW1H OET

Dear David,

COUNTY NATWEST/BLUE ARROW

Thank you for your letter of 29 November advising me of your intention to appoint Inspectors under Section 432 of the Companies Act. I am grateful to you for saying that your officials will keep the Bank informed as the investigation proceeds.

I am copying this letter to the Prime Minister and the Chancellor of the Exchequer.

Yours ever,

Robin

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

30 November 1988

Dear Neil,

PROHIBITION OF SHARE ACQUISITIONS DURING AN MMC INQUIRY

The Prime Minister was grateful for your Secretary of State's minute of 29 November. Subject to the views of the Business Managers and other colleagues, she is content with the proposal to include a further amendment in the forthcoming Companies Bill prohibiting share acquisition involving companies which are the subject of a merger reference.

I am copying this letter to the Private Secretaries to members of E(A), Trevor Woolley (Cabinet Office) and to Brian Shillito (Office of the First Parliamentary Counsel).

Yours,
Paul

Paul Gray

Neil Thornton, Esq.,
Department of Trade and Industry.

CONFIDENTIAL

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

29 NOV 1988

The Rt Hon Tony Newton OBE MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

Dear Tony,

NATIONALISED INDUSTRY REFERENCES TO THE MONOPOLIES AND MERGERS COMMISSION: LONDON UNDERGROUND

We agreed in May that the reference of London Underground (LUL) originally planned for this year was unlikely to start until early 1989. Subsequently my officials told yours that it would not be possible to set a firm date for the reference until we had seen the report of the Investigation into Kings Cross, and taken stock of its implications for LRT.

The Fennell report shows the need for major changes in LRT and LUL, and it will clearly require a huge effort and commitment from management if they are to be implemented quickly and effectively. It would be unreasonable to expect LRT in addition to cope with a major MMC reference during the coming year, and therefore the LUL reference should be dropped from next year's programme. I suggest we should review the position again towards the end of 1989.

I am copying this letter to other members of E(NI) and to Sir Robin Butler.

Yours,
Paul

PAUL CHANNON

CONFIDENTIAL

dti

the department for Enterprise

Prime Minister

The fact that it was the ultra-respectable Fred Fields who advised Elders they could carry on buying demonstrates that the present arrangements are inadequate. George Guise and I agree this is a sensible proposal. Content to agree that the powers be put on a permanent footing as proposed? Regs 29/11

Yes

PRIME MINISTER

PROHIBITION OF SHARE ACQUISITIONS DURING AN MMC INQUIRY

I have been considering whether any changes to the Fair Trading Act are desirable in the light of Elders' behaviour after I referred their bid for Scottish & Newcastle Breweries to the Monopolies and Mergers Commission. You will recall that Elders continued to buy S&N's shares in the market, even though the Office of Fair Trading had, in the usual way, asked them to provide an undertaking that they would not do so. We therefore made an Order to prevent further purchases and I subsequently announced that it would in future be the practice to make a similar Order whenever a bid is referred.

2. These Orders are made under the interim powers in the Fair Trading Act. This means making an emergency Statutory Instrument on each occasion, which is a cumbersome process. As the prohibition is to apply in every appropriate case, I have concluded that it would be better for the prohibition to be put on a permanent footing. The forthcoming Companies Bill - which already contains amendments to the Fair Trading Act - provides a suitable opportunity. I propose to include a further amendment which would automatically prohibit share acquisitions involving companies which are the subject of a merger reference, except with my consent. This prohibition would extend to parents, subsidiaries and associates of the enterprises concerned, and to direct or indirect acquisitions of interests in the shares.

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the department for Enterprise

3. This is essentially a technical change, not affecting the existing policy. I would like it to be included in the Bill as introduced and I should therefore be grateful to know by the end of this week whether there are any objections to what I propose.

4. I am copying this minute to Members of E(A), and to Sir Robin Butler and First Parliamentary Counsel.

D Y

29 November 1988

Department of Trade and Industry

the enterprise initiative

PS2BPP

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

21 November 1988

Dear Neil,

AMENDMENTS TO THE FAIR TRADING ACT:
ORDER MAKING POWERS

The Prime Minister was grateful for your Secretary of State's minute of 11 November. The Prime Minister is content with the proposed powers to require specified information to be provided to the Office of Fair Trading, to require a business to be carried on separately, and to prevent shares being voted. She is, however, concerned about the proposed power to require publication of information to enable third parties who might have suffered damage to see that the problem had been solved or to stop any recurrence. She feels that any such power needs to be properly circumscribed, and would be grateful if your Secretary of State could consider whether the categories of information which could be published could be specified or limited in some way.

I am copying this letter to the Private Secretaries to members of E(A), Sir Robin Butler and First Parliamentary Counsel.

Yours,
Paul

(PAUL GRAY)

Neil Thornton, Esq.,
Department of Trade and Industry.

CONFIDENTIAL

chex.md/mw/123 CONFIDENTIAL

cc PJ

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

AMENDMENTS TO THE FAIR TRADING ACT: ORDER MAKING POWERS

will PG?

David Young copied to me his minute to you of 11 November proposing three specific additions to the order-making powers in Schedule 8 of the Fair Trading Act which are available to remedy adverse effects identified by the Monopolies and Mergers Commission (MMC).

It is clearly right that we should be able to take action where the MMC reaches an adverse finding. If our competition policy is to be effective, we must ensure that our legal powers are appropriate to today's problems. David Young's new proposals are limited in their scope, and directed to specific problems which have already been encountered. Although I find it hard to imagine many circumstances in which he would wish to invoke the second of his proposed new powers, the first and third are clearly desirable and I am content that he should take these three additional powers in the forthcoming legislation.

I am copying this minute to members of E(A), to Sir Robin Butler, and to First Parliamentary Counsel.

Moira Wallace

pp [NL]
18 November 1988

(Approved by the Chancellor and signed in his absence.)

JH/H/9

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PRIME MINISTER

AMENDMENTS TO THE FAIR TRADING ACT: ORDER MAKING POWERS

David Young minuted you on 11 November with specific proposals to strengthen Order Making Powers in Schedule 8 of the Fair Trading Act.

I am very conscious that increasing competition in the product market is the more effective way of ensuring that labour markets are more competitive and flexible. As these proposals avoid the problems of very general powers I would support his proposal to take additional powers in the forthcoming legislation.

I am copying this minute to members of E(A), to Sir Robin Butler, and to First Parliamentary Counsel.

for NF

(Approved by the Secretary of State and signed in his absence)

PRIME MINISTER

FAIR TRADING ACT: ORDER-MAKING POWERS

At E(A) on 6 October, you resisted proposals from Lord Young for a general power to provide for the implementation of MMC recommendations. E(A) invited Lord Young to come forward with proposed additional specific powers designed to cover his points of concern.

Lord Young's minute of 11 November (Flag A) fulfills that remit.

Other papers attached are:

Flag B - comments by George Guise;

Flag C - comments by Richard Wilson;

Flag D - minute from John MacGregor supporting the Lord Young package.

Flags E+F - Letter marks from the Chancellor and Mr Fowler supporting the package.

George Guise continues to see potential difficulties with the more limited order-making powers now proposed, in that there could be future situations where the Government will not be able to implement the MMC's findings. But he recommends supporting the revised proposals.

Richard Wilson's note summarises Lord Young's package, and suggests it can be broadly supported, as being much less sweeping than the earlier general power you resisted. But he suggests that you might urge Lord Young to circumscribe the proposed power to require companies to publish information.

Content to agree the revised Lord Young package, subject to asking Lord Young to specify a limited list of categories of information which could be published?

I do not think it right to take such a wide power to require companies to publish information. It sounds too much like 1984. You may require specific information for the purposes indicated, but you must remain clear not

RLCG.

PAUL GRAY
17 November 1988
DS3ADH

CONFIDENTIAL

B

PRIME MINISTER 17 November 1988

AMENDMENTS TO THE FAIR TRADING ACT

Having been told by the DTI that only general powers could give Government the necessary effectiveness to implement MMC recommendations, it is remarkable how effective the three specific powers now requested appear. These are based on past instances of difficulty and could therefore prove inadequate in some future situation. However, when pressed, the DTI found it difficult to give me good examples of where these three powers would not suffice.

The main weakness of specific powers is that they normally operate through prohibitions rather than requirements for positive action. It is therefore difficult and legally cumbersome to use specific powers in order to cause positive effects. So when the MMC finds that certain initiatives are required to remedy a competition limiting situation, the Secretary of State will have to draft orders in language designed to stop things happening rather than to cause them.

A further area where the present proposals may prove inadequate is in licensing of rights. The Fair Trading Act is about the supply of goods and services, whereas the MMC could be asked to investigate a situation involving competition in the supply of licenced rights. Examples would be entry to car parks or access to intellectual property.

CONCLUSION AND RECOMMENDATION

Despite the limitations of the present proposals, the DTI admit that they go a long way towards remedying the gap which their previous paper identified. These specific powers should therefore be supported while recognising that

there could be future situations where Government will prove impotent in implementing the MMC's findings. Unless any member of E(A) still has difficulties with these three specific powers, it ought not be necessary to convene a special meeting to deal with the matter.

GEORGE R GUISE

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

From the Minister

PRIME MINISTER

AMENDMENTS TO THE FAIR TRADING ACT: ORDER MAKING POWERS

David Young's minute to you of 11 November invited members of E(A) to agree his proposals for taking additional order making powers in forthcoming legislation to amend the Fair Trading Act.

I entirely recognise as creating genuine, practical problems the shortcomings he has described in the current order-making powers of schedule 8 of the Fair Trading Act, namely the absence of specific powers to require certain information; the absence of powers which would enable us to specify more appropriately "tailored" solutions to merger problems than simple divestment of holdings; and the need for clarification of powers to prevent shares being voted. I can therefore give my full support to his revised proposals.

I am copying this letter to members of E(A), First Parliamentary Counsel and to Sir Robin Butler.

JM

JOHN MacGREGOR
17 November 1988

Minister of Agriculture,
Fisheries & Food

Govt MACH: Mergers + Members

Pt 3

CONFIDENTIAL

P 03271

From: R T J Wilson
17 November 1988

MR GRAY

cc Mr Woolley
Mr Monger
Mr Neilson

AMENDMENTS TO THE FAIR TRADING ACT: ORDER-MAKING POWERS

1. You asked whether we had any comments on Lord Young's minute of 11 November.

2. At its meeting on 6 October E(A) rejected proposals by Lord Young for a general power to impose by order such requirements relating to the carrying on of a business as he considered necessary to remedy or prevent adverse effects found by the MMC. Instead the Sub-Committee asked the Secretary of State to consider whether his objective could be achieved in other ways, for example by additional specific powers; and to bring forth proposals accordingly.

3. Lord Young's minute is consistent with this approach. He now proposes taking four additional specific powers:

i. power to require specified information to be provided to the Office of Fair Trading (OFT). This could, for example, enable OFT to monitor compliance with undertakings, to check that monopoly profits were curbed, and to be notified about future acquisitions;

ii. power to require the publication of information to enable third parties who might have suffered damage to see that the problem had been solved or to stop any recurrence;

iii. power to require a business to be carried on separately. The DTI may wish to insist on a business being conducted on an arm's length basis, for example to guard against cross-subsidisation or discriminatory dealings;

iv. power to require the voting rights in shares above a certain level not to be exercised in cases where the MMC had found the share holding to be against the public interest and the holding had not yet been sold.

4. These powers were mostly foreshadowed in the discussion on 6 October. The only one which appears to be new is (ii.) about requiring the publication of information. Potentially the categories of information covered could be wide-ranging. The power would seem to cover the publication of information on such matters as the prices, costs and profitability of particular goods and services. It may therefore attract some controversy. On the other hand, we understand from DTI that it could only be used to the extent necessary to remedy an adverse finding by the MMC and to promote open competition.

CONCLUSION

5. Overall, Lord Young's proposals are much less sweeping than the general order-making power which he proposed earlier. But it might be worth making the point that the proposed power to require companies to publish information (paragraph 4 of his minute) needs to be properly circumscribed. Lord Young might be asked to consider whether the categories of information which could be published could be limited in some way.

R T J WILSON

dti

the department for Enterprise

PRIME MINISTER

AMENDMENTS TO THE FAIR TRADING ACT : ORDER MAKING POWERS

E(A) on 6 October asked me to bring forward proposals for specific additions to the order-making powers in Schedule 8 of the Fair Trading Act which are available to remedy adverse effects identified by the Monopolies and Mergers Commission (MMC).

2. There are a few, limited, additional powers, the lack of which in the past has prevented us from dealing swiftly and effectively with damage to competition. They would enable us to require the provision of information, to require a business to be carried on separately, and to prevent shares already held being voted.

Powers to Require Information

3. We need to be able both to require specified information to be provided to the Office of Fair Trading, and to require information to be published. The first would make it easier for the OFT to monitor compliance with provisions of orders or undertakings. Accounting information may be needed, for example, to guard against cross-subsidisation, or to check that monopoly profits are being curbed. We may also want to be notified of future events, such as further acquisitions in the same field. In the past, such as with the reports on animal waste and on concrete roofing tiles, we have sometimes had to settle for less information than we really needed to monitor the monopolists' conduct.

the Enterprise Initiative

PS4BMT

4. Sometimes, however, the best check on future conduct is full transparency, by requiring the publication of information. In this way, third parties who might have suffered damage can see that the problem is solved or spot any recurrence. This was recommended, for example, in the report on pest control services.

Requiring a business to be carried on separately

5. We may want to stop short of blocking a merger or requiring divestment, but still insist on an arm's-length relationship to guard against cross-subsidisation, or discriminatory dealings, or ensure that a business retains a separate identity. This was something recommended by the MMC when S & W Berisford originally took over British Sugar, for example. It could in some cases avoid the need for a more drastic remedy, in accordance with the principle that we do the minimum necessary to remedy the adverse effects found by the MMC.

Preventing shares being voted

6. Almost always when the MMC find against an existing merger, they recommend that until the shareholding can be sold or reduced, the voting rights in the shares above a certain level should not be exercised. Since we may wish to allow time for sale of the shareholding, to minimise disruption to the market or financial penalty to the holder, it is important that the holding - which the MMC have already found to be against the public interest - should not be exploited to influence the company. Usually, holders are prepared to give suitable undertakings; but this itself can take time, and our ability to press for these is weakened by the lack of suitable powers (even if companies are not necessarily aware of this). We found this a problem with Ferruzzi's holding in British Sugar.

dti

the department for Enterprise

Conclusion

7. I believe it to be essential if we are serious about competition that we should strengthen the existing powers in this way. These limited extra powers are directed at specific problems we have found in the past, and, as with the existing powers, my ability to exercise them would be subject to the constraint that they could only be used to the extent necessary to remedy the adverse affects found by the MMC. On this basis, I hope that the Sub-Committee will be prepared to agree to my taking these additional powers in the forthcoming legislation.

I am copying this minute to members of E(A), to Sir Robin Butler, and to First Parliamentary Counsel.

D Y

11 November 1988

Department of Trade and Industry

the Enterprise Initiative

PS4BMT

PJC to see +
Ret

MR WICKS

For the record.

Christopher Eugster, of Kleinworts, who was on the Node course with me, telephoned me this afternoon at 4.10pm to say he had been trying to get me earlier (as I discovered on my return from Prime Minister's Questions) about S&N/Elders.

He said it was now too late since Lord Young (or more accurately OFT, according to my briefing) was seeking undertakings from Elders not to vote any shares in S&N above 15% and not to acquire any further shares.

Had he been able to get me earlier he hoped I might have put pressure on DTI to get Elders, who had behaved extremely badly, to divest themselves of their purchase today.

I expressed no opinion on the matter or whether, had he got me in time, I would have assisted.

BERNARD INGHAM

10 November 1988

cc PC

AUSTRALIAN HIGH COMMISSION

AUSTRALIA HOUSE
STRAND
LONDON WC2B 4LA
01-438 8000

10 November 1988

CDP
11/K

Mr C.D. Powell
Overseas Affairs
Prime Minister's Office
No. 10 Downing Street
LONDON SW1A 2AA

Dear Charles,

I am now attaching the original letter from the Australian Prime Minister, The Honourable R.J.L. Hawke AC MP, to the Prime Minister in connection with the bid by Elders Brewing Group for Scottish and Newcastle. A copy of this text was forwarded to you on 4 November.

At least I assume those are the contents; we don't have a copy. I'm Lord Young has pronounced!

As ever

David

(D.W. Evans)
Deputy High Commissioner

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL NO. PM680/88

Subject cc Martin OPS

PRIME MINISTER
CANBERRA

2 NOV 1988

Dear Margaret,

You will be aware of the Elders Brewing Group's bid for Scottish and Newcastle. My Government encourages Australian companies to improve their overseas links, as part of a wider objective of effectively integrating the Australian economy with the world economy.

Foreign takeovers can, of course, provoke a range of responses from those most affected, but I hope that the outcome of bids such as that by Elders would be determined on their economic merits to the benefit of the wider community.

We have sought to ensure such assessment of foreign investment in Australia by the considerable lessening we have achieved in our regulation in this area.

I would like to take the opportunity to add how much I appreciate your very prompt and positive action to see what can be done to give effect to our agreement during your visit to strengthen relations between Australia and the United Kingdom. I appreciate your invitation to me and Australian Ministers to visit London in June next year for further discussions and look forward to seeing you then.

With my best wishes
Yours Sincerely
Bob Hawke.

R.J.L. Hawke

The Rt Hon. Margaret Thatcher, MP
Prime Minister
LONDON U.K. SW1

dti

press notice

88/817

10 November 1988

PROPOSED ACQUISITION BY ELDERS IXL LIMITED OF SCOTTISH & NEWCASTLE BREWERIES PLC

Lord Young, Secretary of State for Trade and Industry, has decided, in accordance with the recommendation of the Director General of Fair Trading, to refer the proposed acquisition by Elders IXL Limited of Scottish & Newcastle Breweries 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 four months.

The Secretary of State considers that the merger raises questions of competition in the brewing, wholesaling and retailing of beer which deserve investigation by the Commission.

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

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 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 The Director General recommended that a four month period be allowed for the investigation to permit the Commission to take account of the conclusions of their separate two year monopoly investigation into the supply of beer. This latter report is due by 3 February 1989.

Press Inquiries: 01 215 4469/4471/4475/4472

ENDS

Department of Trade and Industry 1 Victoria Street London SW1H 0ET Fax 01-222 4382

dti

the department for Enterprise

Charles

This is the message we recommend the Prime Minister send to Bob Hawke. We have not yet finalised the text of the announcement.

Letter at flap

Jeremy Godfrey

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

Telex 8813074/5 DTHQ G
Fax 01-222 2629

the Enterprise initiative

CPP AAF

CONFIDENTIAL AND MARKET SENSITIVE

DRAFT LETTER FROM THE PRIME MINISTER

The Hon R J Hawke

Prime Minister of Australia

Thank you for your letter of 4 November which has been passed to me by your Deputy High Commissioner about the proposed acquisition of Scottish & Newcastle Breweries by Elders IXL.

I thought you ought to know that David Young is announcing today that he has decided to refer the Elders bid to the MMC, on the basis of the possible effects of the merger on competition in the UK.

You may wish to see the text of David Young's announcement, which is enclosed.

CONFIDENTIAL AND MARKET SENSITIVE

GOVT MACH: Monop + Mergers pG3

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

4 November 1988

Dear Neil,

I enclose a copy of a letter to the Prime Minister from the Australian Prime Minister about the bid by Elders Brewing Company for Scottish and Newcastle.

I should be grateful for a draft reply in due course.

I am copying this letter and enclosure to Bob Peirce (Foreign and Commonwealth Office).

Yours ever,

CHARLES POWELL

Neil Thornton Esq
Department of Trade and Industry.

CONFIDENTIAL

ccpc

AUSTRALIAN HIGH COMMISSION

AUSTRALIA HOUSE
STRAND
LONDON WC2B 4LA
01-438 8000

4 November 1988

Mr C.D. Powell
Overseas Affairs
Prime Minister's Office
No. 10 Downing Street
LONDON SW1A 2AA

Dear Charles,

I have been asked to pass the text of a letter from the Australian Prime Mnister, The Honourable R.J.L. Hawke AC MP, to the Prime Minister in connection with the bid by Elders Brewing Group for Scottish and Newcastle.

The original of the letter will follow shortly but in the meantime we would be grateful if the text, which is attached, could be brought to the Prime Minister's attention when she returns from Poland.

Yours sincerely,

David Evans.

(D.W. Evans)
Deputy High Commissioner

CONFIDENTIAL

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T169/88

CONFIDENTIAL

SUBJECT
cc MASTER
OPS

Text of letter dated 4 November 1988 from the Australian Prime Minister, The Honourable R.J.L. Hawke AC MP, to the Rt Honourable Margaret Thatcher MP, Prime Minister.

"Dear Margaret,

You will be aware of the Elders Brewing Group's bid for Scottish and Newcastle. My government encourages Australian companies to improve their overseas links, as part of a wider objective of effectively integrating the Australian economy with the world economy.

Foreign takeovers can, of course, provoke a range of responses from those most affected, but I hope that the outcome of bids such as that by Elders would be determined on their economic merits to the benefit of the wider community.

We have sought to ensure such assessment of foreign investment in Australia by the considerable lessening we have achieved in our regulation in this area.

I would like to take the opportunity to add how much I appreciate your very prompt and positive action to see what can be done to give effect to our agreement during your visit to strengthen relations between Australia and the United Kingdom. I appreciate your invitation to me and Australian Ministers to visit London in June next year for further discussion and look forward to seeing you then.

With my best wishes.

Yours sincerely

R.J.L. Hawke

The Rt Hon. Margaret Thatcher, MP
Prime Minister
LONDON SW1"

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dti

the department for Enterprise

CC PU
CC BJP

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Alex Allen Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

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Fax 01-222 2629

Prime Minister
May like to see.
PRC 6
28/10

Direct line 215 5422
Our ref PS4BJP
Your ref
Date 27 October 1988

Dear Alex,

MERGER POLICY

... You might like to see the attached copy of a speech my Secretary of State is giving this afternoon to the International Stock Exchange Conference for Industry. Recent decisions on reference or non-reference of mergers to the Monopolies and Mergers Commission have given rise to a good deal of interest and some comment that the Government's merger policy has either changed, or become inconsistent. There have been calls - for example from Sir Trevor Holdsworth of the CBI - for a clear restatement of the Government's policy, notwithstanding the Blue Paper.

The attached speech is therefore being widely distributed to major companies, as well as to MPs and the Press.

I am sending copies of this letter to Paul Gray, to Private Secretaries to Members of the Cabinet, and to Trevor Woolley.

Yours sincerely,

pp NEIL THORNTON
Private Secretary

the Enterprise initiative

dti

MERGER POLICY

An address presented to
the Stock Exchange Conference for Industry
at the QEII Centre on Thursday 27 October 1988
by the Right Honourable Lord Young of Graffham
Secretary of State for Trade and Industry

MERGER POLICY

An address presented to
the Stock Exchange Conference for Industry
at the QEII Centre on Thursday 27 October 1988
by the Right Honourable Lord Young of Graffham
Secretary of State for Trade and Industry

Mergers Policy

The title of this conference prompted me to look for a subject close to the hearts and minds of both the Stock Exchange and industry. The choice was not difficult. The Government's mergers policy fits the bill on all counts.

Six months ago my Department published a Blue Paper after a thorough review of our mergers policy. Since that Paper was published claims have been made that the rules were being rewritten; or even that there were no rules. I want this evening to set the decisions that I have made over the last six months in the context of our policy.

Any mergers policy must provide industry and commerce with a clear and predictable framework within which to conduct the merger and takeover activity that is an important part of the operation of the market. Our policy, far from being the thing of shreds and patches its detractors would claim, does show a remarkable degree of consistency.

The presumption underpinning all we do is that the market should be allowed to "get on with it". Government interference is justified only when there is a clear expectation that the outcome will not be in the best interests of the economy as a whole. This is not a blind belief in market forces, but rather the empirical judgment that in general market forces will be more likely to be "right" than the deliberations of committees of politicians or bureaucrats. Indeed, as valuable as the MMC is, I am sure they would not wish to take over from the market the decision on the many mergers that take place month after month.

Competition is the Key

The Blue Paper concluded that the basic policy which we have been following for a number of years is correct: that the main consideration in evaluating a merger for a reference to the Monopolies and Mergers Commission should be the potential effect on competition in the UK.

I want to take a minute to explain what that outwardly rather bland statement actually means. My responsibilities are for the UK, not Europe nor the wider world. I look at mergers from the standpoint of the UK customer. It is competition policy which is the great shield of the consumer.

In many cases that consumer is, of course, a business. My concern can therefore be restated as ensuring that UK industry has sufficient choice to be able to buy the materials and components it needs at the lowest possible prices and on the best possible terms.

Let me elaborate on what we do not do. We do not look at mergers from the viewpoint of the companies concerned or of investors. The interests of these parties are promoted by other means. So mergers policy is not in the business of "saving" companies from predators, or indeed from foreign takeovers. I do accept that the threat of takeover adds to the problems faced by those running companies. I am equally certain that removing that threat by adopting a more interventionist stance would not be in the best interests of UK industry. The best defence is, surely, getting your company into such good shape that a predator realises that he can't make a better use of the assets and has no incentive to offer a winning price. This approach is also in the best interests of the economy as a whole.

Whilst competition will be the main consideration in my decision whether to refer I still retain the power to make a reference on public interest grounds. Such cases are exceptional. Public

terest is often claimed as the effect of a merger on employment or R&D. These are matters where the parties themselves may be left to take a view. What is good for the firms in the long run will be good for the economy.

The Reference Procedure

What does a reference of a merger to the MMC actually mean? It certainly does not mean that I have anything against the companies concerned. It means only that there are issues which merit further investigation. It is, if you like, the equivalent of the Magistrates hearing, when they are deciding whether there is a case to answer. It is not the full trial and it certainly does not mean the bid will be blocked — that can only be done if and when the MMC find it against the public interest. Of course, it is not as simple as that, and the delay and uncertainty of a reference can sometimes lead to bids being abandoned. I have asked the MMC to reduce the delay and they have halved the time they take. A decision to refer is not taken lightly. Of around 240 cases considered this year, only 7 have been referred to the MMC for further investigation. The average year produces about eight cases and the highest is 13 in 1986.

There seems to be a belief that references are sometimes used as a kind of political bolt-hole, and that decisions on whether or not to refer can be influenced by extensive — and expensive — campaigns involving lobbying and advertising. I have even known cases where parties to a bid have published open letters addressed to me in full page advertisements in the national press, although, heaven knows, if they did want to write postage would be cheaper. This is not how the system works.

The first step in the process is for the Director General of Fair Trading to analyse the implications of the bid. He discusses the issues with the parties, their customers and competitors. This assessment, which covers the effect on competition, and any other public interest issues, forms the basis for the Director

General of Fair Trading's advice to me whether or not to refer the bid to the MMC. The decision is mine: but I would need very strong reasons to reject the Director General's advice. On only 9 occasions, out of a total of over 2,000 cases since 1979, has that advice not been followed by the Secretary of State of the day. So the message to companies involved in controversial takeovers who want to influence referral is — don't advertise, don't talk to me, talk to Sir Gordon Borrie.

Confidential guidance

Another service available to prospective bidders is the "confidential guidance" available from the OFT. In appropriate cases the Office can give a confidential indication after consulting me of whether I would be likely or not to refer a particular merger. Such guidance does not tie my hands in making a substantive decision and is based on the limited evidence available at a time when the proposal is not public knowledge. Approximately 30 requests for Confidential Guidance are dealt with each year.

Markets Differ

How do some of the more controversial recent reference decisions fit into this framework? I believe with rather more consistency than that adopted by some of the critics. Let me examine some recent cases in more detail.

A competition-based mergers policy is about the economics of evaluating markets and market shares in terms of the competitive structure. In competition terms, market sizes vary greatly.

. . . a local market

Some markets are confined to a part of the UK. For example recently, in the Badgerline case, I referred a merger between two companies running bus services in Bristol and Avon. Bus services are a market where competition is highly localised; to

consider local bus services in the context of the overall UKmarket for bus services throughout the UK would not make a lot of sense!

. . . the UK market

Other products and services do have a national, UK-wide market, where competition for the consumer is essentially between UK companies and where, for whatever reason, imports or international sources play only a very minor part. Take package holidays as an example; competition in the market for foreign inclusive tours by air, which is one of the markets in which Thomson and Horizon operate, is mainly between UK companies. Together they have a large market share. There appeared to be no mitigating factors such as competition from overseas operators; and so the bid raised questions of competition and the bid was referred. How valid the questions are, the MMC will consider.

Let's now take a controversial non-reference decision — Rowntree. Here we looked at the effect on competition in our chocolate confectionery market. Continental chocolates do not sell well in the UK, and thus the markets were different. There were no competition issues: Nestle and Suchard had only 3% and 2% respectively of the UK chocolate confectionery market.

Arguments were put forward that Rowntrees should be referred on public interest grounds. The particular issue was reciprocity. Now reciprocity is a tricky concept — especially in the mergers market. It turned out that Swiss companies like Nestle are virtually immune from hostile bids even from other Swiss companies; that some British companies are in the same position. Indeed I was given a list of over 60 British companies that had, often with the consent of their shareholders, protected themselves against unwelcome bids. There are no Swiss Government rules against mergers involving foreign companies. It goes without saying that there are no UK rules either!

To have referred Nestle's bid simply because Nestle w effectively bid-proof would have sent a dangerously misleading signal to other countries about our attitude to inward investment and invited retaliation against UK investments abroad.

. . . Europe

For other products competition comes from Europe, or even further afield. That means that the UK consumer can purchase from a very wide range of sources and is not limited to UK producers. The creation of UK companies with large shares of the UK output of such products is entirely consistent with our concern to encourage effective competition within open markets.

In only a few weeks British Steel is coming to the market, as a single entity. It still has over 60% of the domestic market for finished steel products, yet in the UK it is still faced by competition from other European producers.

Another recent example: at the end of September I announced my decision not to refer the acquisition by Volvo Bus Corporation of Leyland Bus Group. Although Volvo and Leyland Bus together accounted for over 50% of bus and coach deliveries in the UK in 1987, I took into account the competition from European manufacturers, as assessed by the OFT.

. . . the World

The Minorco bid for Consolidated Gold Fields was referred on competition grounds. The Director General of Fair Trading in the usual way assessed the implications of the bid for the world-wide supply and prices of certain metals and minerals. I accepted his advice. I considered that there was a case to answer — the merger raised competition issues which justified detailed investigation by the MMC.

Incidentally, I have heard it argued that the bid should not have

een referred, because titanium and zircon would account for only a minute part of the new group's activities. This is not the test. What must concern me is not the interests of either of the companies involved, or of the new group, but the effect of the new arrangements on the consumer in the UK. The Director General considered — and I agreed — that the effect of the bid could be to reduce competition. We shall see. I am not prejudging the outcome of the MMC's enquiry. They have hardly begun. The appointment of inspectors under the Financial Services and Companies Acts had no bearing on the reference, nor was the nationality of the bidder in itself a factor.

The Customer is King

So markets vary. It is too simplistic to say merely that Europe ought to be the market against which competition is judged. For some products or services the market may be a single county — for others it may be the UK. There are circumstances where the whole of Europe is the market and as I have shown on occasion we might have to take the whole world into account.

But in each and every case it is the market that is judged and the effect on the customer is the test. If a merger is likely to lead to loss of choice and higher prices for the UK customer, it will probably be referred. But the corollary follows — where the UK customer has adequate choice as the result of effective competition from elsewhere in Europe or the world, apparently high shares of the UK market created by a merger will not necessarily lead to reference.

What this means is that reference decisions cannot be reduced to some simple arithmetical formula based on market shares. There is of course a market share test of 25% (together with an assets test for the acquired company of £30 million) in the Fair Trading Act: but these are no more than trigger levels for determining whether the merger qualified for investigation. Theassessment of the competition implications requires a more sophisticated analysis to determine the effect on the consumer.

The Single Market in Europe

As the Single European Market develops, and 1992 approaches, the remaining barriers to trade among the Community countries will gradually be removed. This will increase the scope for competition from Europe, and increase the importance of that factor in our consideration of mergers.

Our policy of taking account of competition from overseas is often confused with a separate issue — that of international competitiveness of UK firms. It is often argued that we should give more weight to international competitiveness. What people mean by this is that a reduction in competition in the UK should be accepted in order to enable large UK groups to be formed to compete more effectively in world markets. We certainly consider claims that a merger will increase efficiency and international competitiveness: but I have to say that all too often in the past the claims have not been borne out by results, and the track record of post-merger performance does not justify our simply taking such claims on trust. In general, therefore, if a merger poses a threat to competition in the UK, we regard the MMC as the appropriate body to balance the prospective benefits against the detriment to competition.

EC Merger Regulation

I would not want to talk about mergers policy without mentioning the EC proposals for a merger control regulation. Some of the critics of our mergers policy who argue that it is too parochial have gone on to say that implementation of merger control at the European level will provide the ideal solution. I have already made it clear that mergers policy takes the European and international dimension into account, and that there is no need for an EC merger control regulation on this account. In any event, some degree of merger control at the European level already exists in the form of Articles 85 and 86 of the Treaty, which cover competition. It is an entirely separate

estion as to whether the regulation would provide a better regime for controlling mergers at Community level than the existing regime of Articles 85 and 86. It is well known that the UK has reserved its position on the principle of the Regulation, while continuing to participate constructively in Council working group discussions.

Leveraged Bids

An issue which has caused a lot of concern is highly geared, or leveraged, bids. The Blue Paper looked carefully at this question, in the light of the MMC's report on the first major case of this kind in the UK — Elders' bid for Allied Lyons. The conclusion was that I will not normally regard leveraging on its own as a ground for reference: but there may be a case for referral if high leveraging combined with some other feature of the bid may have undesirable effects. This is how our policy has operated.

Some highly leveraged bids have not been referred (such as Barker and Dobson's bid for Dee Corporation): but the most recent example of a reference involving a leveraged bid — Goodman Fielder Wattie's bid for Ranks Hovis McDougall — also reflected competition worries. One of the markets affected by the proposed merger was the bread market, which in the the UK is both important and unusual. There are only two dominant producers, and this in itself can imply significant barriers to large scale entry. The weakening of one of the producers could have a potentially serious effect on competition. While the high leveraging of the bid would not normally, in itself, have been grounds for reference the knock-on effect this could have had on competition was of sufficient concern to justify a reference. In the end the withdrawal of the bid prevented us from putting this to the test.

Public Interest

The reference of the Kuwait Investment Office shareholding in BP was an example of a reference made on wider grounds than

traditional competition concerns. Such cases are very rare and this was truly an exceptional one. The implications of BP coming under the influence or control of a Government which as substantial oil interests, and which is a member of the OPEC cartel, raised issues of public interest which warranted investigation by the MMC. But even here there were issues of competition in the widest sense.

Protectionism

Some mergers involve foreign bids for UK companies. Where these have been referred, some observers have claimed there has been a shift of policy towards protectionism. Where they have not been referred, others have accused us of operating too open a system. The fact that both criticisms can be made speaks for itself. Merger policy is not pro-Swiss, nor is it anti Kuwaiti, anti Australian or anti South African. The nationality of the bidder is not in itself a factor in mergers policy. Nor are we adopting a "fortress UK" posture.

During this decade nearly 500 bids by foreign companies have been cleared, including bids for household names such as Courage beer, Rowntree and Leyland Bus. The Government's general approach to investment from overseas in the UK economy is to welcome it, and to encourage the free flow of investment both inward and outward. Today the UK is the great overseas investor. The value of UK direct investment overseas has risen three-fold since the beginning of the decade to stand at over £90 billion. Since 1986, UK companies have spent on acquisitions overseas £20.6 billion in the United States, £3.1 billion in Western Europe and £0.7 billion in Australia.

Merger Policy

So to look at a number of reference decisions and draw the conclusion that we are, for example, against bids from a

particular country, or a particular type of bid is, if I may say so, so much arrant nonsense. Each merger is different and is considered individually on its merits: we start with a clean slate each time and look at every merger but within the framework of our stated policy. My aim is to achieve open markets. That is why the main criterion in deciding whether to refer a merger to the MMC is the effect on competition in the UK.

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MERGER POLICY

The title of this conference prompted me to look for a subject close to the hearts and minds of both the Stock Exchange and industry. The choice was not difficult. The Government's mergers policy fits the bill on all counts.

Six months ago my Department published a Blue Paper after a thorough review of our mergers policy. Since that Paper was published claims have been made that the rules were being rewritten; or even that there were no rules. I want this evening to set the decisions that I have made over the last six months in the context of our policy.

Any mergers policy must provide industry and commerce with a clear and predictable framework within which to conduct the merger and takeover activity that is an important part of the operation of the market. Our policy, far from being the thing of shreds and patches its detractors would claim, does show a remarkable degree of consistency.

The presumption underpinning all we do is that the market should be allowed to "get on with it". Government interference is justified only when there is a clear expectation that the outcome will not be in the best interests of the economy as a whole. This is not a blind belief in market forces, but rather the empirical judgment that in general market forces will be more likely to be "right" than the deliberations of committees

of politicians or bureaucrats. Indeed, as valuable as the MMC is, I am sure they would not wish to take over from the market the decision on the many mergers that take place month after month.

Competition is the Key

The Blue Paper concluded that the basic policy which we have been following for a number of years is correct: that the main consideration in evaluating a merger for a reference to the Monopolies and Mergers Commission should be the potential effect on competition in the UK.

I want to take a minute to explain what that outwardly rather bland statement actually means. My responsibilities are for the UK, not Europe nor the wider world. I look at mergers from the standpoint of the UK customer. It is competition policy which is the great shield of the consumer.

In many cases that consumer is, of course, a business. My concern can therefore be restated as ensuring that UK industry has sufficient choice to be able to buy the materials and components it needs at the lowest possible prices and on the best possible terms.

Let me elaborate on what we do not do. We do not look at mergers from the viewpoint of the companies concerned or of investors. The interests of these parties are promoted by other

means. So mergers policy is not in the business of "saving" companies from predators, or indeed from foreign takeovers. I do accept that the threat of takeover adds to the problems faced by those running companies. I am equally certain that removing that threat by adopting a more interventionist stance would not be in the best interests of UK industry. The best defence is, surely, getting your company into such good shape that a predator realises that he can't make a better use of the assets and has no incentive to offer a winning price. This approach is also in the best interests of the economy as a whole.

Whilst competition will be the main consideration in my decision whether to refer I still retain the power to make a reference on public interest grounds. Such cases are exceptional. Public interest is often claimed as the effect of a merger on employment or R&D. These are matters where the parties themselves may be left to take a view. What is good for the firms in the long run will be good for the economy.

The Reference Procedure

What does a reference of a merger to the MMC actually mean? It certainly does not mean that I have anything against the companies concerned. It means only that there are issues which merit further investigation. It is, if you like, the equivalent of a Magistrates hearing, when they are deciding whether there is a case to answer. It is not the full trial and it certainly

does not mean the bid will be blocked - that can only be done if and when the MMC find it against the public interest.

Of course, it is not as simple as that, and the delay and uncertainty of a reference can sometimes lead to bids being abandoned. I have asked the MMC to reduce the delay and they have halved the time they take. A decision to refer is not taken lightly. Of around 240 cases considered this year, only 7 have been referred to the MMC for further investigation. The average year produces about eight cases and the highest is 13 in 1986.

There seems to be a belief that references are sometimes used as a kind of political bolt-hole, and that decisions on whether or not to refer can be influenced by extensive - and expensive - campaigns involving lobbying and advertising. I have even known cases where parties to a bid have published open letters addressed to me in full page advertisements in the national press, although, heaven knows, if they did want to write postage would be cheaper. This is not how the system works.

The first step in the process is for the Director General of Fair Trading to analyse the implications of the bid. He discusses the issues with the parties, their customers and competitors. This assessment, which covers the effect on competition, and any other public interest issues, forms the basis for the Director General of Fair Trading's advice to me whether or not to refer the bid to the MMC. The decision is

mine : but I would need very strong reasons to reject the Director General's advice. On only 9 occasions, out of a total of about 2,000 cases since 1979, has that advice not been followed by the Secretary of State of the day. So the message to companies involved in controversial takeovers who want to influence referral is - don't advertise, don't talk to me, talk to Sir Gordon Borrie.

Confidential guidance

Another service available to prospective bidders is the "confidential guidance" available from the OFT. In appropriate cases the Office can give a confidential indication after consulting me of whether I would be likely or not to refer a particular merger. Such guidance does not tie my hands in making a substantive decision and is based on the limited evidence available at a time when the proposal is not public knowledge. Approximately 30 requests for Confidential Guidance have been dealt with so far this year.

Markets differ

How do some of the more controversial recent reference decisions fit into this framework? I believe with rather more consistency than that adopted by some of the critics. Let me examine some recent cases in more detail.

A competition-based mergers policy is about the economics of evaluating markets and market shares in terms of the competitive structure. In competition terms, market sizes vary greatly.

... a local market

Some markets are confined to a part of the UK. For example recently, in the Badgerline case, I referred a merger between two companies running bus services in Bristol and Avon. Bus services are a market where competition is highly localised; to consider local bus services in the context of the overall UK market for bus services throughout the UK would not make a lot of sense!

... the UK market

Other products and services do have a national, UK-wide market, where competition for the consumer is essentially between UK companies and where, for whatever reason, imports or international sources play only a very minor part. Take package holidays as an example; competition in the market for foreign inclusive tours by air, which is one of the markets in which Thomson and Horizon operate, is mainly between UK companies. Together they have a large market share. There appeared to be no mitigating factors such as competition from overseas operators; and so the bid raised questions of competition and the bid was referred. How valid the questions are, the MMC will consider.

Let's now take a controversial non-reference decision - Rowntree. Here we looked at the effect on competition in our chocolate confectionery market. Continental chocolates do not sell well in the UK, and thus the markets were different.

There were no competition issues: Nestle and Suchard had only 3% and 2% respectively of the UK chocolate confectionery market.

Arguments were put forward that Rowntree should be referred on public interest grounds. The particular issue was reciprocity. Now reciprocity is a tricky concept - especially in the mergers market. It turned out that Swiss companies like Nestle are virtually immune from hostile bids even from other Swiss companies; that some British companies are in the same position. Indeed I was given a list of over 60 British companies that had, often with the consent of their shareholders, protected themselves against unwelcome bids. There are no Swiss Government rules against mergers involving foreign companies. It goes without saying that there are no UK rules either!

To have referred Nestle's bid simply because Nestle was effectively bid-proof would have sent a dangerously misleading signal to other countries about our attitude to inward investment - and invited retaliation against UK investments abroad.

... Europe

For other products competition comes from Europe, or even further afield. That means that the UK consumer can purchase from a very wide range of sources and is not limited to UK producers. The creation of UK companies with large shares of the UK output of such products is entirely consistent with our

concern to encourage effective competition within open markets.

In only a few weeks British Steel is coming to the market, as a single entity. It still has over 60% of the domestic market for finished steel products, yet in the UK it is still faced by competition from other European producers.

Another recent example: at the end of September I announced my decision not to refer the acquisition by Volvo Bus Corporation of Leyland Bus Group. Although Volvo and Leyland Bus together accounted for over 50% of bus and coach deliveries in the UK in 1987, I took into account the competition from European manufacturers, as assessed by the OFT.

... the World

The Minorco bid for Consolidated Gold Fields was referred on competition grounds. The Director General of Fair Trading in the usual way assessed the implications of the bid for the world-wide supply and prices of certain metals and minerals. I accepted his advice. I considered that there was a case to answer - the merger raised competition issues which justified detailed investigation by the MMC.

Incidentally, I have heard it argued that the bid should not have been referred, because titanium and zircon would account for only a minute part of the new group's activities. This is not the test. What must concern me is not the interests of either of the companies involved, or of the new group, but the effect of the new arrangements on the consumer in the UK. The

Director General considered - and I agreed - that the effect of the bid could be to reduce competition. We shall see. I am not prejudging the outcome of the MMC's enquiry. They have hardly begun.

The appointment of inspectors under the Financial Services and Companies Acts had no bearing on the reference, nor was the nationality of the bidder in itself a factor.

The Customer is King

So markets vary. It is too simplistic to say merely that Europe ought to be the market against which competition is judged. For some products or services the market may be a single county - for others it may be the UK. There are circumstances where the whole of Europe is the market and as I have shown on occasion we might have to take the whole world into account.

But in each and every case it is the market that is judged and the effect on the customer is the test. If a merger is likely to lead to loss of choice and higher prices for the UK customer, it will probably be referred. But the corollary follows - where the UK customer has adequate choice as the result of effective competition from elsewhere in Europe or the world, apparently high shares of the UK market created by a merger will not necessarily lead to reference.

What this means is that reference decisions cannot be reduced to some simple arithmetical formula based on market shares. There

is of course a market share test of 25% (together with an assets test for the acquired company of €30 million) in the Fair Trading Act : but these are no more than trigger levels for determining whether the merger qualifies for investigation. The assessment of the competition implications requires a more sophisticated analysis to determine the effect on the consumer.

The Single Market in Europe

As the Single European Market develops, and 1992 approaches, the remaining barriers to trade among the Community countries will gradually be removed. This will increase the scope for competition from Europe, and increase the importance of that factor in our consideration of mergers.

Our policy of taking account of competition from overseas is often confused with a separate issue - that of international competitiveness of UK firms. It is often argued that we should give more weight to international competitiveness. What people mean by this is that a reduction in competition in the UK should be accepted in order to enable large UK groups to be formed to compete more effectively in world markets. We certainly consider claims that a merger will increase efficiency and international competitiveness : but I have to say that all too often in the past the claims have not been borne out by results, and the track record of post-merger performance does not justify our simply taking such claims on trust. In general, therefore, if a merger poses a threat to competition in the UK, we regard the MMC as the appropriate body to balance the prospective

benefits against the detriment to competition.

EC Merger Regulation

I would not want to talk about mergers policy without mentioning the EC proposals for a merger control regulation. Some of the critics of our mergers policy who argue that it is too parochial have gone on to say that implementation of merger control at the European level will provide the ideal solution. I have already made it clear that mergers policy takes the European and international dimension into account, and that there is no need for an EC merger control regulation on this account. In any event, some degree of merger control at the European level already exists in the form of Articles 85 and 86 of the Treaty, which cover competition. It is an entirely separate question as to whether the regulation would provide a better regime for controlling mergers at Community level than the existing regime of Articles 85 and 86. As is well known the UK has reserved its position on the principle of the Regulation, while continuing to participate constructively in Council working group discussions.

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referral if high leveraging combined with some other feature of the bid may have undesirable effects. This is how our policy has operated.

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Merger policy

So to look at a number of reference decisions and draw the conclusion that we are, for example, against bids from a particular country, or a particular type of bid is, if I may say so, so much arrant nonsense. Each merger is different and is considered individually on its merits: we start with a clean slate each time and look at every merger, but within the framework of our stated policy. My aim is to achieve open markets. That is why the main criterion in deciding whether to refer a merger to the MMC is the effect on competition in the UK.

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IND INDS Shipbuilding pt 14

PRIME MINISTER

MEETING OF E(A): 6 OCTOBER

Papers for the three Agenda items are in the separate folders.

Item I - Northern Ireland issues

You saw the main E(A) paper - Flag A - over the weekend. Further papers now enclosed are:

Flag B - Further background to the proposed EFL figures for Harland and Wolff and Shorts. I do not think you need bother with this.

Flag C - Cabinet Office brief - you will want to use this to steer the discussion.

Flag D - A note by George Guise. You will want in particular to read George's comments about Shorts.

There are no major difficulties over Mackies.

On Harlands, you will want to consider

- the latest proposals for a successful disposal
- the deadlines to be set
- the implications of run-down for completion of the AOR
- the proposed EFL.

Shorts is very troubling. George's note describes the very difficult relations between Tom King and the company's management. You will want to consider

- the prospects and timescale for identifying potential bidders, either for the whole business or parts of it;
- whether Shorts should even contemplate developing a new 'plane;
- the European Commission aspects;

- the likely financial disposal; and
- the EFL for 1988/89.

Item II - Amendments to Fair Trading Act

You insisted in earlier correspondence that this should come to E(A).

Over the weekend you saw the initial DTI paper - Flag E. I told DTI that you regarded this as inadequate and they have now provided further material in the letter at Flag F.

Other papers included are:

Flag G - you may like to have to hand the Lord Privy Seal's arguments about the earlier proposal to set aside the hybrid instrument procedure, which Lord Young has now dropped.
Flag H - Cabinet Office brief.
Flag I - Note by George Guise

Lord Young has two proposals still on the table:

(i) The creation of a new offence of deliberately or recklessly supplying false information to the competition authorities. The Cabinet Office brief (paragraph 9) points out that this follows a precedent already set on gas licensing. You may therefore feel this point can be quickly agreed;

(ii) the introduction of a general power enabling the Secretary of State to implement recommendations specified in MMC reports.

This is the issue which most concerns you. The Cabinet Office brief fairly sets out both sides of the argument, and highlights the sort of points which have been troubling you. George

Guise, however, comes down strongly in favour of Lord Young's proposal. I think the key points are:

- there is already a general power in relation to prospective mergers. Are you happy to introduce a further general power relating to mergers which have already taken place and to monopolies, on the basis that the power could only be used to remedy or prevent adverse effects specified in the MMC reports?

- can the effects Lord Young is seeking be achieved, without excessive costs, by further elaboration of specific powers?

Item III - Nitrates

You have already seen last weekend:

Flag J - Cabinet Office paper
Flag K - Cabinet Office brief
Flag L - Policy note.

The only additional paper now available is that by the Minister of Agriculture at Flag M. It encloses a research paper which suggests that the application of nitrogen fertilisers by farmers may not be the main reason for the nitrates problem.

The Cabinet Office brief sets out the main points you will want to work through.

PAUL GRAY
5 October 1988

Duty Clerk.

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P 03238

PRIME MINISTER

AMENDMENTS TO THE FAIR TRADING ACT 1973

E(A)(88) 43

[Letter from Lord Young's private secretary to your office of 3 October]

DECISIONS

The main issue is whether Lord Young should include in next session's Companies Bill wide-ranging powers for the Government to remedy adverse findings by the Monopolies and Mergers Commission (MMC). Under the Fair Trading Act 1973 the Government already has powers to require certain specific types of action following an adverse MMC recommendation. Lord Young wishes to replace these by a general power which would enable the Secretary of State to impose any prohibitions or requirements relating to the carrying on of any business if he considers them requisite for the purpose of remedying or preventing the adverse effects specified in an MMC report. There would be examples in the statute of the types of order which could be made, but these examples would be without prejudice to the generality of the order-making powers. The alternative would be to take precise additional specific powers to fill the gaps which have been identified (for instance, to require information to be supplied for the purposes of monitoring). You will wish to decide which approach should be adopted.

2. Lord Young also seeks agreement to the creation of a new offence of deliberately or recklessly supplying false or misleading information to the competition authorities (that is, to the MMC, the Office of Fair Trading and parts of Lord Young's department). But he is not now proposing to disapply the hybrid instruments procedure for divestment orders.

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BACKGROUND

3. It has already been agreed that a number of proposals contained in the report on Mergers Policy published in March should be included in next session's Companies Bill. These include new procedures for voluntary pre-notification of mergers, for the giving of undertakings in place of an MMC reference, and for the introduction of charging to meet the costs of merger control. Mr Maude minuted you on 5 August with proposals for three further provisions for the Bill, which had not been included in the March document. These were to broaden the order-making powers following an adverse MMC finding, to disapply the hybrid instrument procedure for orders requiring the divestment of assets, and to create a wider offence of supplying false or misleading information to the competition authorities. In September your office twice indicated your concern about the scope of the proposed order-making power, and suggested that a discussion at E(A) was required. Lord Belstead expressed doubt in particular about changing the hybrid instrument procedure. Lord Young has now agreed to drop that proposal. He has not, however, made any modifications to the other two proposals in the paper which he has circulated to E(A).

ISSUES

<u>The case for a general order-making power</u>

4. In his latest letter, Lord Young gives examples of the ways in which the Government's existing powers are unsatisfactory. He says that he has been unable to:

i. stop a company (Ferruzzi) exercising its voting rights;

ii. require a company (British Sugar) to carry on a particular business in a subsidiary;

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iii. require a company (British Sugar) to provide accurate accounting information;

iv. secure enough information to monitor whether abuses had been eliminated (MMC Report on Animal Waste);

v. vary a formula governing prices to be charged by monopolists (MMC Report on White Salt);

vi. require distributors to make popular films available to competing cinemas after a 'first run' of 18 days.

5. He therefore wants to give his mergers policy real teeth by avoiding having to fit order-making powers to a very detailed statutory specification which may not be entirely appropriate. He emphasises two particular points:

i. time and resources. The present process takes up a lot of time (particularly of legal advisers) and is therefore wasteful. The cumulative process is quite large;

and ii. risk of challenge. Having to comply with tightly defined powers exposes the Government to legal challenge. Lord Young will point out that major British companies, advised by leading firms of solicitors, have recently been taking a close interest in the Government's order-making powers, and testing out some of their potential shortcomings.

6. Against this, it can be argued that:

i. the proposed power would appear to be very draconian. The only constraints would be that the Secretary of State would have to consider an Order to be necessary to remedy or prevent adverse effects specified in an MMC Report; and that the Order had gone through the negative Resolution procedure in Parliament. Provided that these were satisfied, the Secretary of State would be able to dictate to any company how

it should run itself, in his own words "requring the behaviour we want" (paragraph 10 of his paper). Would this extend to such things as dismissing staff, declaring dividends, closing down a business, carrying out a reorganisation and dictating commercial decisions? Parliament has in the past been very wary of this sort of general power; and the Courts have scrutinised the exercise of such powers very critically (except in wartime and emergencies), importing judicial review and the rule of natural justice wherever possible.

ii. the proposed power would also extend to a much wider range of situations. The present powers apply only to prospective mergers. The new power would extend also to mergers which have already taken place, to monopolies and to people carrying on an uncompetitive practice. This extension is not fully discussed in these papers, but here again Parliament and the Courts might well be critical;

iii. the power does not appear to be essential. In his letter, Lord Young concedes that it has usually been found possible to achieve the desired result in another way, albeit not the most straightforward one. The problem is that finding the solution requires complicated negotiations, and takes up the time of administrators and legal advisers. He says that "whilst rationalising the powers will not make a great deal of difference in terms of their practical effect, it should help to shorten and simplify the process, thereby saving time and resources".

7. Lord Young recognises that further specific order-making powers would be an alternative way forward (paragraph 11). This would be much less controversial, and could remedy at least some of the shortcomings in powers currently identified. It could certainly deal with the problem of needing authority to require information for monitoring purposes. As Companies Bills are taken

through Parliament relatively frequently, there ought to be reasonably regular opportunities to take further specific powers, should this be justified by future events.

8. You will therefore wish to decide whether to endorse the proposed Order-making power in the interests of having an effective and efficient mergers policy; or whether to invite the Secretary of State only to include in the Companies Bill such further specific Order-making powers as are needed to fill clearly defined gaps in the present powers.

New offence of supplying false or misleading information

9. Lord Young recommends that it should become an offence deliberately or recklessly to provide false or misleading information to the competition authorities. It is already an offence to supply false or misleading information in response to a formal request from the competition authorities. However, most of the MMC's work is carried out informally, and informal work will become even more important in relation to the new voluntary pre-notification of mergers procedure. This extension to statutory coverage of information supplied informally was included in the Gas Act 1986 in relation to any work done by the MMC on gas licensing. Lord Young now seeks to extend it to all the MMC's other investigative work. In view of the precedent set on gas, you may be content to agree to Lord Young's proposal.

HANDLING

9. You may wish to ask the Secretary of State for Trade and Industry to introduce the discussion. The Chancellor of the Exchequer, the Secretary of State for Employment, the Lord Privy Seal and other Ministers may wish to comment briefly. You may wish to invite the Lord President and Chief Whip to comment on how they think Parliament would react to the proposed Order-making power.

RJW.

R T J WILSON
Cabinet Office
5 October 1983

cc BUP I

PRIME MINISTER 5 OCTOBER 1988

AMENDMENTS TO THE FAIR TRADING ACT

The DTI proposals are not a bureaucratic attempt to make Government more intrusive and regulatory in the conduct of business. They are the consequence of improved competition and fair trading policy as set out in publications earlier this year which were generally welcomed by business.

1. Misleading information

A major new proposal is that companies be encouraged to provide pre-merger notification detailing the businesses to be combined and future intentions. After a time gap of several weeks, the merger may proceed if no adverse signal has come back from the OFT. This procedure is designed to speed up business activity and it would make nonsense if false information could be given with impunity. To make its provision illegal is therefore a necessary adjunct to the implementation of an improved procedure.

2. Remedying adverse effects reported by the MMC

Once a merger has taken place or an uncompetitive situation has been identified, existing powers of action are limited. The present law is heavily weighted towards action to prevent a merger or monopoly which has not yet come into being.

The KIO/BP case is a very good current example. Under advice from the MMC the Secretary of State has asked the OFT to obtain undertakings from KIO to reduce its BP shareholding to below 9.9%. Government certainly has the power to do this under existing legislation (although there

may be specific difficulties because of KIO's sovereign ownership).

However, the OFT has also been asked to seek undertakings from KIO not to vote more than 9.9% of its BP shareholding of over 20% even though divestiture of the balance has not been completed. If the KIO ignore this request there is very little that Government can do about it. This is an excellent example of the kind of powers being sought. They would only apply to MMC recommended actions and could not be used to set up DTI inspired witch hunts at whim.

RECOMMENDATION

The DTI's proposed amendments to the Fair Trading Act are logical consequences of the improved mergers and fair trading policies already announced. They are necessary legal mechanisms to enable these policies to operate and should be supported.

GEORGE GUISE

Q10

dti

the department for Enterprise

cc/J F

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

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Our ref PS1BMK
Your ref
Date 3 October 1988

Dear Paul

AMENDMENTS TO THE FAIR TRADING ACT : ORDER MAKING POWERS

In advance of Thursday's E(A), you told me the Prime Minister would welcome more details about how the proposed powers would work.

... I attach the existing powers in Schedule 8 of the Act. It is proposed that these powers should be made more general, so that the Secretary of State may impose any prohibitions or requirements relating to the carrying on of any business if he considers them requisite for the purpose of remedying or preventing the adverse effects specified in an MMC report. Part I of Schedule 8 would give examples of the types of Order which could be made, but these examples would be without prejudice to the generality of the Order-making powers.

The existing general provision in paragraph 12, applies only to prospective mergers; in effect it would be extended to mergers which have already taken place and to monopolies. This would make it possible to make an Order imposing prohibitions, restrictions or requirements where a merger has already taken place, or on a monopolist or on someone carrying on an anti-competitive practice.

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Precisely how these powers will be framed is of course for Parliamentary Counsel. Their effect will be to avoid having to fit the terms of our Orders to the very detailed provisions of the existing Schedule, which may not always be entirely suitable. This process takes time (particularly valuable legal advisers' time) and leaves scope for the powers to be challenged. It may be helpful to illustrate this with some examples, showing the kind of problems we have faced in the past.

Implementing the MMC Reports on White Salt and Animal Waste by order would have involved going beyond the scope of the present powers. For white salt, the difficulty related to the formula governing prices to be charged by the monopolists, allowing the formula to be varied by the DGFT to reflect changing circumstances. For animal waste, we needed to ensure that enough information was provided to monitor whether the abuses identified had been eliminated. In the event, in both cases, the parties were willing to agree to undertakings incorporating the necessary provisions, but if they had not been prepared to do so, we could not have enforced this by Order. Our inability to use the threat of an Order also made it more difficult to bring the negotiations to a rapid conclusion.

In the Ferruzzi/British Sugar case, we were unable, under the present powers, to stop Ferruzzi exercising their voting rights pending divestment of their existing holding, as we should have wished. Another problem which arose when Berisford's first took over British Sugar was that we could not require them by order to carry on the business in a separate subsidiary and provide accurate accounting information.

In the recent case of the Cinema Films Order, to implement the MMC's report we wanted to require distributors to make popular films available to competing cinemas after a "first run" of 28 days. The way we are having to do this is prohibit agreements (under paragraph 1 of the Schedule) whereby the films are supplied to cinemas in circumstances where they are shown at a first run cinema, and not shown at a competing cinema, for 28 days, and are then not made available to any competing cinema which wants it. This makes the Order rather complicated.

As the previous examples show, it is usually been found possible to achieve the desired result in another way, although often not the most straightforward one. But this is often at the cost of much detailed negotiation, involving delay in rectifying the problem, and taking up the time of

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the department for Enterprise

administrators and legal advisers. There are only a few examples of a process which, to a greater or lesser extend, has to be gone through on every case, so the cumulative effect is quite large. It would be unsatisfactory to to the powers piecemeal, as has been done before, or further gaps could come to light later. Whilst rationalising the powers will not make a great deal of difference in terms of their practical effect, it should help to shorten and simplify the process, thus saving time and resources. I hope that on this basis the Sub-Committee will be prepared to agree to the change that the Secretary of State proposes.

I am copying this letter to Private Secretaries to the members of E(A) and to Sir Robin Butler.

Yours

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

the Enterprise initiative

X ANNEX A

SCH. 7

PART III

GOODS PARTLY EXCLUDED IN RELATION TO NORTHERN IRELAND ONLY

Description of goods	*Form of supply excluded*
14. Live pigs.	Supply for slaughter.
15. Fresh uncured carcases or parts of carcases of pigs.	Supply otherwise than by way of retail sale.

Sections 56, 73, 74, 77, 89 and 91.

SCHEDULE 8

POWERS EXERCISABLE BY ORDERS UNDER SECTIONS 56 AND 73

PART I

POWERS EXERCISABLE IN ALL CASES

1. Subject to paragraph 3 of this Schedule, an order under section 56 or section 73 of this Act (in this Schedule referred to as an "order") may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, to make or to carry out any such agreement as may be specified or described in the order.

2. Subject to the next following paragraph, an order may require any party to any such agreement as may be specified or described in the order to terminate the agreement within such time as may be so specified, either wholly or to such extent as may be so specified.

3.—(1) An order shall not by virtue of paragraph 1 of this Schedule declare it to be unlawful to make any agreement in so far as, if made, it would be an agreement to which Part I of the Act of 1956 would apply.

(2) An order shall not by virtue of paragraph 1 or paragraph 2 of this Schedule declare it to be unlawful to carry out, or require any person to terminate, an agreement in so far as it is an agreement to which Part I of the Act of 1956 applies.

(3) An order shall not by virtue of either of those paragraphs declare it to be unlawful to make or to carry out, or require any person to terminate, an agreement in so far as, if made, it would relate, or (as the case may be) in so far as it relates, to the terms and conditions of employment of any workers, or to the physical conditions in which any workers are required to work.

(4) In this paragraph "terms and conditions of employment" has the meaning assigned to it by section 167(1) of the Industrial Relations Act 1971.

1971 c. 72.

4. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, to withhold or to agree to withhold or to threaten to withhold, or to procure others to withhold or to agree to withhold or threaten to withhold, from any such persons as may be specified

bed in the order, any supplies or services so specified or bed or any orders for such supplies or services (whether the holding is absolute or is to be effectual only in particular ances).

An order may declare it to be unlawful, except to such extent in such circumstances as may be provided by or under the to require, as a condition of the supplying of goods or services person,—

(*a*) the buying of any goods, or

(*b*) the making of any payment in respect of services other than the goods or services supplied, or

(*c*) the doing of any other such matter as may be specified or described in the order.

An order may declare it to be unlawful, except to such extent in such circumstances as may be provided by or under the order,—

(*a*) to discriminate in any manner specified or described in the order between any persons in the prices charged for goods or services so specified or described, or

(*b*) to do anything so specified or described which appears to the appropriate Minister to amount to such discrimination,

or to procure others to do any of the things mentioned in sub-paragraph (*a*) or sub-paragraph (*b*) of this paragraph.

An order may declare it to be unlawful, except to such extent in such circumstances as may be provided by or under the order,—

(*a*) to give or agree to give in other ways any such preference in respect of the supply of goods or services, or the giving of orders for goods or services, as may be specified or described in the order, or

(*b*) to do anything so specified or described which appears to the appropriate Minister to amount to giving such preference,

or to procure others to do any of the things mentioned in sub-graph (*a*) or sub-paragraph (*b*) of this paragraph.

An order may declare it to be unlawful, except to such extent in such circumstances as may be provided by or under the order, to charge for goods or services supplied prices differing from those in any published list or notification, or to do anything specified or described in the order which appears to the appropriate Minister to amount to charging such prices.

An order may require a person supplying goods or services to publish a list of or otherwise notify prices, with or without such further information as may be specified or described in the order.

(1) Subject to the following provisions of this paragraph, an order may, to such extent and in such circumstances as may be provided by or under the order, regulate the prices to be charged for any goods or services specified or described in the order.

SCH. 8

(2) An order shall not exercise the power conferred by the preceding sub-paragraph in respect of goods or services of any description unless the matters specified in the relevant report as being those which in the opinion of the Commission operate, or may be expected to operate, against the public interest relate, or include matters relating, to the prices charged for goods or services of that description.

(3) In this paragraph "the relevant report", in relation to an order, means the report of the Commission in consequence of which the order is made, in the form in which that report is laid before Parliament.

11. An order may declare it to be unlawful, except to such extent and in such circumstances as may be provided by or under the order, for any person, by publication or otherwise, to notify, to persons supplying goods or services, prices recommended or suggested as appropriate to be charged by those persons for those goods or services.

12.—(1) An order may prohibit or restrict the acquisition by any person of the whole or part of the undertaking or assets of another person's business, or the doing of anything which will or may have a result to which this paragraph applies, or may require that, if such an acquisition is made or anything is done which has such a result, the persons concerned or any of them shall thereafter observe any prohibitions or restrictions imposed by or under the order.

(2) This paragraph applies to any result which consists in two or more bodies corporate becoming interconnected bodies corporate.

(3) Where an order is made in consequence of a report of the Commission under section 72 of this Act, or is made under section 74 of this Act, this paragraph also applies to any result (other than that specified in sub-paragraph (2) of this paragraph) which, in accordance with section 65 of this Act, consists in two or more enterprises ceasing to be distinct enterprises.

13. In this Part of this Schedule "the appropriate Minister", in relation to an order, means the Minister by whom the order is made.

PART II

POWERS EXERCISABLE EXCEPT IN CASES FALLING WITHIN SECTION 56(6)

14. An order may provide for the division of any business by the sale of any part of the undertaking or assets or otherwise (for which purpose all the activities carried on by way of business by any one person or by any two or more interconnected bodies corporate may be treated as a single business), or for the division of any group of interconnected bodies corporate, and for all such matters as may be necessary to effect or take account of the division, including—

(*a*) the transfer or vesting of property, rights, liabilities or obligations;

(*b*) the adjustment of contracts, whether by discharge or reduction of any liability or obligation or otherwise ; SCH. 8

(*c*) the creation, allotment, surrender or cancellation of any shares, stock or securities ;

(*d*) the formation or winding up of a company or other association, corporate or unincorporate, or the amendment of the memorandum and articles or other instruments regulating any company or association ;

(*e*) the extent to which, and the circumstances in which, provisions of the order affecting a company or association in its share capital, constitution or other matters may be altered by the company or association, and the registration under any enactment of the order by companies or associations so affected ;

(*f*) the continuation, with any necessary change of parties, of any legal proceedings.

15. In relation to an order under section 73 of this Act, the reference in paragraph 14 of this Schedule to the division of a business as mentioned in that paragraph shall be construed as including a reference to the separation, by the sale of any part of any undertaking or assets concerned or other means, of enterprises which are under common control otherwise than by reason of their being enterprises of interconnected bodies corporate.

SCHEDULE 9

Section 91.

PROCEDURE PRELIMINARY TO LAYING DRAFT OF ORDER TO WHICH SECTION 91(1) APPLIES

1. The provisions of this Schedule shall have effect where the Secretary of State proposes to lay before Parliament a draft of any such order as is mentioned in section 91(1) of this Act.

2. The Secretary of State shall cause notice of his intention to lay a draft of the order before Parliament to be published in the London Gazette, the Edinburgh Gazette and the Belfast Gazette and in two or more daily newspapers (other than local newspapers), and shall not lay a draft of the order until the end of the period of forty-two days beginning with the day on which the publication of the notice in accordance with this paragraph is completed.

3. A notice under this Schedule shall—

(*a*) state that it is proposed to lay a draft of the order before Parliament ;

(*b*) indicate the nature of the provisions to be embodied in the order ;

(*c*) name a place where a copy of the draft will be available to be seen at all reasonable times ; and

(*d*) state that any person whose interests are likely to be affected by the order, and who is desirous of making representations in respect of it, should do so in writing (stating his interest

cc Local Govt Water pcs
Nat Ind: Shipbuilding pt 15.

PRIME MINISTER

MEETING OF E(A): 6 OCTOBER

You may like over the weekend to have a first look at the papers for next Thursday's meeting of E(A).

There are three items on the agenda:

1. Nitrates

Last February E(A) commissioned the Cabinet Office to coordinate substantial further work. The paper at Flag A fulfils that remit. Briefs by the Cabinet Office - Flag B - and the Policy Unit - Flag C - provide a steer through the issues.

2. Powers to deal with MMC Reports

You were unhappy with the proposals circulated recently by Francis Maude, and asked the Department of Trade and Industry to submit a paper to E(A). That has now been done, and the paper is at Flag D. Briefing will follow next week.

3. Update on Northern Ireland Economic Issues.

Tom King's paper - Flag E - gives an update on the position at James Mackie, Harland and Wolff, and Shorts. Frankly, it doesn't take us much further on any of these issues. Your main aim will be to ensure that effective action is in hand. I doubt if you will want to use E(A) as the right forum to resolve the issues raised on precise levels of external financing limits for Harland and Wolff and Shorts - I suggest you remit that to Northern Ireland Office/Treasury discussions. Further briefing on this paper will follow next week.

PG

30 September, 1988.

4 CCBP cc PU

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

22 September 1988

Dear Francis,

REVIEW OF MERGERS POLICY

Following receipt of a copy of your minute to the Prime Minister of 5 August, my Private Secretary wrote to yours to indicate my initial reservations about setting aside hybrid instrument procedure on divestment Orders. I have now had the opportunity to consider this matter further and, as your proposals are now to be brought to E(A), you may find it helpful if I set out my views.

On such an important piece of legislation as the forthcoming Companies Bill and in what will be a busy session it would, in my view, be a great pity if we found that debate was needlessly diverted into procedural matters and this, I fear, is what could happen if you proceed with your amendment on divestment Orders.

I get the impression from your minute and from your Private Secretary's letter to Paul Gray of 16 September that since 1956 very few divestment Orders have in fact been made. Indeed I am advised that only two schedule 8 Orders seem ever to have been petitioned against - the Solus Petrol (No.2) Order 1966 and the Regulation of Prices (Tranquillising Drugs) (No.2) Order 1973. The first of these lapsed following agreement between the parties and the second was ordered by the House not to be referred, because it was felt that the findings of the MMC could not be faulted. Even if such Orders were to be petitioned against in the future the chances are that on the 1973 precedent the House might decide not to remit them to a Select Committee. I imagine that, more often than not, the threat of the exercise of the order-making power is sufficient to achieve divestment. The existence of the hybrid instrument procedure does not, at least on the

face of it, seem to have materially affected the effective exercise of the powers up to now.

It is true that matters will normally have been fully explored by the MMC before the Order is laid but prior inquiry is not in itself inconsistent with private legislation procedure - Special Procedure Orders will invariably have been subject to public inquiry, for example. And you yourself concede that you will sometimes wish to make divestment Orders as an alternative to a reference to the MMC - in which case, there will of course have been no prior examination.

I particularly want to advise caution in this matter because when the Labour Government tried to exclude the hybrid procedure from applying in a number of bills in the late 1970s the House gave them a very rough ride. I have in mind here the proceedings on the Offshore Petroleum Development (Scotland) Bill in 1975 and the Local Government (Scotland) Bill 1977 when Gordon Campbell led the charge. As a result , the then Government were obliged to withdraw their proposals and introduce the expedited hybrid instrument procedure instead. Many of our own backbenchers will recall those days and our proceduralists will certainly wish to become involved too! Furthermore, while there are, it is true, a few precedents for disapplying the procedure they do not in their subject matter rest happily with what is now being proposed; nor I must emphasise, did they disapply a procedure which had already applied in a particular circumstance for a considerable number of years (which is what you now propose to do).

All in all, I really do wonder whether we may not be going out of our way to look for trouble so far as divestment Orders are concerned and whether in the circumstances we should not let matters lie.

I am sending a copy of this letter to the Prime Minister, members of E(A), James MacKay, Douglas Hurd, John Wakeham and Sir Robin Butler.

Yours Sincerely

BELSTEAD

The Hon Francis Maude MP

Gov't MACH : Monopolies
+ Mergers

Pt 3

CONFIDENTIAL

File

bc: Policy Unit

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

19 September 1988

Dear Chris,

REVIEW OF MERGERS POLICY

Thank you for your letter of 16 September, which the Prime Minister has seen. She continues to have concerns about the proposals as indicated in my earlier letter of 7 September. The Prime Minister would therefore like these proposals to be brought to E(A). I should be grateful if you could arrange for a paper to be prepared for this purpose.

I am copying this letter to the Private Secretaries to the members of E(A), to Paul Stockton (Lord Chancellor's Office), Nick Sanderson (Home Office), Alison Smith (Lord President's Office), Nick Gibbons (Lord Privy Seal's) and Trevor Woolley (Cabinet Office).

Yours,

Paul Gray

Paul Gray

Chris North, Esq.,
Office of the P.U.S.S. (The Hon. Francis Maude MP),
Department of Trade and Industry.

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PRIME MINISTER

REVIEW OF MERGERS POLICY

You expressed serious reservations about the proposals in Francis Maude's minute of 5 August for tightening up provisions on mergers policy to be included in next Session's Companies Bill. (Earlier papers at Flag A)

Rather than suggest that Mr. Maude put a paper direct to E(A), I asked his office to set out in more detail his arguments for introducing more general order-making powers and disapplying the hybrid instruments procedure for divestment orders.

The DTI letter of 16 September (Flag B) fulfils that remit. The burden of their case is that the proposed changes are necessary to make competition policy effective; and that there are automatic checks in the system, given that the use of powers would be limited to dealing with adverse effects identified by the MMC.

DTI point out that Lord Belstead has expressed reservations about disapplying the hybrid instruments procedure. But both Home Office and Treasury Ministers have expressed themselves content with the package.

If you still want these issues to go to a Cabinet Committee, the obvious choice is E(A). We already have heavy agendas for that Committee at meetings scheduled for late September and early October. And given the evident pressures on your diary, it would be very difficult to fit in another meeting.

Are you now content with the DTI proposals, subject to Lord Belstead's further consideration of the hybrid instruments point? Or do you want us to try to squeeze in a slot for collective consideration? - Yes - we must consider such sweeping power and demands for - yet further withdrawal - from company at E(A). It seems to me an area of bureaucratic zeal

RLG.

Paul Gray

16 September 1988

DG2ARK

dti
the department for Enterprise

B
cc PU

The Hon. Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs

PS/Prime Minister
10 Downing Street
LONDON
SW1

Department of Trade and Industry

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Our ref
Your ref
Date 16 September 1988

Dear Mr Gray,

REVIEW OF MERGERS POLICY jap

You wrote on 7 September about the proposals in my Minister's minute of 5 August.

The Prime Minister was concerned, first, that the proposed new order making powers would be very sweeping. It is true that they would give us a wide-ranging power to make prohibitions or requirements in relation to the carrying on of businesses. However, like the existing powers, the Secretary of State could only use them to remedy or prevent effects adverse to the public interest which the Monopolies and Mergers Commission have identified. Any attempt to overstep the limits the MMC's findings impose would be open to challenge.

The present powers (copy at Annex A) are already wide-ranging (including, as well as powers to prohibit agreements and control prices, a power to require a company to sell off parts of its business). But since they take the form of specific provisions it can sometimes be difficult to fit what the MMC may recommend, or we may think appropriate, to remedy the adverse effects within the powers. In addition to the difficulties mentioned before - in relation to obtaining information to help monitor compliance with an order, or requiring a particular business to be carried on by a separate subsidiary - many of the powers relate only to goods and services and not other business activities such as the granting of licences to enter on or use land (eg for car parking); it can in some cases be difficult to restrict the exercise of voting rights; and the powers to require publication of information are limited. Such problems can result in unnecessarily complicated drafting or in delay. These have

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the Enterprise initiative

arisen in a number of cases. One example is the 1983 MMC report on cinema film distribution, on which we have just announced our intention to make an order; because of the terms of Schedule 8, this has had to be couched in the roundabout terms of prohibiting agreements, rather than simply insisting on particular action.

Adequate remedies are essential to an effective competition policy. Once the MMC have found something to be against the public interest, any difficulties or delays in dealing with it only allow further exploitation of consumers - both industrial and final consumers - with consequent costs to the economy. It would be possible to add to the detailed provisions but this could still leave gaps; since we have the opportunity, it seems preferable to take a general power with specific examples. The ultimate safeguard against abuse would remain that this could only be used to deal with the adverse effects found by the MMC. Moreover, if other Departments' interests were affected one could not envisage these powers being used without prior consultation, in addition to the statutory requirement for public notice.

The other point raised by the Prime Minister was about disapplying the hybrid instruments procedure from divestment orders. Lord Belstead has already expressed some reservations about this, and said that he would like to consider it further. My Minister recognises that this could cause difficulties with the Lords, and that the offsetting advantages are hypothetical, until the need arises - but this may occur at any time. The arguments here are the same as for orders generally; that effective remedial powers are essential to the success of the policy. The case for taking them out of the ambit of procedures designed to protect private interests, is that those private interests would already have been found by the MMC to be in conflict with the public interest; and there is also a consultation procedure in the Act. The delay which could be caused by the need for a Lords Committee to hear representations, and then possibly refer the matter to a Select Committee - even if that did not lead to the MMC's findings and recommendations being over-turned - could allow anti-competitive situations to be prolonged.

The need for these powers will be greater once we accept undertakings to divest parts of businesses instead of referring mergers to the MMC. Accepting undertakings could weaken our position on anti-competitive mergers unless undertakings can be adequately enforced. Like other undertakings obtained under competition legislation, we propose making these directly enforceable in the Courts, but in the last resort we may need to make an order by statutory instrument. Previous instances where the hybrid instruments procedure has been disapplied are

GOVT. MACH: Monopolies & Mergers
Pt. 3

dti

the department for Enterprise

the Local Government Act 1972, Schedule 3, paragraph 1(3); the Water Act 1973, Section 3(11), and the Independent Broadcasting Authority Act 1974, Section 3(7).

Finally, John Cope's letter to my Minister of 9 September expresses concern about whether the new order-making powers will apply to terms and conditions of employment. This is something officials are discussing, and requires careful consideration: but is subject to whatever is decided on the more general power.

I am copying this letter to the Private Secretaries to members of E(A), the Lord Chancellor, Douglas Hurd, John Wakeham, Lord Belstead and Sir Robin Butler.

Yours sincerely,

Chris North

CHRIS NORTH
Assistant Private Secretary

JCHAFD

the enterprise initiative

34 ACQUISITIONS AND MERGERS IDENTIFIED WITH FRENCH CONCERNS : 1987 TO DATE

YEAR	QUARTER	UK COMPANY	£m. PRESENT VALUE (where known)	FRENCH COMPANY
1987	1	BRENT CHEMICALS INTE		BLANCOMME SA
1987	1	HORTONS GROUP		AUXIGLASS
1987	1	PEPE GROUP	2.6	BUFFALO SA
1987	1	SAMUELSON GROUP		SOCIETE ANONYME MONEYESQUE VIDEAU
1987	2	BRENT CHEMICALS		PACKAGING INTERNATIONAL
1987	3	AVON RUBBER	3.8	ABUR CAOUTCHOUE
1987	3	COURTAULDS PLC		DLR TEXTILES
1987	3	GUINNESS PLC		HEDIARD
1987	4	GRAMPIAN HOLDINGS PL	2.2	ASSETS OF PATRICK SA
1987	4	GRANADA GROUP	7.3	GL DISTRIBUTION
1987	4	KUNICK PLC	0.7	COIN EQUIPMENT
1987	4	MEGGITT HOLDINGS	0.5	SDMI SA
1987	4	ROWNTREE MACKINTOSH		CANDICE-MARTIAL
1987	4	RUGBY PORTLAND CEMEN	6.0	SOCIETE FINANCIERE V
1987	4	STEETLEY PLC	10.0	DOUANNE
1987	4	W H SMITH & SONS	0.7	TV SPORTS CHANNEL
1987	4	WCRS GROUP PLC		GROUP BELIER
1988	1	COATES BROS PLC		LORILLEUX INTERNATIONAL
1988	1	GRANADA GROUP PLC	1.1	GL DISTRIBUTION
1988	1	KWIK-FIT HOLDINGS PLC	5.6	TOURS PNEUS
1988	1	STEETLEY PLC	25.7	SOCIETE CARRIERES DE LA MEILLERAIE
1988	1	W H SMITH & SON (HOL)		FRENCH-LANGUAGE TV S
1988	2	CAP GROUP PLC	94.0	SEMA-METRA
1988	2	MAXWELL COMMUNICATION	0.1	FRANCOIS IMPRIMERIE
1988	2	MILLS & ALLEN GROUP	0.1	EUROPOSTER
1988	2	PEARSON PLC	0.1	LES ECHOS
1988	2	SAVAGE GROUP PLC	0.1	TRIPLEX
1988	2	T & N PLC	3.8	SIME INDUSTRIE

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Handed to P.M. by Lord Young 1/9
PA – Mergers Policy Ch.
PECG 1/9

YEAR	QUARTER	UK COMPANY	PRESENT VALUE (where known)	FRENCH COMPANY
1988	2	THE LAIRD GROUP PLC	22.3	CPIO GROUP
1988	2	THE WCRS GROUP PLC	64.4	SGGMD
1988	3	HYMAN	2.8	FRANCEL
1988	3	LOWE HOWARD SPINK & BELL	0.6	ADVERTISING ARM OF QUADRILLAGE
1988	3	MCCARTHY & STONE PLC	15.1	MERLIN IMMOBILIER
1988	3	THORN EMI PLC	87.0	HOLOPHANE

DW4ANC

LS-P-05

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Department of Employment
Caxton House Tothill Street London SW1H 9NF
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Minister of State

The Hon Francis Maude MP
Parliamentary Under Secretary of State
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1

9 September 1988

Dear minister

REVIEW OF MERGERS POLICY

I have seen the Prime Minister's response to your note of 5 August, as recorded in the Private Secretary's letter of 7 September.

This Department has a particular concern because of the possible implications of broadening the existing order-making powers, as you propose, to affect agreements relating to terms and conditions of employment. These are currently excluded. I am sure that such a change would require careful consideration and I would therefore like us to be represented in any further discussions.

I am copying this letter to the Prime Minister, members of E(A), James Mackay, Douglas Hurd, John Wakeham, John Belstead and to Sir Robin Butler.

Yours sincerely

Robert Ledlam

pp JOHN COPE

(Approved by the minister and signed in his absence)

CONFIDENTIAL

CC90

ST. ANDREW'S HOUSE
EDINBURGH EH1 3DG

NBPM
RRG
9/9

The Hon Francis Maude MP
Parliamentary Under-Secretary of State
for Corporate Affairs
Department of Trade and Industry
1 -19 Victoria Street
LONDON
SW1H 0ET

9 September 1988

Dear Francis,

REVIEW OF MERGER POLICY

I have now seen your minute of 5 August to the Prime Minister and copied to colleagues seeking comments by 9 September on proposed changes to improve the operation of the Fair Trading Act.

I am content with the changes you propose and have no detailed comment to offer.

Copies of this letter go to the recipients of your.

Yours ever,

MALCOLM RIFKIND

IPP242F4

GON MACH : Monopolies + Mergers
pt 3

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DG2 CWN

bc BG

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

7 September 1988

Dear Andrew,

REVIEW OF MERGERS POLICY

The Prime Minister was grateful for Mr. Maude's minute of 5 August. She has also seen the Home Secretary's letter of 19 August and the Financial Secretary's of 31 August. The Prime Minister is concerned about some aspects of these proposals. In particular she regards the proposed new order making powers as very sweeping and wonders, for example, who would decide on their use and on what basis. She is also not persuaded that it would be appropriate to change the hybrid instrument procedure for divestment orders.

The Prime Minister would be grateful for further comment on these points, and has commented that it may be necessary to convene a meeting to discuss the proposals.

I am copying this letter to the Private Secretaries to the members of E(A), to Paul Stockton (Lord Chancellor's Office), Nick Sanderson (Home Office), Alison Smith (Lord President's Office), Nick Gibbons (Lord Privy Seal's Office) and to Trevor Woolley (Cabinet Office).

Yours ever,

P J Gray

Paul Gray

Andrew Heyn, Esq.,
Parliamentary Under Secretary of State's Office (Mr. Maude),
Department of Trade and Industry.

CONFIDENTIAL

Y SWYDDFA GYMREIG
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WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switsfwrdd)
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Cadi arth Ysgrifennydd Gwladol Cymru

cc PUS

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switchboard)
01-270 (Direct Line)
From The Secretary of State for Wales

MBR
RRL 6/9

The Rt Hon Peter Walker MBE MP

5 September 1988

PS/PM OOR

REVIEW OF MERGERS POLICY

Thank you for sending me a copy of your minute of 5 August 1988 to the Prime Minister.

Although I can foresee some difficulties on the way, and the provisions will need to be carefully framed, I do not disagree with your intention to seek these powers.

I am copying this letter to the Prime Minister, other members of E(A), James Mackay, Douglas Hurd, John Wakeham, John Belstead and Sir Robin Butler.

The Hon Francis Maude MP
Parliamentary Under Secretary of State
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

Gov Mach

Mem

Pt 3

PRIME MINISTER

A

REVIEW OF MERGERS POLICY

Flag A Francis Maud's minute of 5 August sought E(A) agreement to three of the tightening up provisions on mergers policy for next session's Companies Bill that might prove controversial:

1. Extending the order-making powers to remedy matters which the MMC find against the public interest.

2. Disapplying the hybrid instrument procedure for divestment orders following adverse monopoly or merger reports.

3. Introducing a general offence of deliberately or recklessly supplying false or misleading information to the Secretary of State, Director General of Fair Trading or MMC.

Flag B The Home Secretary (19 August) and Financial Secretary (31 August) Flag C are content.

The proposals strike me as justified.

Content to give policy agreement, subject to any other detailed comments by colleagues?

No - there are really sufficient powers (i.e. 1 + 2) and they must be agreed in the appropriate Cabinet committee.

MT

S. Mains
P. Clark
pp PG

5 September, 1988.

JD83

253/77/JRF

Treasury Chambers, Parliament Street, SW1P 3AG

The Hon Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

31 August 1988

Dear Minister,

REVIEW OF MERGERS POLICY

I have seen a copy of your minute of 5 August to the Prime Minister about the review of mergers policy.

Nigel Lawson and I have very much welcomed this review and Treasury officials have been closely involved with yours in working out the details. I am content with the three changes you propose.

I also note that in your view, the other technical amendments are minor and likely to attract little attention. I understand that these are to be cleared at official level, and am content for them to be handled in this way.

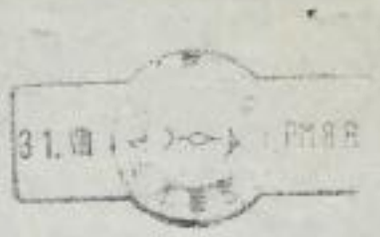
Copies of this letter go to the Prime Minister, members of E(A), James Mackay, Douglas Hurd, John Wakeham, John Belstead and Sir Robin Butler.

Yours sincerely,

Robert Sutherland

pp NORMAN LAMONT

(Approved by the Financial Secretary and signed in his absence)



Sav MAGI

M&M

P+3

B cc PS

CF
Leave it until
next week. Then the
P/F again.

QUEEN ANNE'S GATE
LONDON SWIH 9AT

19 August 1988

Dear Francis,

You copied to me your letter of 5 August to the Prime Minister.

My interest lies in the proposed new criminal offence of supplying false or misleading information to the competition authorities in the standard questionnaire. I am content with the proposed offence in principle but should be grateful if my officials could be consulted about its detailed formulation.

A copy of this letter goes to the recipients of yours.

Yours ever,

Douglas.

The Hon Francis Maude, MP

GOTT MACHT: Würfeln + Neuzeit PB

dti

the department for Enterprise

To:

Prime Minister

From:

Francis Maude

5 August 1988

REVIEW OF MERGERS POLICY

Earlier this year, QL agreed that next session's Companies Bill should incorporate a number of provisions relating to mergers. These were to implement the proposals agreed by E(A) for the voluntary pre-notification of mergers, statutory undertakings instead of reference to the MMC, and a charge to cover the costs of merger control; and also to make a number of technical amendments to the existing provisions. Most of these are minor changes designed to improve the working of the Fair Trading Act, and should attract little attention. However three of them involve some strengthening of the powers, and for that reason, whilst likely to be the most useful, could also prove controversial. I am therefore writing to seek the agreement of colleagues to the three changes described below.

Order-making Powers

Schedule 8 of the Fair Trading Act sets out the powers which can be used to remedy matters which the Monopolies and Mergers Commission has found to be against the public interest. It is very detailed and specific - for example, orders can declare specified agreements to be unlawful, prohibit the withholding of goods or services or prohibit discriminatory treatment. But the list is by no means comprehensive, and does not for example allow us to insist on the provision of information to help monitor compliance with the order, or to require a particular business to be carried on by a separate subsidiary. Rather than attempting to extend the list of specific provisions, which might still leave gaps, we propose taking a broader power to impose such prohibitions or requirements in relation to the carrying on of any business as are considered requisite to remedy or prevent the adverse affects found by the MMC; there might be a list of examples, but without prejudice to the generality of the powers.

This change will reinforce our powers to act on MMC reports, and to some extent simplify the process, by allowing us to impose whatever remedies seem most suitable to deal with the adverse effects, without having to fit them to the very specific provisions of the schedule. But it may be criticised as giving us new and more far reaching powers. The answer to

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this is that, as at present, we shall only be able to make orders following an adverse finding by the MMC, and will be tied by the MMC's conclusions, reached after a full enquiry. All interested parties will have had an opportunity to put forward their views to the MMC, and will also be able to make representations on the draft order itself. It is quite wrong if something which the MMC have already found to be against the public interest, can continue to the detriment of the public merely because of insufficient powers to deal with it.

Divestment Orders

Part II of this Schedule gives powers to order divestment, following adverse monopoly or merger reports. The orders are subject to Affirmative Resolution, and as they affect persons' private rights are subject to the hybrid instrument procedure. This gives those adversely affected by the order a right to petition the Lords; a Committee then hears written and oral representations, and may recommend that there should be a further enquiry by a Select Committee (although this recommendation may be overturned by the House itself).

It is clearly unsatisfactory that a matter which has already been fully examined by the MMC should be open to re-examination by a Select Committee before action can be taken. It means such orders are harder to make, and whilst there have been very few in the past, the power is an important one, which I have made clear we are prepared to use when appropriate . It will in any case be needed to back up divestment undertakings obtained instead of a merger reference, as proposed in the mergers Blue Paper. Apart from the initial MMC inquiry, parties have the opportunity to make representations before the order is laid, and any matters still unresolved can be aired when the orders are debated. For these reasons, I believe we can justify disapplying the hybrid instruments procedure, for which there are a number of precedents. However, such a change will inevitably prove controversial, particularly in the Lords, and will require careful handling.

New offence of providing false or misleading information

At present, supplying false information to the Competition authorities is only an offence if done in response to the formal powers to obtain information. These are seldom invoked, and most information is supplied to a greater or lesser extent voluntarily. The new voluntary merger pre-notification procedure in particular will rely heavily on the information supplied in the standard questionnaire being correct. Supplying false information would clearly be an attempt dishonestly to obtain an advantage, whether it is clearance of a merger, or diverting the authorities from the activities of the monopolist. We therefore propose to introduce a general offence of deliberately or recklessly supplying false or misleading information to the Secretary of

dti

the department for Enterprise

State, Director General of Fair Trading, or MMC for the purpose of their functions under the Fair Trading Act, Competition Act 1980, Telecommunications Act 1984 or Airports Act 1986. My officials have already discussed this with those in the Home Office.

I should be grateful to know whether colleagues are content with these proposals by 9 September.

I am copying this minute to the members of E(A), James Mackay, Douglas Hurd, John Wakeham, John Belstead and Sir Robin Butler.

FM

MN3ACN

the Enterprise initiative

GOUT mach : Mano images pt3

18

SECRET 3
COMMERCIAL IN CONFIDENCE

c/fC a

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB
Telephone 01-218 2111/3

MO 26/8/2L

22nd July 1988

Dear Charles,

SALE OF SINGER LINK MILES LTD

You wrote to Brian Hawtin on 7th July seeking comments on a note by a member of the Policy Unit on the possible sale of Singer Link Miles to Thomson CSF. I should emphasise that MOD has not been approached by either company and that there are unsubstantiated rumours that others may also bid for the business. GEC and MBB are two names which have surfaced. We have no information on the likelihood of the sale.

Singer Link Miles are a major defence contractor. In 1986/87 the company had approximately £75.5m of MOD work on their books, the majority with the air systems controllerate. They have an involvement with Jaguar, Tornado, Sea Harrier, Harrier, Lynx and Sea King. The company are currently bidding for the Trident Command Team Trainer, and are also included on the list of recipients for the specification for the Precision Gunnery Trainer for the Challenger 1 tank.

On some projects the company have had and, if they are successful in the Trident competition, will need access to sensitive information. However information classified as confidential and above is covered by standard contractual conditions which would be called up in the relevant contracts. Such information can only be handled by nominated individuals who have previously been cleared by the MOD. Should a company divulge any information to unauthorised personnel it would be in breach of its contract and the company would also be debarred from receiving future MOD orders.

We do not consider that the possible sale of the company to Thompson CSF presents any cause for concern. The MOD do not seek to influence the ownership of private companies and foreign ownership does not of itself debar a company from receiving MOD contracts. You may like to note that, following the sale of the Reddifusion Simulation business to Hughes of America, there are no UK owned simulator manufacturers. Sensitive information in this area is protected in the contracts let by MOD in the manner described above.

Yours sincerely,

John Colston.

(J P COLSTON)
Private Secretary

Charles Powell Esq
10 Downing Street

P.S. Since writing this, I understand that we have had informal indications from Thomson, that they might be interested in a joint purchase with VSEL and an unnamed Italian company.

COMMERCIAL IN CONFIDENCE
SECRET

GOURMACH: marketing & mgt pt3

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

7 July 1988

SALE OF SINGER LINK MILES LTD

I enclose a copy of a note by a member of the No.10 Policy Unit about the proposed sale of Link Miles to the French Group Thompson CSF. I should be grateful for any comments you may have.

C. D. Powell

Brian Hawtin, Esq.,
Ministry of Defence.

SECRET - MARKET SENSITIVE

SECRET - MARKET SENSITIVE

MR POWELL 6 July 1988

SALE OF SINGER LINK MILES LTD

An anglophile American consultant has informed me of the following: Link Miles is a British subsidiary of the US Singer Group which is currently being broken up and sold off in bits by the US corporate raider, Belzerian. Current negotiations are underway for the sale of Link Miles to Thompson CSF of France for a price of the order of $200m. It was originally planned that BAe would bid in conjunction with Thompson CSF but BAe subsequently dropped out.

I am advised that, inter alia, Link Miles is involved with British MOD work involving training and combat simulators for tanks and submarines. My informant believes the intellectual property within Link Miles is of considerable military value and that our MOD should seek to prevent the sale to France. He has taken this up with the US DOD but claims that they are so preoccupied with scandal quenching on other fronts that they cannot be relied upon to pursue the matter. In any case US defence interests may be less involved than ours.

I will let you know the name of the consultant if you wish who assures me that he has no direct or indirect financial interest in the outcome of the proposed sale.

GEORGE GUISE

COMMERCIAL IN CONFIDENCE

PA

Prime Minister

BRC6
23/6

Ref. A088/1925

MR GRAY

Mr Robert Maxwell and Societe Generale de Belgique

Rumours have been breaking in Continental papers that Mr Maxwell is coming on the scene as a 'White Knight' in an attempted takeover of the Belgium conglomorate, Societe Generale de Belgique (SGB), by the Italian entrepreneur Signor De Benedetti. Mr Maxwell wanted the Prime Minister to know the facts, although only part of what follows will be contained in a press statement which he is putting out this evening.

2. Signor De Benedetti has been trying to gain control of SGB, but has not quite succeeded in gaining an overall majority. Mr Maxwell has entered an agreement with the French company, Suez, under which Mr Maxwell will buy a proportion of Signor De Benedetti's shares in SGB, and then will set up a joint company with Suez with capital of £400 million - part provided by Mr Maxwell and part provided by SGB - which will diversify into areas of the communications industry in Europe. Mr Maxwell sees this as a benefit to his own business in extending his communications interests into Europe in a way which is complementary to his interests here, but which also contributes to the UK's effort towards 1992 and the single market.

3. Mr Maxwell emphasised that this information is for the Prime Minister alone for the time being: he will be telling Lord Young about these plans shortly.

M Wadley

MP ROBIN BUTLER

22 June 1988

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FRBAHT

cc RG

MBM

RRCG

2016

CONFIDENTIAL

QUEEN ANNE'S GATE
LONDON SWIH 9AT

20 June 1988

Dear Norman.

RESTRICTIVE LABOUR PRACTICES:
POSSIBLE FURTHER REFERENCE TO THE MMC

Thank you for your letter of 14 May. I agree that the Deregulation Unit is probably the most suitable means of compiling information about promising candidates for further reference under section 79. I am therefore nominating Mrs M E Moxon as your official contact.

I am copying this letter to the Prime Minister, members of E(CP) and to Sir Robin Butler.

Yours

Douglas.

The Rt Hon Norman Fowler, MP.

CONFIDENTIAL

GOVT MACH : Monopoles and Meters PTB

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the department for Enterprise

The Hon. Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

The Rt Hon Norman Fowler MP
Secretary of State for
Employment
Department of Employment
Caxton House
Tothill Street London SW1H 9NF

Direct line 01-215 4417

Our ref

Your ref

Date 13 June 1988

Dear Norman,

RESTRICTIVE LABOUR PRACTICES: POSSIBLE FURTHER REFERENCES TO MMC

I refer to your letter of 14 May to Nigel Lawson about restrictive labour practices and possible further references to the MMC.

I agree that we should undertake a general trawl to identify further possible candidates for reference under Section 79. In examining likely industries and services there are a couple of points worth emphasising. First a reference must specify a particular practice to be investigated - though the decision whether it does amount to a restrictive labour practice is for the MMC - and the MMC cannot go on a "fishing expedition". Second the reference must relate either to commercial activities generally or to the supply of specific goods or services or the export of specific goods; this means that the practice must be prevalent in an industry and not merely confined to a few firms. The term "commercial activities" would also rule out some public services.

I have asked Mr Herron in this Department to contact Mr Johnson in your Department. Meanwhile I am copying this letter to my colleagues in DTI in order to start the search for possible candidates who fall within their areas of responsibility.

JCEAAR

the Enterprise initiative

GOV'T MACH: Monopolies + Mergers Pt 3

dti

the department for Enterprise

I am also copying this letter to recipients of yours.

FRANCIS MAUDE

JCEAAR

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

7 June 1988

Thank you for your letter of 27 May to Nigel Wicks with which you enclosed your Minister's paper on accounting for mergers and acquisitions. The Prime Minister has seen this and noted your Minister's view that it would be wrong to try to restrict the permitted treatments by law while the profession is itself reviewing accounting standards.

Dominic Morris

Andrew Heyn, Esq.,
Department of Trade and Industry.

PRIME MINISTER

Agreed - no need for us to intervene. We will await the professions review of accounting standards

Francis Maude's paper on merger accounting covers the one item of unfinished business from last year's review of mergers policy.

BACKGROUND

You and colleagues were concerned that current accounting procedures could be used by firms in a takeover to disguise the cost of the subsequent reorganisation and to make post-merger acquisition performance look more attractive than it really is.

Paragraph 11 of the paper lists the main vulnerabilities of the present system. In brief, firms can use one or other of the two accounting treatments (merger or acquisition accounting) as suits their book and can put an artificially low value on the assets being used when measuring how well they are performing. This happens when goodwill is eliminated when it is passing through the profit and loss account.

You agreed last year that the key was greater disclosure.

DTI's PROPOSALS

The paper proposes to keep the two types of accounting treatment. Its key feature is the additional statutory disclosure powers which DTI intend to put into the Companies Bill scheduled for the coming session. The main proposals are in paragraph 18. In brief, the disclosure should ensure that shareholders and analysts will be made aware which of the alternative accounting treatments have been used and of the different results recorded.

DTI have drawn back from using legislation to outlaw some of the more creative accounting methods used in bids over the last couple of years.

They do propose, however, that in calculating goodwill in acquisition accounting companies cannot write off acquired goodwill to a revaluation reserve (i.e. it stops them artificially depressing the price of acquired assets and keeping them off the profit and loss account).

DTI also have reserved their position to introduce future secondary legislation to deal with companies using merger relief and acquisition accounting to get the best of both worlds. The threat of legislation is to keep the accounting standards bodies on their toes during the review of the next six months.

CONCLUSION

I think that these proposals address the key elements of the concern you expressed last year and would not suggest any intervention in the correspondence.

DM.

DOMINIC MORRIS

3 June 1988

THE TIMES

THURSDAY JUNE 2 1988

PA – Mergers

United Biscuits' chief hits out at shareholders selling UK fi

'At any price it is still prostituti

By Sir Hector Laing

Calling for a re-think: Sir Hector Laing, opening Poplar business park in London's Docklands this week

Who *are* the shareholders? And what *do* they want? The "shareholders" who make the life-or-death decisions for British public companies are approximately 50 or 60 fund managers in major financial institutions, who may or may not personally own a few shares, but who have been appointed agents to manage millions of shares for millions of individual pension fund members and life policy holders.

Those managing agents probably believe that, by maximizing the value of their funds through short-term dealing, they are acting in their clients' best interests. But perhaps we should be asking them, and they should be asking themselves, if they really are.

Do we really want to go down in history as the generation which sold for a mess of pottage the finest British companies, which have successfully built brand names and franchises of high repute over a century or more – companies which are well managed and provide a good return on investment, and which are committed to making a contribution to the communities in which they trade and operate in terms of leadership as well as resources? I do not believe the vast majority of people want to see British industry sold abroad for jam today.

Considering the number of major British companies currently the subject of takeover speculation, it seems that in the present climate any and all of British industry is for sale if the price is right. Prostitution is not a pretty word, and I am sure we will not sell ourselves cheap – but at any price it is still prostitution.

Do we suppose that a national institution like Marks and Spencer could not fall to foreign control if someone offered double the present share price? What then of their "Made in Britain" policy? What prospects then for the Yorkshire textile industry? British trade, industry and commerce are interdependent, and loss of control of key companies would have very damaging knock-on effects.

If too many of our major companies are taken over by non-British owners, and free market forces make that more rather than less likely, then the UK will become increasingly a satellite economy, with decision-makers based elsewhere. If the strategic management decisions about businesses operating in this country are taken in Munich or Milan, in Minneapolis or Melbourne, who will then uphold the interests of British employees and British communities? Do we not care or do we not understand?

As a Scot I have not enjoyed seeing the control of many large businesses moving out of Scotland because of the concentration of wealth and power in the South-east of England, where those who call the shots are more likely to be based. As a Briton I do not want that to happen to the United Kingdom as a whole, because it would not be loss of commercial power only, but ultimately of political power as well. If Britain loses its economic power base with the loss of ownership of its major businesses, who in the world would heed our views? We would be reduced to political serfdom too.

I recognize that it is important for Britain to remain an open market, and that our financial services industry depends on a free international flow of money, but the City enjoys a substantial degree of protection under Banking and Financial Services Acts.

It is said that chauvinism is wrong, but the Germans, French and Japanese have free market economies and trade successfully in world markets, and they are certainly chauvinistic – much more so than we are. They have economic and financial structures which safeguard their national interests. Are we so sure that our policy is right and everyone else's is wrong? We must safeguard *our* national interest – otherwise, some of what we think of as large British companies, but which are by world standards very small, will become increasingly easy takeover targets for much larger foreign predatory companies.

The Government should now redefine the terms of reference of the Monopolies and Mergers Commission so that we can create world-class British companies specialized in one industry, even if this appears to reduce UK competition. In parallel, perhaps we should at least stall the speed at which control of our businesses can be transferred, and block those speculators whose only interest is to make a quick killing by putting a company in play.

In a contest something inc potence of a c employees, wh with the conc the hands of managers. It se arbitrageur wh shares only las the fate of the who have give service.

Would it no some formula t balance betwe For example, r required to " holding their s and employees equivalent to shares by lengt 10 years.

We have f Britain indepe going to sell th cash gratificat money always so cynical that Wilde's definit price of everyt nothing"? Wh grandchildren doing while C sold her indep her self-respect them?

I am not calli in our capital sy attitudes to ma acceptance of re ship on the par that they are b term interests c and the nation.

THE TIMES

THURSDAY JUNE 2 1988

PA – Mergers (H)

United Biscuits' chief hits out at shareholders selling UK firms

'At any price it is still prostitution'

Calling for a re-think: Sir Hector Laing, opening Poplar business park in London's Docklands this week

By Sir Hector Laing

Who *are* the shareholders? And what *do* they want? The "shareholders" who make the life-or-death decisions for British public companies are approximately 50 or 60 fund managers in major financial institutions, who may or may not personally own a few shares, but who have been appointed agents to manage millions of shares for millions of individual pension fund members and life policy holders.

Those managing agents probably believe that, by maximizing the value of their funds through short-term dealing, they are acting in their clients' best interests. But perhaps we should be asking them, and they should be asking themselves, if they really are.

Do we really want to go down in history as the generation which sold for a mess of pottage the finest British companies, which have successfully built brand names and franchises of high repute over a century or more – companies which are well managed and provide a good return on investment, and which are committed to making a contribution to the communities in which they trade and operate in terms of leadership as well as resources? I do not believe the vast majority of people want to see British industry sold abroad for jam today.

Considering the number of major British companies currently the subject of takeover speculation, it seems that in the present climate any and all of British industry is for sale if the price is right. Prostitution is not a pretty word, and I am sure we will not sell ourselves cheap – but at any price it is still prostitution.

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If too many of our major companies are taken over by non-British owners, and free market forces make that more rather than less likely, then the UK will become increasingly a satellite economy, with decision-makers based elsewhere. If the strategic management decisions about businesses operating in this country are taken in Munich or Milan, in Minneapolis or Melbourne, who will then uphold the interests of British employees and British communities? Do we not care or do we not understand?

As a Scot I have not enjoyed seeing the control of many large businesses moving out of Scotland because of the concentration of wealth and power in the South-east of England, where those who call the shots are more likely to be based. As a Briton I do not want that to happen to the United Kingdom as a whole, because it would not be loss of commercial power only, but ultimately of political power as well. If Britain loses its economic power base with the loss of ownership of its major businesses, who in the world would heed our views? We would be reduced to political serfdom too.

I recognize that it is important for Britain to remain an open market, and that our financial services industry depends on a free international flow of money, but the City enjoys a substantial degree of protection under Banking and Financial Services Acts.

It is said that chauvinism is wrong, but the Germans, French and Japanese have free market economies and trade successfully in world markets, and they are certainly chauvinistic – much more so than we are. They have economic and financial structures which safeguard their national interests. Are we so sure that our policy is right and everyone else's is wrong? We must safeguard *our* national interest – otherwise, some of what we think of as large British companies, but which are by world standards very small, will become increasingly easy takeover targets for much larger foreign predatory companies.

The Government should now redefine the terms of reference of the Monopolies and Mergers Commission so that we can create world-class British companies specialized in one industry, even if this appears to reduce UK competition. In parallel, perhaps we should at least stall the speed at which control of our businesses can be transferred, and block those speculators whose only interest is to make a quick killing by putting a company in play.

In a contested takeover, there is something inequitable in the impotence of a company's long-service employees, which contrasts strongly with the concentration of power in the hands of a relatively few fund managers. It seems all wrong that an arbitrageur who might have bought shares only last month could decide the fate of thousands of employees who have given many years of loyal service.

Would it not be sensible to devise some formula by which to redress the balance between money and time? For example, shareholders might be required to "earn" their vote by holding their shares for, say, a year, and employees might "earn" a vote equivalent to a defined number of shares by length of service – say after 10 years.

We have fought wars to keep Britain independent. Are we now going to sell that heritage for instant cash gratification? It is said that money always talks, but are we really so cynical that we conform to Oscar Wilde's definition of knowing "the price of everything and the value of nothing"? When our children and grandchildren ask us what we were doing while Great Britain Limited sold her independence, and with it her self-respect, how will we answer them?

I am not calling for a radical change in our capital system but a re-think of attitudes to trading in capital, and an acceptance of responsibilty of ownership on the part of fund managers, so that they are better serving the long-term interests of the ultimate owners and the nation.

dti

the department for Enterprise

The Hon. Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs

Peter Lilley Esq MP
Financial Secretary
HM Treasury
Parliament Street
LONDON
SW1

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 4417
Our ref
Your ref
Date 31 May 1988

Dear Peter

ACCOUNTING FOR MERGERS AND ACQUISITIONS

My officials have been considering, in consultation with the Treasury, what changes we should introduce in the Companies Bill planned for the 1988/89 Session in the area of accounting for mergers and acquisitions. You may like to see the result of that work which is reflected in the attached two detailed papers. The conclusions were endorsed recently by the DTI/Treasury Group on accounting issues which Sir Anthony Wilson chairs. I have now looked at this and I agree that we should go ahead on the lines proposed. I should be grateful if you could confirm that you are also content.

The main change we envisage is much improved statutory disclosure requirements which should end the confusing and sometimes misleading way in which certain companies show the effect of mergers and acquisitions in their accounts and make it difficult for the outsider to understand what has been happening. We considered more radical options but concluded that it would be wrong to try to restrict the permitted treatments by law at a time when the accounting profession is itself embarking on a full scale review of this subject. I would not in any event wish Government to step unnecessarily into territory best covered by accounting standards.

Yours

FRANCIS MAUDE

RH2DWN

the Enterprise initiative

SEVENTH DIRECTIVE: ACCOUNTING FOR MERGERS AND ACQUISITIONS

ISSUE

What changes should we include in the Companies Bill on accounting for mergers and acquisitions in the light of responses to the Department's consultative letter of 23 December 1987?

RECOMMENDATIONS

2 In the next Companies Bill:

(i) we should implement Article 20 of the Directive, which permits "merger accounting" under stated conditions, at the option of the company in question. We should introduce broadly the legislative conditions specified in the Directive but leave it open to accounting standards to set tighter conditions for the use of merger accounting. (The net effect is to maintain the existing position with a slight tightening of the conditions under which merger accounting is available.) (para 17).

(ii) we should introduce additional statutory disclosure requirements to enable the effects of mergers and acquisitions to be clearly seen and compared. The details are at para 18.

3 We should not proceed with the other options on accounting for mergers and acquisitions floated in our consultative letter. However, in implementing the Directive provisions on acquisition accounting we should ensure that the calculation of goodwill reflects the difference between the fair value of the net assets acquired and the fair value of the consideration given.

4 In announcing these changes, (as soon as the policy is agreed) we should make clear that we intend to look again at some of the legislative options we identified in the light of the

outcome of the review of the standards on goodwill and accounting for acquisitions and mergers now being undertaken by the ASC. (Some of these can be made by regulation).

5 The closely related topic of the reserves against which it should be permissible to write off goodwill (touched on in our consultative letter) is dealt with in a separate paper.

INTRODUCTORY COMMENTS

6 The accounting treatment of mergers and acquisitions in consolidated accounts is a hotly debated subject amongst accountants and businesses and a wide range of views is held as to the suitability of the alternative methods - "merger accounting" and "acquisition accounting". The implementation of the Seventh Directive requires us to choose between certain options governing the use of these treatments which were set out in the note issued by the Department in December 1987 (Annex A). Comments on this note have now been received from interested parties.

7 Acquisition Accounting. This is the usual treatment and is the basic method prescribed by the Directive. It is at present covered in accounting standards, not the law. The assets and liabilities acquired are brought onto the consolidated balance sheet at fair value. Any excess of the fair value of the consideration over the net asset value is described as goodwill and must either be written off immediately to reserves or amortised against profits over its useful economic life. (The Fourth Directive does not allow goodwill to be carried forward permanently as an asset). Profits of the acquired company are included in the consolidated accounts only from the date of acquisition.

8 Merger Accounting. Merger accounting emerged as an alternative to acquisition accounting for cases where there is a true merger rather than a take-over of one company by another and where no resources leave the group. The essence is to treat the

combination as if the group had always been combined. In contrast to acquisition accounting the assets and liabilities of the combining companies are stated in the consolidated accounts at book values. Profits of the acquired company are included in the consolidated accounts for the whole year. The Directive gives member states the option of allowing merger accounting under stated conditions. Merger accounting is at present defined in accounting standards, not the law, though statutory merger relief (see below) is a necessary precondition for its use. Very few groups use merger accounting.

Merger Relief

9 Merger relief was introduced in the 1981 Companies Act. Basically it relieves companies of the obligation to set up a share premium account when it issues shares in exchange for at least 90% of the shares of another company. Thus the company can show the shares so issued at nominal values in its own accounts. Merger relief is necessary where merger accounting is to be used in the consolidated accounts - though merger relief and merger accounting are conceptually quite distinct. The other effect of merger relief is that it will in certain cases increase the ability of the issuing company to make distributions.

AREAS OF CONCERN

10 One concern is that the different accounting treatments permitted might distort take-over activity itself. The variety and flexibility of treatment, it is argued, encourages take-overs which would be difficult to justify purely on economic fundamentals: post merger performance suggests that by no means all mergers and acquisitions have been unqualified economic success stories. These concerns emerged to some extent during the recent review of mergers policy. But, by the very nature of the problem, evidence is hard to come by. Some companies have put forward the argument in our current consultation exercise that a tightening of the accounting rules would remove the competitive edge they believe they have in bidding in North America against US

competitors who are subject to a less permissive accounting regime. This argument is of course two-edged. The companies wish to preserve their advantage in making acquisitions but, equally, it can be argued that this simply enables them to pay over the odds for acquisitions. Another argument which is logical, if difficult to demonstrate, is that permitted accounting treatments currently tilt the playing field more than would otherwise be the case in favour of the listed company who can issue shares in a takeover and against the unlisted company who by and large must make a cash bid. But overall the evidence of distorting effects is sparse and subjective. We do not favour legislating to change the permitted accounting treatments on the basis of these arguments.

11 The other principal area of concern is that too much flexibility in permitted accounting treatment leads to confusing and misleading accounts and makes inter company and inter year comparisons difficult. However, there is little pressure to cure this by eliminating either of the methods permitted at present. The main criticisms of the present situation are:

(a) the two forms of accounting present equivalent transactions in different lights, making it difficult to make meaningful comparisons between companies;

(b) the conditions intended to restrict merger accounting to "true" mergers are too wide and open to manipulation (though this criticism would have more force if merger accounting were used more widely);

(c) the ability to use acquisition accounting in consolidated accounts in cases where the acquiring company has taken merger relief in its own accounts is an abuse. In particular such treatments can be difficult to follow and may result in the wrong figure being shown for goodwill arising on consolidation.

(d) Disclosure of the impact of the acquisition on the consolidated accounts is inadequate, in particular very few companies give information about adjustments made to book values of assets and liabilities acquired.

12 Opinions range right across the spectrum on all these points. The Accounting Standards Committee is attempting to find a consensus in its review of the accounting standards on accounting for business combinations and goodwill. However, we need to take decisions on the legislative framework before the review is complete. The letter circulated in December said that we did not, in implementing the Directive, intend to step into territory best covered by accounting standards.

THE CONSULTATIVE LETTER

13 The consultative letter sought to focus consultees on legislative changes rather than prolong general debate on the merits and demerits of merger and acquisition accounting and the treatment of goodwill. It sought views in particular on the following:

(1) Should we take advantage of the option in the Seventh Directive to permit (but not require) merger accounting where certain conditions are met?

(2) Should we require additional disclosure to enable the effects of mergers and acquisitions on the consolidated accounts to be clearly seen whichever treatment is used?

(3) Should we bring the conditions for merger relief into line with those we introduce for merger accounting?

(4) Should we require consistent treatment between individual and consolidated accounts?

(5) Should we restrict merger accounting to "real" mergers?

RESULTS OF CONSULTATION

14 The consultation reveals a consensus in favour of steps (1) and (2) but relatively little support for going ahead at this stage with any of steps (3) to (5). A summary of the main responses is at Annex B.

15 The lack of enthusiasm for going beyond better disclosure reflects the controversy within the accounting profession on many of the issues raised in our letter:

(i) Many consultees argue that the Department should await the review of the relevant accounting standards. This review has of course been announced since we wrote and the "threat" of legislation was probably a factor in getting agreement to it. The argument is that the changes would be controversial and, regardless of one's view on the merits, would need much fuller debate before any changes to the law.

(ii) Some argue that many of the changes canvassed should be for accounting standards rather than the law. One reason for putting forward the legislative option; and seeking to take advantage of the opportunity provided by implementation of the Seventh Directive, was that we doubted the ability of the existing Accounting Standards Committee to get to grips with this issue. However, post-Dearing the accounting standards setting body may be in a better position to tackle this subject.

(iii) Others argue on the merits. A number emphasise the need to keep the current flexibility as long as companies are not able to retain goodwill on the balance sheet as a permanent asset. One of the attractions of merger accounting is that no goodwill arises on consolidation and the problems of dealing with it are thus side-stepped.

16 The general conclusion is that we would need an extremely strong case before enforcing radical change against the considerable doubts of the accounting profession.

DETAILED PROPOSALS

(1) PERMIT BUT NOT REQUIRE MERGER ACCOUNTING UNDER 7TH DIRECTIVE

17 The Directive requires explicit legislative provision to be made if merger accounting is to continue to be available. No consultee favours outlawing merger accounting though some favour restricting its use (at least in the longer term) to very tightly defined circumstances. **We recommend therefore that we follow the option in Article 20 of the Directive to permit the use of merger accounting.** The Directive lays down minimum conditions which must be met. We intend to introduce the Directive conditions with an addition designed to overcome a technical weakness. We also intend to make clear either when we announce firm proposals or during the passage of the Companies Bill that we consider that accounting standards can set conditions in addition to those specified in the Directive. This is important if existing conditions in accounting standards not taken from the Directive are to remain available.

(2) ADDITIONAL DISCLOSURE

18 **Consultees are almost unanimous in favour of more extensive disclosure and that this should be covered in legislation. There is also a wide measure of agreement on the detail. We recommend therefore requiring disclosure:**

(a) **for all mergers and acquisitions in the financial year in question:**

(i) **the names of the combining undertakings;**

(ii) whether merger or acquisition accounting has been used;

(b) in respect of each material acquisition or merger in the financial year in question:

(i) details of the composition and fair value of the consideration for the merger or acquisition;

(ii) where acquisition accounting has been used, a table showing the book values and fair values of the assets and liabilities acquired, including (a) the effect of applying consistent accounting policies, (b) an explanation of significant adjustments and (c) the amount of the goodwill arising on the acquisition;

(iii) where merger accounting has been used, the effect of applying consistent accounting policies on the assets and liabilities acquired, including an explanation of significant adjustments;

(iv) a breakdown of results for (i) the period up to the date of the acquisition or merger (or disposal) and (ii) the prior year.

Consultees tended to the view that it was unrealistic to seek a breakdown of results post merger or acquisition and we do not propose to require this.

(c) In respect of acquisitions, the cumulative amount of goodwill written off, net of disposals.

(3) ALIGN CONDITIONS FOR MERGER RELIEF WITH THOSE FOR MERGER ACCOUNTING

19 We put this forward on the basis that merger relief had

been introduced to facilitate merger accounting and that there was therefore no reason to set different conditions for merger relief and for merger accounting. A clear majority - though far from all - consultees take a different view.

20 The argument turns on one's views of the use of acquisition accounting in conjunction with merger relief. This has become an increasingly common practice since merger relief was introduced in 1981. It is attractive to companies in that it enables them to write off goodwill arising on consolidation against the share premium that would have been created in the absence of merger relief, whilst enjoying the advantages of using acquisition accounting (which tends to reflect the steepest profits growth). Critics of the practice see it as enabling companies to get the best of two worlds: certainly it was not envisaged when merger relief was introduced. On the other hand many argue that, whatever the original purpose of merger relief, its use in conjunction with acquisition accounting has proved beneficial, given that the Fourth Directive does not allow goodwill to be carried as a permanent asset.

21 If it is considered acceptable to take merger relief in the parent company's individual accounts and combine this with acquisition accounting on consolidation then there is no reason in principle for bringing the conditions for merger relief and merger accounting into line. A number of consultees recognise that this is a controversial topic within the profession and argue that the Department should stay its hand pending the review of accounting standards. Some go further and argue that the purposes of merger relief and merger accounting are quite distinct: merger relief is about capital maintenance and merger accounting about consolidated accounts. Whilst the first part of this argument is technically correct it ignores the fact that merger relief was introduced specifically as a necessary precondition to permit merger accounting.

22 On balance, however, we recommend that we do not introduce this into the next Companies Bill but await the review of the accounting standards. We should make clear that at that stage we shall reconsider. There is power in the Companies Act to amend the merger relief provisions by regulation. This would enable us to align the conditions for merger relief with those for merger accounting.

(4) CONSISTENT TREATMENT BETWEEN INDIVIDUAL AND CONSOLIDATED ACCOUNTS

23 We also favoured this option, though acknowledged it could have the undesirable side effect of affecting distributable reserves of some companies. Almost all consultees are against this option, on broadly the same grounds as for (3).

24 The thinking behind consistent treatment is that (i) it would prevent the more outlandish and difficult to follow accounting treatments found at present, in particular where goodwill arising on consolidation is not calculated by setting off the fair value of the consideration against the fair value of the acquisition and (ii) it is preferable that the value in the parent's accounts reflects whether the company perceives the acquisition as a merger or acquisition.

25 Since we wrote, however, we have thought further and we recommend that we do not go ahead with this option as such. The wrong set off tends to be made where merger relief is taken (and nominal values used in the parent company's accounts) and this is followed by acquisition accounting on consolidation. However, we are now clear that we can require the correct set-off to be shown in implementing Directive provisions on acquisition accounting. The effect will be that, where a company takes merger relief and uses nominal values in its individual accounts for the shares issued, it will be forced to make a consolidation adjustment to ensure that goodwill is calculated correctly. This does not go quite as far as requiring consistent treatment but, when coupled

with the disclosure at (2) above, should have much the same effect. We should make this clear in announcing our intentions.

(5) SHOULD WE RESTRICT MERGER ACCOUNTING TO "REAL MERGERS"?

26 This was included in the consultative letter but not as a serious option for legislation. Drafting legislation to achieve this end would be extremely difficult with every chance of it failing to achieve its purpose. Nothing has emerged from the consultation which inclines us to change our assessment and we **recommend** that this is not pursued. This does not mean that the option is without its attractions. A number of consultees favour moving in this direction but probably via accounting standards rather than the law and not within the timescale of the next Companies Bill.

Companies Division Branch 3
April 1988

Annex A

DEPARTMENT OF TRADE AND INDUSTRY
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E Tait Esq
Secretary
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27 Queen Street
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23 December 1987

Dear Ed,

IMPLEMENTATION OF THE EC SEVENTH COMPANY LAW DIRECTIVE ON CONSOLIDATED ACCOUNTS: ACCOUNTING FOR MERGERS AND ACQUISITIONS

Since the formal consultation on implementation of the EC Seventh Company Law Directive in 1985/86 there has been a lively debate in the accountancy and business world on the possible shortcomings of acquisition and merger accounting and the flexibility of treatment presently permitted. Ann Wilks wrote to you on 1 May on the wider issues raised by this. We are grateful for the very helpful responses to her letter from you and other consultees.

In the light of this, and of the possible review of SSAPs 22 and 23, we have looked again at the legislative changes we might make, linked to implementation of Articles 19 and 20 of the EC Seventh Company Law Directive. I am writing to invite your views on this specific aspect.

I attach a note setting out the main legislative options we have identified. (As you will see, these are not mutually exclusive.) The requirement to show that we have implemented the directive in a binding manner means some legislation is inevitable. But it is not our intention to step into territory best covered by accounting standards. I should particularly welcome your comments on the respective roles of standards and the law in this area.

Our preliminary view is to favour the following legislative changes:

(i) permit but not require merger accounting where the directive conditions are met; otherwise require acquisition accounting;

(ii) require additional disclosure where businesses have combined, on the lines suggested in Option B;

(iii) bring the conditions for obtaining merger relief into line with the directive conditions for merger accounting, as in Option C;

(iv) require consistent treatment between parent and consolidated accounts, on the lines of Option D or Option E.

Another change which we believe merits serious consideration would be to restrict the ability of companies to cancel the share premium account through the courts using the procedures in sections 135-137 of the Companies Act where this is used to create a reserve against which to write-off the goodwill arising on consolidation.

I should welcome comments on both the desirability and practicability of these changes.

We believe that in the main accounting standards rather than legislation provide the best way of dealing with the related issues of the treatment of goodwill and of provisions made in the context of an acquisition. We intend to legislate, however, to make clear that it is not permissible to write-off goodwill to the revaluation reserve. You may recall that this proposal was floated in a consultation note issued by the Department in 1986.

I should be grateful for written comments by 19 February 1988.

I am writing in similar terms to the other CCAB bodies, the ASC, the CBI, the Stock Exchange, the Law Society and the Law Society of Scotland.

Yours sincerely,

Neil Worman

N M K WORMAN

EC6ABZ

Annex

ACCOUNTING FOR MERGERS AND ACQUISITIONS: OPTIONS FOR LEGISLATION

OPTION A - MINIMAL CHANGE

Implement the seventh directive so as to disturb the existing position as little as possible ie:

(a) allow merger accounting where the conditions set out in the directive are met. Require acquisition accounting otherwise.

(b) limit disclosure to that which is mandatory under the directive;

(c) make no change to the merger relief provisions.

Comment. This option is favoured either if we conclude that there is no serious problem or that any problems which warrant change should and will be dealt with by accounting standards.

OPTION B - ADDITIONAL DISCLOSURE

As Option A, but with additional disclosure required by law. The main disclosure requirements should be:

(a) the names of the combining companies (Article 20 of the Seventh Directive requires this for merger accounting);

(b) whether merger or acquisition accounting has been used;

(c) details of the composition and fair value of the consideration for the merger or acquisition;

(d) where acquisition accounting is used, a table showing the book values and fair values of the assets and liabilities acquired, including the effect of applying consistent accounting policies and an explanation of significant adjustments;

(e) where merger accounting is used, the effect of applying consistent accounting policies on the assets and liabilities acquired including the explanation of significant adjustment;

In addition we might require a breakdown of the results for (i) the period up to the date of the acquisition or merger (or disposal); (ii) the prior year; (iii) the period from the date of acquisition to the year end. We should welcome views in particular on whether such an additional requirement would lead to the provision of useful and meaningful information.

Comment. This is at present dealt with primarily in accounting standards. There is a broad consensus in favour of better disclosure, if not on precisely what this should cover. Since

the directive already requires some disclosure (in Article 28 for example) we favour a statutory requirement to disclose the most important information. This would not of course rule out further requirements in a revised accounting standard.

OPTION C - ALIGN CONDITIONS FOR MERGER RELIEF WITH THOSE FOR MERGER ACCOUNTING

As Option B, but with conditions for s131 merger relief tightened in line with the directive requirements for merger accounting.

Comment. This option would slightly restrict the availability of merger relief and with it the opportunities for taking merger relief followed by acquisition accounting. As at present, however, accounting standards would be able to set stricter conditions for merger accounting than the legislative conditions for merger relief (and merger accounting). Under this option, therefore, there would still be cases where a company took merger relief but had to use acquisition accounting in the consolidated accounts.

OPTION D - CONSISTENT TREATMENT BETWEEN PARENT AND CONSOLIDATED ACCOUNTS

As B or C, with the additional requirement that treatment in the consolidated accounts must be consistent with treatment in parent's accounts. This means:

Merger relief + merger reserve in the parent's accounts, followed by: acquisition accounting in the consolidated accounts.

Merger relief without merger reserve in the parent's accounts, followed by: merger accounting in the consolidated accounts.

No merger relief in the parent's accounts, followed by: acquisition accounting in the consolidated accounts.

One way of achieving this might be to specify how the "book value of shares" held by the parent in the subsidiary are to be valued (ie nominal or fair value).

Comment. This would avoid some of the more curious and difficult to follow treatments - in particular where merger relief is taken in the parent's accounts (without establishing a merger reserve) following this with acquisition accounting on consolidation. In consequence some companies do not calculate the goodwill element in an acquisition by setting off the fair value of the investment against the fair value of the net assets acquired. Moreover this may not be readily apparent from the accounts although good disclosure can help to remedy this defect. The accounting treatment required by this option could in certain circumstances affect the amount of a company's distributable reserves.

It would be unusual to make a treatment in the parent's accounts dependent on the accounting method used on consolidation but we do not see that this would cause any difficulty since in practice the accounting policies will be decided at the same time.

OPTION E - PROHIBIT MERGER RELIEF IN PARENT COMPANY'S ACCOUNTS WHERE ACQUISITION ACCOUNTING IS USED ON CONSOLIDATION

This is a tighter version of Option D. Companies which wished to use acquisition accounting on consolidation would be barred from taking merger relief in the parent's accounts.

Comment. Given that there are additional conditions in accounting standards (and possibly in legislation) which companies have to meet before they can merger account this option would also have the effect of restricting merger relief beyond the s 131 conditions. It should eliminate the treatment where companies take merger relief, create a merger reserve and acquisition account on consolidation.

Like Option D it may make the accounting treatment in the parent's accounts dependent on the treatment in the consolidated accounts.

OPTION F - MAKE MERGER ACCOUNTING MANDATORY WHERE MERGER RELIEF IS TAKEN

As Option C, with the additional requirement that merger accounting must follow merger relief and (by implication) acquisition accounting would apply where there was no merger relief.

Comment. This would remove one of the problem areas - the use of acquisition accounting with merger relief - and would cut down on the flexibility in the choice of accounting methods. There is a difficulty, however, in that the accounting standards would not be able to prescribe restrictions on the use of merger accounting over and above those in legislation.

OPTION G - RESTRICT MERGER ACCOUNTING TO "REAL" MERGERS

This is an alternative to Option C. It would involve either imposing much more restrictive conditions for the use of merger accounting than those set out in the directive (broadly on US or Canadian lines) or achieving the same effect indirectly by setting much tighter conditions for merger relief.

Comment. This would return more closely to what the Department had in mind when the merger relief concession was introduced. It would mark a substantial departure from current practice. It is likely that it would prove extremely difficult to draft legislation which could not be undermined in practice.

OPTION H - OUTLAW MERGER ACCOUNTING

Only the acquisition accounting provisions in the directive would be implemented. This could be done with or without altering the merger relief provisions. We could still require additional disclosure for acquisition accounting.

Comment. This is a radical option which would mark a sharp break with existing UK practice. We do not consider that there is sufficient evidence of abuse in this area to warrant such a change.

Companies Division 3
December 1987

ANNEX B

ACCOUNTING FOR MERGERS AND ACQUISITIONS

SUMMARY OF MAIN RESPONSES

Treasury

Share many of our concerns.

Agree on need for better disclosure: favour, in addition to our proposals, a permanent record of goodwill (now included).

Favour prohibition on use of merger relief where acquisition accounting used on consolidation.

Emphasise need to consider changes within comprehensive framework - in particular in relation to treatment of goodwill (favour inclusion in consolidated accounts at cost less provisions for permanent fall in value.) (We have sympathy with this but have to implement 7th Directive in the context of 4th Directive - change not realistic in short term - and fact that review of SSAPs 22 and 23 only just under way.)

ACCA

Favours:

- merger accounting restricted to "true mergers" with watertight criteria in standards

- minimum conditions which must be met for merger accounting prescribed in legislation

- bringing conditions for merger relief and merger accounting into line

- in place of our consistent treatment option, legislative provision that where merger relief is taken and acquisition accounting used company must either (i) create merger reserve in the holding company's own accounts or (ii) make a consolidation adjustment to give correct calculation of goodwill. (This is in line with our current thinking)

- by implication awaiting outcome of review of SSAPs 22 and 23 and Dearing Committee.

ICAEW

Favours:

- minimum changes necessary to implement directive

- allowing merger accounting and leaving circumstances to

N23AAO

Accounting standards

- better disclosure.

Against options on consistent treatment.

Divided views as to whether conditions for merger relief and merger accounting should be brought into line. Propose that do not for the time being align the two.

Suggests aligning conditions for merger relief and merger accounting in case of S133(1) only.

ICAS

Favours minimal legislative changes for time being.

Favours discussion and consultation on radical approach to accounting for business combinations:

(i) all assets and liabilities to be revalued following any major change in the combination of the group;

(ii) consolidation to be on merger accounting basis;

(iii) reorganisation costs to be disclosed in the year of combination;

Against:

- alignment of conditions for merger relief and merger accounting

- consistent treatment.

ICAI

Favour minimum change.

Law Society

Overall in favour of minimum change but with additional disclosure.

Specifically against amendments to S131 and alignment of merger relief and merger accounting conditions.

Arthur Andersen

Favour:

- opportunity for all to express views before any legislation

N23AAO

- leaving as much to SSAPs as possible

- restricting merger accounting to cases where no dominant party (though recognises this cannot be agreed quickly)

- consistent treatment (in principle)

- additional disclosure (more extensive than we proposed)

Price Waterhouse

Regard use of S131 with acquisition accounting as unintended but beneficial.

Against legislative change until review of standards complete.

Can accept additional disclosure.

Arthur Young

Favour minimal changes to S131 since share premium to do with capital maintenance rather than financial reporting.

Also against alignment of merger relief and merger accounting conditions.

Also against consistent treatment.

Peat Marwick

Against precipitate change. .

Favour minimal change with additional disclosure.

Against other options.

Spicer & Oppenheim

Letter focuses on concern that Government might restrict use of merger relief to cases where merger accounting used on consolidation. Argues strongly against any such change.

International Stock Exchange

Favour implementing merger accounting option from Directive, additional disclosure and tightening of merger accounting conditions.

Other changes should be deferred until review of SSAPs complete.

N23AAO

(Interim reply only)

Favours restricting merger accounting to true mergers.

No change should be made to availability of merger relief until the "question of the treatment of goodwill had been finally agreed".

A summary table is attached.

N23AAO

ACCOUNTING FOR MERGERS AND ACQUISITIONS: SUMMARY OF PRINCIPAL RESPONSES TO CONSULTATIVE NOTE

	(1)	(2)	(3)	(4)	(5)
HMT	N	Y	Y	Y	Y(a)
ICAEW	Y	Y	N	N	N
ACCA	Y	Y	Y	N(b)	Y(c)
ICAS	Y	Y	N	N	N
ICAI	Y	N(d)	N	N	N
CIMA	N				Y
Law Society	Y	Y	N	N	N
Arthur Andersen	N	Y	Y	Y	Y(e)
Spicer & Oppenheim			N		
Deloittes (f)			N		
Arthur Young (g)	Y		N		
Peats	Y	Y	N	N	N
Stock Exchange	Y	Y	Y	N	N
CBI(h)					Y

Key

(1) Permit but not require merger accounting under 7th

(2) Additional disclosure beyond that mandatory under Directive

(3) Align conditions for merger relief and merger accounting

(4) Consistent treatment of individual and consol. accounts

(5) Restrict merger accounting by law to "real mergers"

Footnotes

(a) but sees possible EC complications
(b) but in favour of variant
(c) in principle - "watertight" criteria to be agreed in standards
(d) only disclosure required by directive
(e) in principle, if consensus could be found
(f) Mr Holgate's personal views
(g) Mr Paterson's personal views
(h) Preliminary reply only.

RESERVES AVAILABLE FOR GOODWILL WRITE OFF

Issues

Should we further restrict the reserves available for goodwill write-off? In particular:

(i) should we restrict the ability of companies to seek the approval of the courts to cancel their share premium account for the purposes of creating a reserve which is used in the consolidated accounts for the purposes of writing off goodwill?

(ii) should we amend para 34 of Schedule 4 of the Companies Act to make it clear beyond doubt that it is not permissible to write-off goodwill to the revaluation reserve in (i) individual accounts and (ii) consolidated accounts?

Recommendations

2 We recommend:

(a) that we do not pursue (i) above for the next Companies Bill. We should make clear, however, that this is an option we may want to reconsider in the light of the outcome of the current review of the accounting standard on the treatment of goodwill.

(b) that we amend Schedule 4 to make clear that purchased goodwill (i) in individual accounts or (ii) arising on consolidation cannot be written off to the revaluation reserve;

Timing

3 We should announce our intentions together with the closely related proposals covered in the separate paper on

accounting for mergers and acquisitions.

Explanation of the Main Terms Used

4 Purchased Goodwill is the amount by which the fair value of the price paid for a business exceeds the fair value of its separate net assets. The prescribed treatment in the acquiring company's accounts is either to amortise goodwill through the annual profit and loss account or write it off to reserves. The Fourth Directive does not permit goodwill to be carried indefinitely as an asset.

5 The revaluation reserve is the reserve created when a company revalues an asset and initially represents an unrealised profit. Usually it is only reduced when the same asset is depreciated falls in value, is sold, or where the accounting convention changes (eg from current cost to historical cost). A number of companies write off acquired goodwill to the revaluation reserve.

6 The share premium account represents the excess of the fair value over the nominal value of shares issued. The Companies Act tightly restricts the purposes for which the share premium account can be used, on grounds of capital maintenance. However, sections 135-137 of the Companies Act enable companies to apply to the courts to reduce capital. These procedures are intended to be used by companies in severe financial difficulties but are increasingly used to create a reserve which can be used in the consolidated accounts for goodwill write-off.

INTRODUCTORY COMMENTS

7 In the consultative letter sent out in December on accounting for mergers and acquisitions we suggested that we wanted to look at the possibility of restricting the ability of the courts to cancel a company's share premium account for the purposes of writing off goodwill; we also said that following

earlier consultation we intended to clarify the law to make clear that goodwill cannot be written off to the revaluation reserve. The response on the first point from both companies and the accounting profession was almost uniformly hostile; on the second there were strong objections from companies who write off goodwill in this way but the views of the accountancy profession were mixed and on balance in favour of changing the law as proposed.

8 To give perspective to what to the non accountant seems a technical issue of only presentational significance, I address first the question as to why companies attach importance to the rules governing the reserves available for goodwill write-off. The simple answer is that companies are naturally keen to put the best available gloss on their accounts. For an acquisitive company, particularly one in the service sector, the figure for acquired goodwill to be dealt with in the consolidated accounts can be very large since much of the value of what is acquired, eg creative teams in advertising, cannot be treated as assets under accounting rules. The way in which this goodwill is dealt with can significantly affect the appearance of the accounts and, arguably, the perception of the company by the outside world. Until recently companies have had the option of retaining goodwill as a permanent asset. Were this still the position companies would probably attach little importance to the issue of reserves to which goodwill may be written off. Of the two available treatments for goodwill companies are generally reluctant to use amortisation where the goodwill figure is large since this will depress the reported figure for group profits. Most companies therefore have a policy of immediate write-off. (Companies which traditionally have amortised goodwill are tending to change their accounting policies in favour of immediate write-off.) Companies either with limited reserves available for write-off or who, for presentational reasons, do not wish to use the profit and loss reserve will be attracted to use any other reserve which is available or can be created. Some companies therefore use the revaluation reserve or seek (via the courts) to cancel the share premium account and use the reserve created in its place for

goodwill write off.

9 The two issues are considered separately below.

USE OF THE SHARE PREMIUM ACCOUNT FOR GOODWILL WRITE OFF

10 The idea of restricting the ability of companies to cancel their share premium account in order to write off goodwill was mentioned in our consultative letter but not developed. The reasoning behind the idea is that the Companies Act clearly prohibits direct write off to the share premium account. Seeking the court's approval to cancel the share premium to create a reserve for this purpose is a device to circumvent the restriction. In addition it is strange that a provision of the Act intended to assist companies in financial difficulties is being used by sound companies to deal with the presentational problem of goodwill arising on consolidation.

11 With one exception reaction has been hostile. We recommend that this is not pursued for the next Companies Bill: even though the arguments raised against the proposal are not conclusive, we would need to spend time working up a much more carefully developed proposal and then consult more widely. Since the proposal is clearly controversial we do not believe there is time to develop this idea. In announcing our intentions, however, we should make clear that we may wish to look again at this option once the Accounting Standards Committee has completed its review of SSAP 22 (accounting treatment of goodwill).

12 Consultees deploy the following arguments against the proposal:

(i) as long as companies cannot retain goodwill as a permanent asset there must be flexible options open to a company to enable immediate write-off;

(ii) there are safeguards against abuse since the process requires the approval of shareholders and the court is required to look to the interests of existing creditors;

(iii) the proposal confuses the role of individual accounts and consolidated accounts: the share premium account has a special status in individual accounts as a protection of a company's capital base but this concept has no real meaning in consolidated accounts.

13 These arguments are not conclusive.

- On (i), we recognise that companies need a means of writing-off goodwill immediately. However, where no other option is available, a company can create a goodwill write-off reserve with a zero opening balance to which the goodwill is debited. There is no bar on this in the Companies Act. This has the merit of showing clearly the cumulative amount of goodwill written off though there are mixed views on whether negative reserves are in principle desirable.

- On (ii), it should be borne in mind that the cancellation of the share premium account is reflected first in a company's individual accounts and is carried through to the consolidated accounts. A side effect of this - which we trust is fully appreciated by the courts - is that it can eventually enhance the realised reserves of the parent company. In gaining the Court's approval for the cancellation a company will typically give an undertaking that the special reserve created in place of the share premium account will not be treated as realised profit as long as any existing creditor remains unpaid. It is, however, relatively simple to pay off or re-finance existing creditors, in which case the reserve would be realised and thus distributable.

- Point (iii) is technically correct but ignores the potential effect on the individual company's distributable reserves explained at (ii).

USE OF THE REVALUATION RESERVE FOR GOODWILL WRITE OFF

History

14 The revaluation reserve is specifically covered in the Fourth Directive (Article 33.2 - extract at Annex A). In implementing the Directive as part of what became the 1981 Companies Act the UK decided to allow the revaluation reserve to be reduced only in the ways specified in the Directive. It was not the intention to allow the writing off of goodwill to the revaluation reserve.

15 The relevant legislation is now found in para 34 of Schedule 4. (extract at Annex B). Unfortunately the law did not unambiguously achieve the intended effect. The Directive provision, that the revaluation reserve must be reduced to the extent that the amounts transferred to it are no longer necessary "for the implementation of the valuation method used and the achievement of its purpose", is implemented in para 34(3) by reference to the amounts being no longer necessary "for the purpose of the accounting policies adopted by the company." A number of companies believe this can be taken to refer to all of their accounting policies, not just those relating to revaluations and in consequence write off goodwill to the revaluation reserve.

16 This problem came to light in 1985 when the accounting profession expressed concern that the law was unclear. In consequence the Department published a consultative note (Annex C) in 1986 which argued that the law should be changed to make clear that the revaluation reserve could not be used in this way. This was presented primarily on the basis that the Fourth Directive did not permit this use of the revaluation reserve.

Results of Consultation

17 Most respondents to the 1986 consultative note agree that legislation is desirable since the existing law is uncertain. A majority - but by no means all - consider that the solution is to make clear that such write-offs are not permissible. Some argue that more debate is needed within the profession and doubt that the practice involves a real abuse; others draw a distinction between individual and consolidated accounts; and a number argue that this issue has to be considered in a broader context. Recent responses to our consultative letter of 23 December 1987 (which said that the Department intended to legislate on the lines proposed in the earlier consultative note) also reflect mixed views - even if one allows for the vested interests of some of the companies who have replied. Several people suggest that Article 33 of the 4th Directive allows member states to "lay down rules governing the application of the revaluation reserve ..." and that this would allow the UK to provide specifically that the writing-off of goodwill is a permitted use of the revaluation reserve.

Where do we go from here?

18 It is superficially attractive to say that this should be a matter for accounting standards rather than the law. Unfortunately the structure of the Fourth Directive prevents this. The revaluation reserve can only be used in this way if specifically permitted by law. We must therefore consider the legal and policy aspects as regards (i) individual accounts (ii) consolidated accounts.

Interpretation of Article 33(c) of the 4th Directive

19 Whether or not the 4th Directive allows Member States to permit the writing-off of goodwill to the revaluation reserve turns on the interpretation of the second paragraph of Article 33(c). Could the "rules" referred to in the first line

over this?

20 The wording itself is opaque. It is difficult purely on a textual analysis to conclude with certainty that such a rule is not permitted. However, from consideration of the context in which Article 33 was prepared, and from recent discussion with the Commission, it is clear to us beyond doubt that this was not the intention. The Commission has made clear that the second para of 33(c) is intended to permit reductions (i) where part of the reserve becomes realised as the asset to which it relates is depreciated and (ii) where the reserve may become realised in whole or in part on disposal of the asset to which it relates, and for no other purpose. The revaluation reserve is seen as a capital reserve; it should indicate the extent to which the basis of valuation in the accounts has moved away from purely historical cost. For these reasons it is singled out for specific rules under the Fourth Directive. Taken in context it would be extremely curious if Member States were free to allow reductions for quite different purposes.

21 Given the obscurity of the wording, we believe that the European Court would try to make sense of the Directive by reference to the context and intention. We consider it likely, were the question to be put, that the Court would uphold the argument that the Fourth Directive does not allow a Member State to permit the write off of goodwill to the revaluation reserve.

22 Article 29.1 of the Seventh Directive applies the Fourth Directive valuation rules, including Article 33, to consolidated accounts. Legally therefore, it is difficult to argue that the position is different in consolidated accounts than in individual accounts.

Policy Considerations: (i) Individual Accounts

23 The reason for distinguishing between the writing off of goodwill in individual company accounts (which arises where a

company buys an unincorporated body) and goodwill arising on consolidation (which is much more common) is that only in the former case does the effect on the ability of a company to make a distribution have to be considered.

24 Whether a reserve is realised (and thus available for distribution) is relevant only in the case of an individual company's accounts. The revaluation reserve is usually an unrealised reserve though over time may become realised because of the additional depreciation charged to the profit and loss account on the revalued assets. Although not strictly true, it is commonly held that write offs to this reserve have the advantage of enabling a company to preserve other distributable reserves.

25 In most cases goodwill is written off immediately as a matter of accounting policy, not because there has been a loss of value in a business just purchased. In such cases it is not self evident that an unrealised reserve such as the revaluation reserve should not be used for the initial write-off. SSAP 22 does not rule this out in principle though an ED which preceded it did so. However, SSAP 22 requires, since goodwill cannot be retained as a permanent asset, that any initial write off to an unrealised reserve should be followed by a series of transfers so as to deplete realised reserves in the same way as if the amortisation route had been followed. Unless transfers are made the resulting revaluation reserve could comprise a mixture of realised and unrealised profits and losses. The interpretation of the resulting balance could be impossible for readers of accounts and is potentially misleading.

26 On balance we favour a bar on write offs of goodwill to the revaluation reserve in individual accounts. This will:

(a) prevent confusion as to the extent of distributable reserves.

(b) ensures that the revaluation reserve relates solely to the

- revaluation of assets which will improve the transparency of accounts.

Policy Considerations: (ii) Consolidated Accounts

27 Most goodwill arises from the acquisition of one company by another and thus affects the consolidated accounts. The treatment of goodwill on consolidation is thus of much more practical importance to companies than the treatment in individual accounts.

28 It is more difficult to see a strong case for prohibition in consolidated accounts where the ability to distribute profits is not an issue. It is in any event difficult to read too much into the split or level of consolidated reserves.

29 It must also be remembered that the alternatives to the use of the revaluation reserve may not be preferable from our point of view. Possibilities include the creation of a negative goodwill write off reserve and applying to the courts for the reduction of share premium account. It is also conceivable - though perhaps fanciful - that a company might capitalise the revaluation reserve (as is permitted) and then apply to the courts to authorise the cancellation of the share capital so created for the purposes of writing off goodwill.

30 Purely on policy grounds we would be prepared to allow companies to write off goodwill to the revaluation reserve in the consolidated accounts, pending the review of the relevant standards.

Conclusions

31 In individual accounts we consider that policy and legal considerations point in the same direction and we do not propose to permit the use of the revaluation reserve for goodwill write off.

32 In consolidated accounts, the legal considerations indicate that we would need strong policy reasons for wishing to permit the writing off of goodwill to the revaluation reserve. We do not believe that strong enough reasons exist and we propose therefore to make clear that this is not a permitted use of the revaluation reserve.

Companies Division Branch 3
April 1988

ANNEX A

FOURTH DIRECTIVE

Article 33

2. (a) Where paragraph 1 is applied, the amount of the difference between valuation by the method used and valuation in accordance with the general rule laid down in Article 32 must be entered in the revaluation reserve under 'Liabilities'. The treatment of this item for taxation purposes must be explained either in the balance sheet or in the notes on the accounts.

For purposes of the application of the last subparagraph of paragraph 1, companies shall, whenever the amount of the reserve has been changed in the course of the financial year, publish in the notes on the accounts inter alia a table showing:

- the amount of the revaluation reserve at the beginning of the financial year,

- the revaluation differences transferred to the revaluation reserve during the financial year,

- the amounts capitalized or otherwise transferred from the revaluation reserve during the financial year, the nature of any such transfer being disclosed,

- the amount of the revaluation reserve at the end of the financial year.

(b) The revaluation reserve may be capitalized in whole or in part at any time.

(c) The revaluation reserve must be reduced to the extent that the amounts transferred are no longer necessary for the implementation of the valuation method used and the achievement of its purpose.

The Member States may lay down rules governing the application of the revaluation reserve, provided that transfers to the profit and loss account from the revaluation reserve may be made only to the extent that the amounts transferred have been entered as charges in the profit and loss account or reflect increases in value which have been actually realised. These amounts must be disclosed separately in the profit and loss account. No part of the revaluation reserve may be distributed, either directly or indirectly unless it represents gains actually realised.

(d) Save as provided under (b) and (c) the revaluation reserve may not be reduced.

ANNEX B

COMPANIES ACT 1985
SCHEDULE 4

Revaluation reserve

34 (1) With respect to any determination of the value of an asset of a company on any basis mentioned in paragraph 31, the amount of any profit or loss arising from that determination (after allowing, where appropriate, for any provisions for depreciation or diminution in value made otherwise than by reference to the value so determined and any adjustments of any such provisions made in the light of that determination) shall be credited or (as the case may be) debited to a separate reserve ("the revaluation reserve").

(2) The amount of the revaluation reserve shall be shown in the company's balance sheet under a separate sub-heading in the position given for the item "revaluation reserve" in Format 1 or 2 of the balance sheet formats set out in Part 1 of this Schedule, but need not be shown under that name.

(3) The revaluation reserve shall be reduced to the extent that the amounts standing to the credit of the reserve are in the opinion of the directors of the company no longer necessary for the purpose of the accounting policies adopted by the company; but an amount may only be transferred from the reserve to the profit and loss account if either -

(a) the amount in question was previously charged to that account; or

(b) it represents realised profit.

(3) The treatment for taxation purposes of amounts credited or debited to the revaluation reserve shall be disclosed in a note to the accounts.

ANNEX C

(EXTRACT)

SCHEDULE 4

COMPANIES ACT 1985

THE RULES RELATING TO DEPRECIATION CHARGED ON REVALUED ASSETS AND THE USE OF THE REVALUATION RESERVE

—

A CONSULTATIVE NOTE

THE DEPARTMENT OF TRADE AND INDUSTRY

April 1986

EC1AAY

SCHEDULE 4, COMPANIES ACT 1985: THE RULES RELATING TO DEPRECIATION CHARGED ON REVALUED ASSETS AND THE USE OF THE REVALUATION RESERVE

INTRODUCTION

This paper deals with two questions of interpretation of accounting law in the Companies Act 1985 on which it has become apparent that there are differences of opinion among companies and in the legal and accountancy professions. The first concerns the rules relating to the valuation of fixed assets and the depreciation to be charged on them (paragraphs 17 to 19 and 32 of Schedule 4 to the 1985 Act) and the second concerns the uses which may be made of the revaluation reserve, particularly in relation to goodwill (paragraph 34 of Schedule 4). On each of these issues the paper sets out the interpretation of the rules which the Department believes to be legally correct and puts forward for consideration proposals to amend the rules so as to remove any ambiguity that currently exists.

Comments should be sent to:

The Department of Trade and Industry
Companies Division
Room 513
Sanctuary Buildings
16-20 Great Smith Street
London SW1P 3DB

and should arrive by 30 May 1986 .

A. Depreciation

1. The rules relating to the valuation of fixed assets and the depreciation to be charged on them are set out in paragraphs 17 to 19 of Schedule 4 to the Companies Act 1985. They implement Article 35(1) of the Fourth Directive. These provisions are set out in the Annex.

2. Paragraph 18 of Schedule 4 (Article 35(1)(b)) sets out the normal rules for depreciation by requiring that the value of every fixed asset which has a limited useful economic life must be reduced by provisions for depreciation on a systematic basis over its useful economic life. It is not stated explicitly in Schedule 4 or in the Directive that these provisions must be charged to the profit and loss account but the Department considers that it is implicit from the existence of format headings 7(a) and A4(a) in Formats 2 and 4 (and note 17 to the

7. Views would be welcome on the perceived need for and advisability of such an amendment.

B. Revaluation Reserve

8. The problem over the revaluation reserve has arisen specifically as a result of consideration in the profession of the guidance in SSAP22 over the write off of goodwill against undistributable reserves, but it is in fact of more general relevance.

The issues

9. SSAP22 provides that purchased goodwill should normally be eliminated from the accounts immediately on acquisition by writing off against reserves, but it may be eliminated by amortisation through the profit and loss account over its useful economic life. Appendix 2 to the Standard provides guidance for use in cases where companies write off the goodwill against reserves and suggests that where, for example, a company lacks sufficient distributable reserves to cover the purchase cost of the goodwill, it may be appropriate for that goodwill to be written off initially against a 'suitable unrealised reserve'. It goes on to say, 'it should be noted that the restrictions regarding the use of the revaluation reserve set out in paragraph 34(4) of Schedule 8 (now paragraph 34(3) of Schedule 4) may make it inappropriate to charge the amount written off against that reserve'. Finally, it suggests that in cases of doubt, legal advice should be sought.

10. Despite this note of caution, the Department is aware that an increasing number of companies are choosing to write off goodwill against the revaluation reserve, both in individual and consolidated accounts, and that there is concern within the profession.

11. This difference of views has arisen because of uncertainty over the interpretation of paragraph 34(3) of Schedule 4. That paragraph implements Article 33(2) of the Fourth Directive which states quite clearly the uses which may or must be made of the revaluation reserve. (See Annex)

12. No provision was made for Article 33(2)(b) in UK law because it was considered that there is nothing to prevent a company from capitalising its revaluation reserve if its Articles of Association provide for such capitalisation.

13. Article 33(2)(c) was implemented by paragraph 34(3) of Schedule 4 but while Article 33 says that the revaluation reserve must be reduced to the extent that the amounts transferred to it are no longer necessary 'for the implementation of the valuation method used and the achievement of its purpose', this was changed in paragraph 34(3) to refer to the amounts being no longer necessary 'for the purpose of the accounting policies adopted by the company'. The

Department understands that this phrase in the legislation has been interpreted by some companies as referring to all of their accounting policies and not only those relating to revaluation; thus, for example, in the case of goodwill, if they have an accounting policy of writing off goodwill against the revaluation reserve, they consider that to be permitted by paragraph 34.

14. It was never intended that this provision should be interpreted so broadly and the Department considers that since the revaluation reserve is created only as a result of the valuation accounting policies, it may be reduced only to the extent that the amounts credited to it are no longer necessary for the purpose of those valuations. This is consistent with Article 33(2)(c) of the Directive. The Department therefore proposes to make an amendment to paragraph 34(3) so that it reflects more clearly the provision of the Directive in Article 33(2)(c).

15. The remainder of Article 33(2)(c), concerning transfers to the profit and loss account from the revaluation reserve, is reflected in the latter part of paragraph 34(3) of Schedule 4.

16. Article 33(2)(d) is not specifically reflected in UK legislation. However, given the uncertainty that has arisen the Department now considers that it would be useful to add a specific provision along these lines.

17. In the specific case of goodwill, the Department considers that amendments as described in paragraphs 14 and 16 would prohibit the practice of writing off goodwill against the revaluation reserve, both in individual and, given paragraphs 61 and 62 of Schedule 4, consolidated accounts.

18. Views are invited on the proposals in paragraphs 14 and 16 above. Amendments would be made to paragraph 34, to bring the wording of sub-paragraph (3) more closely into line with Article 33(2)(c) and to add a new sub-paragraph reflecting Article 33(2)(d).

dti

the department for Enterprise

The Hon. Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs

Private Secretary
10 Downing Street
LONDON

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 4417
Our ref
Your ref
Date 27 May 1988

Dear Nigel,

ACCOUNTING FOR MERGERS AND ACQUISITIONS

... You may like to see the enclosed letter and enclosures which my Minister has recently sent to the Financial Secretary. Although the subject is specialised it is one in which I understand the Prime Minister expressed an interest at an earlier stage.

Yours sincerely

Andrew Heyn

ANDREW HEYN
Private Secretry

RH2DWL

the Enterprise initiative

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 20 May 1988

Prime Minister

I have not troubled you with the earlier exchanges but you may like to note this above.

PRCC 20/5

Dear Nigel.

MONOPOLIES AND MERGERS COMMISSION: PROPOSED PROGRAMME OF NATIONALISED INDUSTRY REFERENCES

Thank you for your letter of 29 April accepting the programme of references now available and urging an early announcement.

I am content to proceed as you suggest and propose to make an announcement by means of a Parliamentary question on 26 May. The text of my answer, which has been agreed by officials at the Departments concerned, is attached.

The programme being announced is, of course, more limited than we had originally planned. In particular I have avoided references to "a 1988" programme, not only because we are well into the year but also because the timing of the London Underground reference may slip further. Although we were planning on a reference during the second half of 1988 I now understand that the report on the Kings Cross Investigation is unlikely to be available before the Autumn. A great deal of

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the department for Enterprise

senior LUL management time and effort is bound to be needed to prepare a response to the investigation's findings and recommendations. In these circumstances I think that it would be unreasonable to embark simultaneously on a major MMC inquiry into LUL, and colleagues should be aware that the reference is now unlikely to start until early next year. This does not, of course, lessen the need to be ready with a new programme early next year and my officials will be contacting sponsor Departments in the Autumn for their proposal for 1989.

Copies of this letter go to the recipients of yours.

KENNETH CLARKE

CD4ABR

FOR PROPOSED ANSWER ON 23 MAY

QUESTION

To ask the Chancellor of the Duchy of Lancaster what progress has been made in implementing the current programme of references of nationalised industries to the Monopolies and Mergers Commission and what further references are planned.

ANSWER

The Commission's report on the Welsh Water Authority was published on 18 May and I expect to publish the report on the Post Office Counters Services shortly. The Commission are currently investigating British Coal's capital investment and British Rail's Provincial Services.

Further references will relate to the United Kingdom Atomic Energy Authority, the Northern Ireland Transport Holding Company and, once the Kings Cross investigation is completed, London Underground.

Gov Mach: Monopoles
1
Merger Pt 3

File

dF

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

19 May 1988

I am writing on behalf of the Prime Minister to thank you for your letter of 19 May and to acknowledge receipt of the enclosed background note.

Paul Gray

Kenneth Dixon, Esq.

PREM 19/5

Rowntree

Kenneth Dixon
Chairman

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

19th May, 1988

Dear Prime Minister,

You may find useful the enclosed summary of the key commercial and public interest issues which we believe surround the decision on an MMC reference of the Nestlé bid for my company.

A great amount of paper has already been generated by this case but I hope you will find time to glance at this short aide memoire.

Copies are being sent to a number of your ministerial colleagues and senior back benchers.

Yours sincerely,

Kenneth Dixon

Rowntree plc
York YO1 1XY
England

Telephone 0904 612261
Telex 57525 Rowmac G
Facsimile 0904 625086

ROWNTREE / NESTLÉ

A background note prepared by Rowntree plc

This note summarises the key commercial and public issues surrounding the decision on an MMC referral of the bid for Rowntree.

ROWNTREE'S STRONG OPPORTUNITIES AS AN INDEPENDENT COMPANY

- Confectionery is an industry in which Britain is a world leader. There are only six world-scale confectionery manufacturers; Rowntree and Cadbury together account for just under 30 per cent. of their combined sales.
- The marketing flair which has enabled Rowntree to secure its world position for British brands is universally recognised and admired.
- Rowntree has for years been planning strategically and successfully to achieve a world presence.
- In particular, in recent years, the careful building of a European business ahead of 1992 has established Rowntree's brands as an important and growing power in European confectionery.
- The opportunities for Rowntree's European and, indeed, world business are outstanding. Rowntree is on a threshold - not by chance but by design.
- This strategy has been formulated and led by senior managers with a commercial and marketing flair which has been rare in Britain.

THE SWISS HAVE NOT BEEN ABLE TO COMPETE WITH ROWNTREE

- Swiss confectionery marketing has been stodgy for some years - they are in the slow growing parts of the market and have been unsuccessful in building brands where the market is strong.
- Nestlé want to buy what they cannot build - they know Rowntree may be their last chance.

BRITAIN'S LOSS

- If Nestlé succeed and if the current threat to Cadbury also materialises, Britain will no longer own a major confectionery business.
- The uninspired performance by Nestlé's confectionery brands suggests that Rowntree's success may be dissipated under their ownership, as Nestlé's different culture stifles Rowntree's enterprise and creativity.

IS THERE A BRITISH SOLUTION ?

- Official statements suggest that large scale domestic mergers might now be allowed, in line with the government's evolving policy stated in its "Mergers Policy" blue paper. There have been no test cases of this policy involving major companies.

- Complex corporations should not try to cobble together mergers against a deadline set by a bid and by a recent change in the interpretation of merger policy.

- Key issues which managements would have to explore to decide whether merging could be a commercially sensible course would be:

  - *are the business strategies of the companies compatible?*

  - *are their market strengths complementary so that combining them adds value?*

  - *can their distinctive skills be organised so that they are developed, not stifled?*

  - *what redeployment of manufacturing capacity would be required to achieve the commercial benefits?*

  - *in short, would a merger produce enough additional value and potential to justify it to shareholders?*

IS THE OPPORTUNITY OF 1992 ALSO A THREAT TO BRITAIN ?

- The Rowntree affair shows the likelihood that successful British companies, well prepared for 1992, will become the targets for foreign companies less well prepared.

- This trend will be reinforced because aggressive bidders know they are unlikely to succeed elsewhere in the EC. Our successful companies are ripe to be plucked.

- The Swiss are likely to be particularly aggressive because of their concern about exclusion from the EC - but they will go on protecting their own companies from aggressive acquisition by foreigners.

- Reciprocity is an important principle of free trade - it needs to be upheld consistently. The government has already shown itself willing to stand up for British commercial interests in the case of Japan.

- "Mergers Policy" explicitly recognises non-reciprocity as a possible basis for referral (see Note).

THE PUBLIC CASE FOR REFERRAL IS CLEAR

Referral will:

- give an opportunity for these new issues to be given mature and careful thought.
- give the government the opportunity to:
  - review this test case of merger policy ahead of 1992
  - consider UK policy in the context of the developing EC merger policy
  - combine our free market preference with the encouragement of British international enterprise

NOTE:

"One consideration that may be relevant in some cases is the extent to which UK companies have reciprocal freedom to acquire companies based in the home country of the prospective acquirer" - Mergers Policy (para. 2.26)

10 DOWNING STREET
LONDON SW1A 2AA

THE PRIME MINISTER

18 May 1988

Dear Mr. Dixon

Thank you for your letter of 10 May drawing my attention to some of the national issues raised by Nestle's bid for Rowntree.

David Young addressed your concerns about the focus of the Government's competition policy in his speech at the CBI Annual Dinner on 12 May. He confirmed that the Government takes account of the geographical nature of the market when assessing the effect of a merger, whether that market be regional, UK, European or international. He continued:

> " If we are open to products from the rest of Europe, and perhaps the rest of the world, then it may not matter if there is only one UK supplier, because that supplier faces competition from outside."

The full text of David Young's speech is enclosed.

With regard to the possible reference of the Nestle bid to the Monopolies and Mergers Commission, it falls to the Director General of Fair Trading to consider these developments under the Fair Trading Act 1973 and to advise the Secretary of State for Trade and Industry in the normal way. The main consideration in deciding whether to make a reference to the Commission is the effect on competition, but the Director General and Secretary of State also take into account other relevant aspects of a case including wider public interest issues. One consideration which may be

relevant in some cases is the extent to which UK companies have reciprocal freedom to acquire companies based in the home country of the prospective acquirer.

Yours sincerely

Margaret Thatcher

Kenneth Dixon, Esq.

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

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10 Downing Street
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Direct line 215 5422
Our ref DC5AKF
Your ref
Date 16 May 1988

Dear Paul

Thank you for your letter of ~~10~~ Mar May enclosing a letter received by the Prime Minister from Mr Kenneth Dixon, Chairman of Rowntree plc.

A draft reply to Mr Dixon is attached.

Yours

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

the Enterprise initiative

dti

the department for Enterprise

R. Lyne to Prime.

RHG
16/5

DRAFT REPLY FOR THE PRIME MINISTER TO SEND TO:

Kenneth Dixon Esq
Chairman
Rowntree plc
York
YO1 1XY

CH3CMD.

Thank you for your letter of 10 May drawing my attention to some of the national issues raised by Nestle's bid for Rowntree.

David Young addressed your concerns ~~over~~ about the ~~parochiality~~ focus of the Government's competition policy in his speech at the CBI Annual Dinner on 12 May, ~~in which~~ He confirmed that the Government takes account of the geographical nature of the market when assessing the effect of a merger, whether that market be regional, UK, European or international. He continued:

> "If we are open to products from the rest of Europe, and perhaps the rest of the world, then it may not matter if there is only one UK supplier, because that supplier faces competition from outside."

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deciding whether to make a reference to the Commission is the effect on competition, but the Director General and Secretary of State also take into account other relevant aspects of a case including wider public interest issues. One consideration which may be relevant in some cases is the extent to which UK companies have reciprocal freedom to acquire companies based in the home country of the prospective acquirer.

Economic success

Tonight we are able to celebrate success, the success of the British economy and the success of people in business.

In the 50's, the 60's and the 70's we became the sick man of Europe.

Now, in 1988, our competitors have no doubt.

"The most dynamic economic nation in Europe" writes an influential German newspaper.

Or, as Fortune says, we have suddenly stopped declining and come roaring back.

I quote from our competitors overseas because they know.

If they are worried, then we really are having an effect.

But far too many people here still don't recognise how successful our economy is compared to the rest of the world.

We are entering our eighth successive year of steady growth and increasing productivity, faster than all other major European Community countries.

We have been losing our share of world trade for as long as I have been alive, indeed longer, now over a hundred years! But no longer.

Since 1981 we have stopped the rot.

Last year we actually increased our share of world exports of manufactured goods!

Now let us accept our own success.

Lack of confidence and writing ourselves down is not an inevitable part of the British culture.

Confidence, but not complacency, should be the order of the day.

We are doing better; we are still not doing well enough.

Our productivity is still as much as 30 per cent behind France and Germany.

Thirty percent! To close that gap we must look for better:

better design,
better quality,
better reliability

That is why we introduced the Enterprise Initiative.

Then, training.

We have all been talking about training, and the need for training for years and years.

Now something is, at long last, being done about it.

And you are doing it.

Carry on with the Management Charter Initiative.

Who knows, soon we might have a career pattern for individuals and encouragement for companies to recognise the value of training.

It is up to you.

Then, employee involvement.

We have given tax incentives for employee share schemes and profit related pay.

Closely involving employees in their company is responsible for major differences in productivity levels between businesses.

See what the Japanese have done, not over there but over here.

Forget the two sides of Industry.

They don't exist.

All there is is the firm and the customer.

Forget the customer and you are finished.

Forget that everyone who works with you is part of your firm then you too are finished.

More and more today recognise that the two sides of industry is an outdated concept.

You need the people who work in your business, wanting to work there, enjoying working there, and being motivated to work there.

You are all in the "people business".

So am I!

All these elements - innovation, training, and employee involvement - add up to greater flexibility, better use of resources and therefore higher productivity.

Many companies have achieved these changes; too many still have to.

My job is to work with you in tackling those goals.

To influence the attitudes and behaviour of people in business.

First, to encourage open competitive markets.

How?

We have always had a relatively open economy.

Now it is becoming an international economy.

The stock of direct and portfolio investment in the UK by overseas residents has tripled since 1979 from about £30 billion to about £90 billion at the end of 1986.

Investments overseas by UK residents have risen much more, up sixfold from about £40 billion at the end of 1979 to £240 billion at the end of 1986.

So we live in an international economy - an economy that must be competitive.

Competition Policy

That is why we are putting so much effort into competition policy.

We have published a Green Paper on restrictive trade practices proposing far-reaching changes to the law on agreements with anti-competitive effects.

And we have published a Blue Paper on competition policy which said that the main criterion in my decisions whether to refer mergers to the MMC is the effect on competition.

To-night is not the night for individual cases, either past or present.

But some say that our policy is too parochial, that it fails to take into account the wider international context.

That criticism is based on a misconception.

Of course we look at the effects of a merger in terms of the effects on UK customers and consumers.

But the geographical nature of the market is clearly relevant: it may be a region of the UK; it may be the whole UK; but equally it may be the European or indeed a wider international market.

If we are open to products from the rest of Europe, and perhaps the rest of the world, then it may not matter if there is only one UK supplier, because that supplier faces competition from outside.

Past merger decisions testify to this.

There have been many cases in recent years when a merger has created a high market share - sometimes in excess of 80% - yet the merger has not even been referred to the MMC for closer scrutiny, let alone been stopped.

Competition is what 1992 is all about.

Its purpose is to sweep away the many remaining barriers to trade among the Community countries.

As I have pointed out on many occasions, this will not only create extra opportunities for our firms in the rest of Europe but will also increase the challenge from them here.

Our mergers policy has taken this into account.

competition increases from other Community countries so it will assume an even greater role in examining mergers.

1992 will not call for a sea change in mergers policy - just a further evolution of the approach we have taken for many years.

The second part of our role in DTI is to encourage people to develop their enterprise and their skills in business.

Partnership with business

We can only do this if we work in partnership.

This does not mean that we will uncritically reflect the views or complaints of business within Government; no more than we expect you to accept our policies uncritically.

I haven't noticed you doing that!

As an aside, I should say that I have noted the points in the President's speech.

I am well known as a man who shuns publicity so I shall say nothing about exchange rates.]

Of course we talk with you, we listen to you and we argue within Government for policies to encourage enterprise and against policies which hamper it.

This is an enterprise strategy.

Our job is to help you to help yourselves, so that you decide and take the action that is needed to create a successful economy.

Government grants have all too often in the past done just the opposite.

It is up to you to decide about your own business - our job is to make sure that you have all the information.

1992

That is why, in partnership with you, we must take the message about 1992 into every business.

Many business leaders are playing a key part in advising me and in working as part of our campaign.

Many business organisations, including the CBI, are working with us to organise seminars throughout the country to spread awareness and to generate action.

By 1993 Europe will be our home market.

With the opening of the Tunnel we will be physically part of the rest of Europe.

We should be thinking now about Bremen and Barcelona - just as we do about Bradford, Birmingham or Bristol.

But our horizons should be must broader than that.

We should be thinking about alliances, joint ventures and direct investment.

Perhaps we have been slower in the uptake than our competitors.

Doing business in Europe means operating as a European business.

I do not intend to tell you how to respond.

What we can do, and what we are doing, is to raise awareness about 1992; to provide comprehensive information on what will occur and when; and to offer an action check list;

So, ring our hotline - 01 200 1992

use our database - Spearhead

but, most of all, get prepared for the Single Market.

We have to get two facts across.

First, the Single Market is going to happen.

Now we have majority voting on most major issues, not even two major nations in Europe will be able to block decisions.

On tax, of course, unanimity is required.

Second, the Single Market is already happening.

Some issues, argued about for years have already been agreed.

The barriers are already coming down all over Europe.

Peroration

I believe, in this area as in many others, we must provide information, encouragement to enterprise, the climate of low inflation and competitive markets.

When we have done that - you get on with the job.

If we cannot put our faith in your enterprise and skill then we will not be a successful country anyway.

The subsidies, the pressures, and the intervention of previous Governments reflected a deep seated belief that business could not be trusted.

Even more, business would fail unless Government "helped", and I say "helped" in inverted commas.

Those attitudes, persisted over many decades made us ill, the sick man of Europe.

Sick not because the economy or business was inherently ill but because the good doctor of Government insisted on prescribing its own quack medicines.

Over time people became hooked on the drug, they began to believe the message.

Luckily, many people in business didn't.

I didn't, and I don't.

The last few years has shown that setting business free has created the healthy man of Europe.

If I have one ambition about the future it is simple and it is this.

As we go into the next decade and enter fully into Europe, they will say of us that we were the best prepared nation in Europe.

The rest is up to you - and today, unlike ten years ago - I have not the slightest doubt of the outcome.

Oort mach: Monopolie
PTG

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CONFIDENTIAL

cc BG

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NBM

PRC6

1615

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
LONDON SW1P 3AG

May 14

Dear Nigel.

RESTRICTIVE LABOUR PRACTICES: POSSIBLE FURTHER REFERENCES TO MMC

Now that we have successfully referred the question of restrictive labour practices in TV broadcasting and films to the MMC I am sure we must continue to search vigorously for further candidates.

The Section 79 inquiry procedures should be able to contribute significantly to a more competitive economy. But for that to happen, they need to be used in a continuing and systematic way. It would be wrong to see the broadcasting reference as an isolated event and I believe there is a natural expectation of more to come.

What I suggest we must now do is to work up a store of potentially worthwhile further references. We should have this ready in good time before we have the MMC report on broadcasting, due by the end of the year, so as to be in a good position to decide on the most suitable next and subsequent references and the best timing. The exercise should cover the range of likely industries and services.

I recognise that this further general trawl will require some care and effort in sponsor Department to indentify promising candidates; perhaps this is a task that the individual de-regulation units could undertake.

I am asking Mr A G Johnson in this Department to take these suggestions forward, and to co-ordinate responses with a view

to my reporting to E(CP) later in the year. I should be grateful if you and colleagues in sponsor Departments would each nominate an official for him to contact.

I am copying this letter to the Prime Minister, other members of E(CP), Douglas Hurd, and to Sir Robin Butler.

Yours ever: Norman

NORMAN FOWLER

010

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Nigel Wicks Esq CBE
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Our ref DC4AOI
Your ref
Date 12 May 1988

Dear Nigel,

MERGERS

You spoke to my Secretary of State this afternoon, he agreed that we would provide a draft text for you to consider issuing to Private Secretaries to other members of the Cabinet. I attach a draft which has been cleared by Lord Young.

Yours sincerely

Stephen Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

the Enterprise initiative

NOT FOR PUBLICATION, BROADCAST, OR USE ON CLUB TAPES BEFORE 18·30 HOURS G.M.T./B.S.T. ON WEDNESDAY 11 MAY 1988

SUMMARY OF SPEECH BY THE SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AND AFFAIRS, THE RT HON SIR GEOFFREY HOWE QC MP TO THE AGRICULTURAL FORUM: 11 MAY 1988

"1992: THE RURAL REVOLUTION"

The farmer must again become an entrepreneur, Sir Geoffrey Howe Howe told the Agricultural Forum on 11 May. For years, farmers had been able to produce more, knowing that Governments would buy and taxpayers would pay. Now that was changing.

The trend was towards a dramatic reduction of subsidies. The farmer must focus on the market place and become more conscious of customer needs. That would mean greater specialisation or diversification. Additional activities - such as farm shops or tourism-related projects - would supplement the farmers' income: more and more farmers would rightly see themselves, not just as producers, but as protectors of the environment and providers of recreation for an urban population. And technology would bring work back to the countryside as more people were able to take their jobs with them. We had to preserve the countryside, but not as a museum.

The farmer must strengthen his links with the processor and retailer. Consumer tastes were changing both in the UK and on the Continent, with an increasing emphasis on processed foods. The farmer would have to develop a marketing and export strategy which identified and satisfied changing taste in hitherto untapped Community markets. But European consumer demand for food was limited. Real expansion would have to come from outside the Community in countries where prosperity was increasing and populations still growing.

Sir Geoffrey Howe said that British companies needed to be able to buy into or take over European companies: "they should not be thwarted by barriers placed in their way. That is true for the Community; and for our trading partners outside it. Swiss companies, for example, expect to make takeovers in our market; their Government must ensure British firms can make takeovers in theirs".

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CHECK AGAINST DELIVE...

NOT FOR PUBLICATION, BROADCAST, OR USE ON CLUB TAPES BEFORE 8.30 HOURS G.M.T./B.S.T. ON WEDNESDAY 11 MAY 1988

SPEECH TO THE AGRICULTURAL FORUM: 11 MAY 1992: THE RURAL REVOLUTION

- The thing about Daniel was that, against all outward appearances, the odds were stacked in his favour. He knew right was on his side. The lions knew it. Only his persecutors did not. So he could afford to go into the den smiling.

- The farmer in his den is an altogether more daunting prospect. If, therefore, I approach this audience and this subject with hesitation, it is not because I expect to be torn limb from limb. It is, rather, that anyone who ventures to speak to an audience such as this, and to speak about your livelihood and your future, would be rash to think he could emerge totally unscathed.

CHECK AGAINST DELIVERY

- Daniel was saved from the lions' jaws by an angel. I can expect no such divine intervention. So I shall endeavour not to try your patience too far. My aim is not to write prescriptions but to provoke discussion.

- For years the farmer has been the victim - sometimes the willing victim - of many of the worst aspects of State control. He was encouraged to produce when the market was growing. And even after it had stopped growing. As is often the case when the State takes over, farmers came to think that high prices were the norm. Inevitably, high prices encouraged high costs and incomes were squeezed. This led to a never-ending ratcheting up of prices and costs.

- Worst of all, farmers lost contact with their customers. The consumer was <u>obliged</u> to pay high prices. The normal laws of supply and demand got turned upside down.

- You all know better than me about growing for intervention. Demand from real consumers has been supplemented by a wholly artificial demand, in the shape of the intervention store, operated at the taxpayers' expense.

- After European markets were saturated, we pushed our surpluses on to the world market. Paradoxically, this exacerbated the appalling chasm of hunger and famine in Africa.

- The problem of producing for already saturated markets was made worse because of technological advance. We passed the point where new and faster-growing strains of wheat were filling a fundamental nutritional gap. They were, and are, simply boosting over-supply.

- We now have to face up to the consequences of that reality.

- We have started to face up to it within the European Community in ways you know. We are facing it internationally in the Uruguay round of trade negotiations. What we need is a contribution from all countries. What the EC is doing, the Americans and Japanese must also do. The United States have proposed the total elimination of all subsidies. Past history, not just in the US, suggests that reforming zeal all too often expires on the doorstep of domestic electoral reality. But the trend is - and must be - towards a dramatic reduction of subsidy. Towards a return to the marketplace.

- What does that marketplace look like? For a start, it does look more like a marketplace.

- Farmers can no longer plan to produce ever-increasing quantities in the sure knowledge that governments will buy the product and taxpayers will pay for it, even if consumers do not want it or cannot afford it.

- When governments who have been doing much of the buying stop buying, the first consequence has to be that prices will fall and farmers produce less. That is inescapable. The second consequence has to be that the farmer discovers his true purpose - as an entrepreneur. He will have to become more conscious of what his customer wants: conscious of quality; conscious of consistency; and conscious of value for money.

He has to find new ways of tapping demand. He has to diversify into new areas.

- In industry, it happens all the time. It's an old trick learnt from the farmer in the first place and called not putting all your eggs in one basket.

- For years, we have put producers in categories: wheat producer, dairy producer, beef producer. That will change. Some farmers will specialise more - identifying a market and catering for it. Others will diversify. Many are already doing so.

- More and more farmers will rightly see themselves, not just as producers, but as protectors of the environment and providers of recreation for an urban population.

- A farm in my constituency opened its doors to visitors a few years ago. It was a working farm with a handful of visitors. Now it is a working farm with hundreds of visitors. It remains a

working farm. But its income comes as much from the visitors as the visited. And the visitors go to the local pub and the local shops. And a thriving rural economy based in and on a farm, but branching out from it, has grown up.

- In hitherto remote rural areas like the South West, farm and land prices have started to climb as improved access from London brings a new kind of buyer. Of course it is sad if the traditional sheep farmer is obliged to sell out to the yuppie stockbroker.

- But it is not inevitable. Nor, if it happens, does it necessarily mean the demise of farming.

- It is not inevitable because a lot of farmers are themselves diversifying. About a third of British farmers have a second job. Only 15% earn their living solely from the land. Farmers

are branching out in many directions. Tourism is a favoured area. More than 3,000 farmers in Wales alone are involved in tourist projects. But there are many strings to the rural enterprise bow - food processing, fish farming, farm shops.

- A farm that might once have gone derelict may be able to remain a farm if its owner can supplement his income. Or a farm which might once have gone derelict may remain a farm because someone has the will and the money to invest in it. Either way, that will help safeguard the rural economy.

- The first industrial revolution took the farm labourer off the land and put him into the factory. The second industrial revolution may return his descendants to the countryside.

- More and more industries are less and less dependent on city infrastructure. The umbilical cord which tied the office to the availability of urban services is being cut. The telephone and the computer have become as mobile as the people who use them. Instead of moving to look for jobs, people will increasingly move and take their jobs with them.

- As more business moves away from the centre, as more farms diversify, as more people seek to expand rural enterprise, there will be inevitable pressure on the land.

- In a country such as ours, with open space at a premium, no single group has a monopoly on concern for the environment. It is the heritage of each one of us. But we must distinguish between preserving the countryside for our benefit and preserving it as a museum-piece; as an inactive tribute to a bygone age.

- The charm of the Yorkshire Dales or the Sussex Weald or the Welsh Marches lies not just in their natural beauty but in their natural beauty as shaped by the hand of man.

- The first dry stone wall probably changed the face of the countryside just as much as the first time a farm was turned into a golf course.

- I am not suggesting a wholesale policy of beating plough shares into golf clubs. But I am suggesting that there is no place for Luddism in the rural marketplace. Or in the Council Chamber.

- Change and technological change are part of the pattern of farming life. Technology will continue to revolutionise production.

- To the dramatic advances in chemical technology of the last four years are now being added those brought about by genetic engineering. Commercial production of the hormone bovine somatotropin (BST), which is now possible thanks to biotechnology, offers the prospect of milk yields increased by up to 25%.

- Improved technology will enable the farmer to produce more, more cheaply. But, unless we have a policy geared to the market place there is a risk of more production, leading straight down the same dead end we are in now. That is especially true if the farmer produces more for a European market where population is declining.

- So technology has to be harnessed in different ways; harnessed to meet the demands of the market place at a lower price.

- The information technology that will allow the town dweller to work from the country could also help the farmer - by giving him instant access to market information and forecasts. Not just in Britain. But all over Europe.

- Perhaps, even, new technology - which has already revolutionised financial markets around the world - can come to the aid of the agricultural markets. Perhaps producers themselves will make more use of futures markets to hedge against price changes. Might not the grain broker come to play as important a role as that now played by the intervention storekeeper?

- Some of these developments will inevitably encourage production on a scale that will squeeze the smaller farmer, as the supermarket squeezed the corner greengrocer in the 1950s.

- But it is worth noting, before we mourn the demise of the cornershop retailer, that he is back. He may sell more newspapers than cabbages, more Sunday morning yoghurt than daily milk. He may come from Karachi rather than Cardigan. He may be called Patel rather than Powell. But the cornershop Patels have identified a need and catered for it. They have supplied what the customer wanted; when he wanted it. They have exploited the opportunity in change. Not succumbed to the threat implied by change. There is a lesson for the farmer there too.

- In a world governed by subsidy the producer can all too easily become divorced from the processor and retailer. That too is changing. You know better than me how the retail market is changing. Some of it, like the demand for organic produce, has been consumer-led.

- But processors and retailers have not been slow to identify the change in consumer demands which that implies. Nowadays, the local health food store is likely to be called Tescos or Sainsburys or Marks and Spencer.

- The days when convenience food was more 'convenient' than 'food' are over. Most children learn their 'E' numbers with their alphabet. Today's convenience food is as likely to be moules marinières as beefburgers.

- One of Britain's most successful turkey farmers started off with half a dozen scrawny birds and an idea. The idea was that turkeys weren't just for Christmas. Everyone told him he was daft. Today he sells millions of turkeys a year - throughout the year. And in every shape - boned, rolled, sliced - that you can imagine.

- Not everyone can have that flair. But every farmer is going to need a marketing strategy. To have his ear to the ground of consumer demand. To establish an ever-closer relationship with the processor and retailer. To be imaginative and adaptable. And tuned to the European market.

- Farmers must look to ways of differentiating themselves from their neighbours. It is already happening. Who would have thought 10 years ago that you could sit down to a British cheese board which could run to 20 farmhouse cheeses, none of which was the traditional variety. Beenleigh from Dorset is a blue cheese made from ewe's milk, which rivals anything France can produce.

- And that too is a sign of a new trend: it is as untrue to suggest that the British housewife buys only baked beans and beefburgers as it is

to think that the French housewife still goes three times a day to buy her bread at the boulangerie. The French housewife, like the British, goes more and more to the supermarket. More and more, like her British counterpart, she is buying convenience foods of better and better quality; and specialist foods of even greater diversity.

- That is a market which British producers, processors and retailers must increasingly tap into. I am very glad to see that it is happening. In 1987 British food and drink was promoted in nearly 2,000 department stores and supermarkets in France, Germany and the Benelux countries. Our food exports to those countries rose 18%. Recent export successes to France include Weetabix, smoked salmon, Mr Kipling's cakes and - perhaps surprisingly - spam. But our imagination and entrepreneurial skill must

not stop there. We must be looking for the new markets of the next few years.

- Between now and 1991 £35 billion of European Community money will be spent on developing the economies of what are now the poorer member states of the Community, mainly Greece, Portugal and Spain.

- The days are gone when every British tourist in Spain used to sit sipping warm Watneys in a pub called "El Pussycat". The growth in British consumption of wine and lager bears witness to that.

- Because our taste is changing does not mean that theirs won't. Quite the reverse. It is a two-way process.

- Growing prosperity will mean growing demand. And a taste for new tastes. When paella palls for the Spanish family, why should Italian pasta take its place?

- I am not suggesting that British taste can be translated unchanged to Community dinner tables. But why should we not supply the changing consumer demands of Spain, Portugal and other EC member states?

- We have to identify and meet - and even create - their demand. Some of that will be clever marketing. Why else does generation after generation grow up on hamburgers and cola drinks? I find it hard to believe that this loyalty can be traced solely to the intrinsic merits of the product. It is, rather, a tribute to marketing and retailing.

- Where marketing and retailing can't win the market, then cooperative ventures and takeovers may.

- One of the effects of 1992 and the single market must be to make that process of merger and acquisition more of a two-way process than it is now.

- British companies need to be able to buy into/take over European companies. They should not be thwarted by barriers placed in their way. That is true for the Community; and for our trading partners outside it. Swiss companies, for example, expect to make take overs in our market; their government must ensure British firms can make take overs in theirs. We want the Single Market to be an open market. But if the away teams are going to play on a level pitch when they come to the Community, we shall want to see them levelling their pitch too for the return match.

- The 'C' in the Common Agricultural Policy has never before stood for competition. It must now start to do so.

- But we must also be competitive beyond the Community's borders. Within Europe we are catering for stomachs which are more or less full. There is ample scope for changing people's taste. But only limited scope for increasing their net consumption. Marketing can persuade a man that he needs three cars and two televisions. Marketing can persuade a man to eat moules marinières in preference to mutton. It is hard to persuade him to eat both in sufficient quantity to increase consumption overall.

- If you can generate, and satisfy, new demand there will be profit to be made. But one producer will still displace another; as we have already seen with the increase in

consumption of white meat at the expense of red.

- Outside Europe, however, the world population is growing. There is still the chasm of starvation to be filled. It will best be filled in the long run in Africa, as it has been in India, by cheap domestic production. Not expensively subsidised imports. And new technology will come to the aid of third world production, further reducing the opportunities for large-scale exports of traditional agricultural commodities.

- But there <u>will</u> be more opportunities for producers and exporters. Not necessarily for the large scale food exporter. But for the specialist producer and the producer of processed food.

- The European Community is constantly developing and expanding its economic links with

a wide range of third countries, from ASEAN and China to the Central American states and the countries of the Andean Pact.

- With increasing prosperity, demand in those countries will grow. "Selling ice cream to eskimoes" may no longer be a measure of the impossible but a real test of enterprise and ingenuity.

- To identify new, specialist markets will require a radical new approach. The farmer will have to become a businessman and the businessman will have to work in partnership with the farmer.

- That may sound like a harsh message. But the message of challenge and opportunity is the same for the food industry as for every other industry.

- It is the government's business to ensure that our food industry can compete on equal terms with the rest of Europe.

- The government cannot make our food industry more competitive than the rest of Europe.

- That is your business.

- It is our business to help with the process of adaptation and to ensure that rural enterprise and the rural environment can live amicably, profitably and responsibly together.

- The first ever market was a farmer's market. The single market can be a farmer's market too.

RESTRICTED

DG280

File

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

12 May 1988

Dear Private Secretary,

MERGERS

The Prime Minister was questioned this afternoon in the House about the interest of Swiss companies in Rowntree Mackintosh. The Prime Minister refused to be drawn as she has refused in the past to be drawn on merger or potential merger cases.

The Prime Minister regards it as important that no Minister should make any public comment which expresses, or could be construed as expressing, a view on any particular merger case in advance of the Secretary of State for Trade and Industry's decision whether to refer the matter to the MMC. The line must be that it is for the Secretary of State for Trade and Industry to make his decision as to reference in accordance with his statutory responsibilities, and in the light of the Director General's advice; and that meanwhile any other comment is inappropriate. The Prime Minister would be grateful if Ministers would bear this in mind when giving speeches or interviews.

I am writing in similar terms to the Private Secretaries to the other members of the Cabinet, to the Private Secretaries to the Chief Whip and the Paymaster General and to Sir Robin Butler.

Yours sincerely,

Nigel Wicks.

N. L. Wicks

The Private Secretary

RESTRICTED

PRIME MINISTER

Lord Young telephoned today to say that he was somewhat concerned about the report (Flag A) in today's Financial Times concerning a speech by Sir Geoffrey Howe on merger policy. In fact, Sir Geoffrey's comments (Flag B) were more innocuous than the newspaper report suggested, and the FT has given them, perhaps inevitably, an unhelpful twist. Sir Geoffrey will be telephoning Lord Young to set matters right.

Already done

Lord Young has suggested, and I agree, that I might send a letter to Private Secretaries to Cabinet Ministers saying that you think it important that Ministers should not make public comments which express, or could be construed as expressing, a view on any particular merger case, in advance of his decision to refer the matter to the MMC. A draft is at Flag C.

Agree that I should write in these terms (though I would replace the first paragraph suggested by the Department of Trade and Industry by the manuscript change)?

Yes MT

N.L.W.

MT

(N.L. WICKS)

12 May 1988

DA1AHG

FINANCIAL TIMES

Thursday May 12 1988

Howe intervention on Rowntree adds to merger policy confusion

BY PETER RIDDELL AND DAVID WALLER

CONFUSION about the Government's competition policy increased yesterday as Sir Geoffrey Howe, the Foreign Secretary, intervened in the row over the possible Swiss takeover of Rowntree, the York-based chocolate group. He warned Switzerland that it must be ready to allow British companies to make takeover bids there without legal restrictions.

The Government faced increased pressure at Westminster to clarify its policy after conflicting official statements, including a speech yesterday by Sir Gordon Borrie, the Director-General of Fair Trading, in which he defended the flexibility of the Government's merger policy, but emphasised that "our principal concern is bound to be the effects of a merger on competition in the UK."

The calls for clarification came from opponents of the possible takeover both of Rowntree and of Cadbury Schweppes, by non-European Community groups.

Sir Geoffrey made no mention of the £2.1bn bid by Nestlé, the Swiss food group, for Rowntree, but, echoing the concern of several opponents of the offer, he told a meeting in London: "British companies need to be able to buy into and take over European companies. They should not be thwarted by barriers.

"Swiss companies, for example, expect to make takeovers in our market . . . We want the single market to be an open market. But if the away teams are going to play on a level pitch when they come to the community we shall want to see them levelling their pitch too for the return match," he added.

Sir Gordon, while pointing up the prime UK concern in policy to a European Study Conference, also cited recent examples to show that the international dimension of a merger was taken into account.

One was the approval of the link-up between the two main British manufacturers of automotive bearings, Vandervel and a subsidiary of T&N, "because the automotive bearings market was powerfully influenced by international competition."

Sir Gordon said: "The policy will not need to be changed to take into account (1992) . . . because the policy is one which already takes the facts as it finds them (including the impact of international competition). I believe that Britain's present mergers policy is well designed for the 1990s."

Comments in recent days by both Lord Young, the Trade and Industry Secretary, and Mr John MacGregor, the Agriculture Minister, have suggested that a merger of two UK companies producing a monopoly in the domestic market might be permitted in the context of the larger European internal market to be created after 1992.

Mr Tony Blair, Labour's trade spokesman, last night wrote to Lord Young asking whether there was any question of UK domestic competition considerations ceasing to be relevant or whether it was just that, in certain areas, broader questions of European-wide competition applied.

For the second successive day in the Commons, ministers came under pressure to refer the Rowntree bid to the Monopolies and Mergers Commission. The issue was raised a dozen times, and the two main Conservative and Labour motions were backed by 140 MPs.

In spite of the mounting calls, Rowntree's share price remained relatively firm against the general fall in the stock market. The shares edged down 1p to 904p, 3½p above the value of the bid if dividends are taken into account. Nestlé, which yesterday declared that it owned 13.4 per cent of Rowntree's shares, was again adding to its holding.

Mr Kenneth Dixon, chairman of Rowntree, met a group of more than 30 MPs to seek support on the grounds of absence of reciprocity (given that Swiss companies are bid-proof), the company's regional base and roots in York and the north, and its employment record. MPs were left with the impression that any rationalisation would involve redundancies in the 12,500 workforce in the hundreds rather than thousands.

The Agricultural Forum

- Where marketing and retailing can't win the market, then cooperative ventures and takeovers may.

- One of the effects of 1992 and the single market must be to make that process of merger and acquisition more of a two-way process than it is now.

- British companies need to be able to buy into/take over European companies. They should not be thwarted by barriers placed in their way. That is true for the Community; and for our trading partners outside it. Swiss companies, for example, expect to make take overs in our market; their government must ensure British firms can make take overs in theirs. We want the Single Market to be an open market. But if the away teams are going to play on a level pitch when they come to the Community, we shall want to see them levelling their pitch too for the return match.

C

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DRAFT LETTER FOR THE PRIVATE SECRETARY TO THE PRIME MINISTER TO SEND TO:

Dear Pte Sec.

MERGERS

The Prime Minister ~~has seen press reports suggesting that there is confusion over the Government's policy on mergers. These appear to have resulted from public comments made by Ministers in relation to~~ was questioned this afternoon in the House about the interest of Swiss companies in Rowntree Mackintosh. The PM requested to be drawn as she has refused in the past to be drawn on merger or potential merger cases. She ~~The Prime Minister~~ regards it as important that no Minister should make any public comment which expresses, or could be construed as expressing, a view on any particular merger case in advance of the Secretary of State for Trade and Industry's decision whether to refer the matter to the MMC. The line must be that it is for the Secretary of State for Trade and Industry to make his decision as to reference in accordance with his statutory responsibilities, and in the light of the Director General's advice : and that meanwhile any other comment is inappropriate. The Prime Minister would be grateful if Ministers would bear this in mind when giving speeches or interviews.

Stat underlining

I am only issuing ~~Copies of this minute go~~ to the Private Secretaries to members of the Cabinet, Private Secretary to the Chief Whip + the Paymaster General and to Sir Robin Butler.

DC4AOM

Kenneth Dixon

10 DOWNING STREET
LONDON SW1A 2AA

C/F

From the Private Secretary

10 May 1988

I attach a copy of a letter the Prime Minister has received from Mr Kenneth Dixon, Chairman of Bowntree plc.

I should be grateful for an urgent draft reply to send to Mr Dixon, as we discussed.

PF 11

Paul Gray

Stephen Ratcliffe, Esq.,
Department of Trade and Industry.

Rowntree

Kenneth Dixon
Chairman

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

10 May 1988

Dear Prime Minister

I would like to call your attention to some national issues which are being raised by Nestlé's bid for Rowntree.

As we approach 1992, British companies are at a substantial disadvantage to other European companies as a result of present competition policy. The Government's current policy discourages British companies within the same industry from merging, if the effect of the merger would be to reduce competition in the UK market. This policy runs counter to the Government's recently expressed objective that British companies should compete aggressively and from a position of strength in the European market. Indeed it is significant that the DTI's recent paper "Mergers Policy" does not address this important new issue.

Furthermore, British companies which are successful in preparing for 1992 by developing a competitive position in Europe are the natural targets for Continental European companies determined to consolidate their position in Europe. The UK has one of the most open markets in the world. There are material practical obstacles to completing contested takeovers on the Continent.

The confectionery industry is but one example of this phenomenon. Pharmaceutical, insurance, other food companies, and oil and gas companies are logical candidates, as well. Indeed, some activity has already been experienced in these sectors. As a result, we face a substantial risk that 1992 will see the decline of international British industry, rather than its growth.

We submit that a review of these critical issues and UK competition policy is urgently called for. Rowntree should have the opportunity to benefit from such a review, rather than being the cause célèbre which emphasises the need for change. The only way to address this issue in the short term - and the matter is urgent because the two Swiss companies, Nestlé and Suchard, already own more than 40% of our shares - is for the Secretary of State to refer the bid on national interest grounds to the Monopolies and Mergers Commission immediately.

Yours sincerely
Kenneth Dixon

Rowntree plc
York YO1 1XY
England

Telephone 0904 612261
Telex 57525 Rowmac G
Facsimile 0904 25086

Registered in England
Number 51491
Registered Office
York YO1 1XY

RESTRICTED

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

10 May 1988

MERGERS

The Prime Minister is most grateful for the factual briefing note enclosed with your letter to me of 9 May.

Paul Gray

Stephen Ratcliffe, Esq.,
Department of Trade and Industry.

RESTRICTED

dti

the department for Enterprise

cc Nigel Wicks
John Whittingdale

Dan p.c.
Rec 6
10/5

RESTRICTED

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Paul Gray Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Department of Trade and Industry

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London SW1H 0ET

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Direct line 215 5422
Our ref PS1AUA
Your ref
Date 9 May 1988

Dear Paul,

MERGERS

... As requested this morning, I attach a factual briefing note covering the various current "merger situations", the powers and procedures under UK and Swiss legislation and the policy on reciprocity. Any of this may be used publicly, except for the passage marked "not for public use".

I hope this is helpful. Please let me know if you require any further information.

Yours ever

Steph Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

the Enterprise initiative

MERGERS EXAMINATION PROCEDURE

1. If a merger qualifies under the Fair Trading Act 1973 for reference to the Monopolies and Mergers Commission (it does so if the merged company would account for 25% of a relevant market or if the merger involves the acquisition of assets worth £30 million or more) the Director General must advise the Secretary of State on whether it should be referred. The Secretary of State has discretion whether or not to refer : but he has acted against the Director General's advice on only nine occasions (out of over 2000 qualifying mergers) since 1979.

2. In general the collection and analysis of information by OFT can be expected to take some four weeks. But contentious cases may however take longer; and the OFT as far as possible takes account of the bid timetable.

NESTLE/ROWNTREE

On Tuesday 26 April Nestle, the Swiss food group announced a £2.1 billion takeover bid for Rowntree. The Nestle offer valued Rowntree at 890p per share. Rowntree shares now stand at 904p having declined from a 928p high point following the announcement of the bid.

SUCHARD/ROWNTREE

Jacobs Suchard, the Swiss confectionary group, acquired a 14.9% stake in Rowntree in a dawn raid on 12 April. Suchard have now increased their shareholding to at some 28%. Some sources claim that Suchard now hold 29.9%.

GENERAL CINEMA/CADBURY

General Cinema Corporation, a US company operating exclusively in that country in cinema ownership and soft drinks bottling acquired an 8.5% shareholding in Cadbury Schweppes plc in January 1987. It raised its holding to 18.2% in November 1987. On 26 April General Cinema announced that it should no longer be regarded as a "passive investor". The OFT advised that the 18.2% shareholding constituted a merger situation.

THE POSITION OF FOREIGN TAKEOVERS UNDER SWISS LAW

The Swiss Government has no powers to intervene to stop a takeover, even one involving a foreign company.

SLHAAG

But Article 686 of the Swiss Civil Code enables Swiss companies in effect to block unwelcome bids, whether from Swiss or foreign companies. A Swiss company may through appropriate provisions in its Articles of Association, refuse to register the shares of any person whom the board regards as "undesirable". The owner of these shares thereby loses voting rights.

REFERENCE POLICY

Our policy is that in deciding whether to refer a merger to the MMC, the main consideration is the effect of that merger on competition. However, in exceptional circumstances references may be made on other public interest grounds.

RECIPROCITY

In general the Government welcomes investment in the UK by foreign concerns, whether direct investment or investment by acquisition of UK companies. The UK, as a substantial investor abroad has an interest in open markets. Nevertheless, in some cases foreign ownership of a UK company may raise issues which justify investigation by the MMC. A factor which may be relevant in some instances is the extent to which UK companies have reciprocal freedom to acquire companies based in the home country of the prospective acquiror.

[Not for public use]

RESTRICTED

In practice, lack of reciprocity may be a contributory factor to a decision to refer, but it is difficult to conceive of circumstances in which lack of reciprocity by itself could justify a reference. It would be necessary for the Secretary of State to be satisfied that the MMC might conclude that lack of reciprocity was responsible for that particular merger being against the public interest.

THE INDUSTRY ACT 1975

The Act enables the Secretary of State to prohibit foreign control of important undertakings in manufacturing industry which would be contrary to the national interest, and if necessary to vest the share capital of the target company in the Government.

These powers have never been used. They apply only to "important manufacturing undertakings" and cannot be used against EC companies without serious risk of challenge under the Treaty of Rome.

SLHAAG

For the purposes of this Act, 'control' is defined as possession of 30% or more of the voting rights.

SLHAAG

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

From the Minister

RA

Prime Minister
You may wish to see.
RRG
5/5

CONFIDENTIAL

The Rt Hon Lord Young of Graffham
Secretary of State
for Trade and Industry
1 Victoria Street
LONDON
SW1H OET

5 May 1988

Dear David,

The current bid by Nestle for Rowntree and the accompanying threat from Suchard raise an issue of considerable importance both to the food and drink industries, for which I am sponsoring Minister, and to industry generally.

My concern is with reciprocity. The circumstances and importance of the Rowntree case, and the growing political criticism to which it is giving rise, are such that we do now have to face up to this issue. The whole basis of our approach to mergers and acquisitions has been that, provided they do not have an adverse effect on competition, we should wherever possible leave it to market forces, operating freely, to determine the outcome. The bidding company and the target company have the opportunity to bid or counterbid and in the end the shareholders determine the outcome, as they should do. But it is clear that this kind of free operation of market forces is not possible in this case.

The position in Switzerland was described in yesterday's cable from Zurich of which your officials have a copy. The conclusion is clear that an unfriendly takeover of a Swiss Company a majority of whose shares are registered (and we understand that both Nestle and Suchard are in effect in this category) by a foreign company "is, for all intents and purposes, impossible". The essential pre-condition for the effective working of our policy is therefore missing and market forces are not permitted to work.

/Although I would ...

Although I would have preferred this matter to be considered by Ministers, I suspect that under the legislation the courses open to us are more restricted. If that is the case, than I suggest that the Nestle bid for Rowntree should be referred to the Monopolies and Mergers Commission with a specific request to them to consider the question of reciprocity.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, Nigel Lawson and Sir Robin Butler.

Yours ever,

JOHN MacGREGOR

C.F. - p.c.

MR GRAY

ROWNTREE

This is to record my conversation today with Sir Michael Franklin, now a Director of Rowntree, about the article by Jeremy Warner in today's Independent (attached). Sir Michael said that there had been some dismay in Rowntree when they had read the comment that:-

> "One source close to Downing Street thinking described the company as 'just a lot of pinkos'."

Sir Michael went on to say that that sort of comment derived, no doubt, from the activities of certain charitable trusts which had been established by members of the Rowntree family. But those trusts were quite independent of the company; indeed, one, which had financed certain SDP activities, no longer held any Rowntree shares.

I told Sir Michael that I was as certain as I could be that no such comment had emanated from No.10. The Prime Minister's firm rule was not to get involved in takeover matters, and to direct all enquiries to the Department of Trade and Industry. I was certain that she would take that line with this particular enquiry and would not wish to intervene.

Sir Michael expressed himself relieved.

N.L.W.

N.L. Wicks

28 April 1988

MJ2CHQ

...ply to boost the value of its ... bid for Swiss companies as they have to bid for British ones.

Northard, 61, or at British ...pointed dep- the corpora- ...o work along- ...ting deputy ...eth Couzens, ...xpires at the ...r.

The Co-oper- increased its the placing of ...lative redeem- shares 2013 of

...ed: Publishing ...ernational has ... for a US inte- ...up, Communi- **Page 27**

...l spurt: Nigel ...ellor of the Ex- ...hat 1987 saw a ...ount of venture ...d in UK busi- ...pped £1bn for

...ase: Chemical ...co Minsep re- ...er cent rise in ...5m before tax **27**

...hts: Westbury, ...der, took advan- ...r cent rise in full ...profits to £15.4m ...o-for-five rights

Crude price rises: Crude oil prices rose 10-15 cents a gallon on news that six non-Opec producers offered to cut exports by 5 per cent contingent on a similar Opec sacrifice.

BP blocked: British Petroleum's plans to take a 40 per cent stake in a new $520m Seoul refinery have been blocked by the South Korean industrial conglomerate, Hyundai. **Page 27**

Guinness payment: The non-disclosure of the £5.2m payment to former Guinness director Thomas Ward was a breach of company law and Guinness's articles of association, the company's counsel told the Court of Appeal yesterday. Mr Ward is appealing against a judgement that he should return the money.

Ramsden in court: Racehorse owner and share dealer Terry Ramsden appeared in Southwark Crown Court to deny allegations of avoiding payment of more than £500,000 VAT on stockbroking deals.

Diamonds rise: The price of uncut diamonds is going up by 13.5 per cent on Tuesday in response to booming demand worldwide, De Beers announced yesterday. **This page**

Hopes pinned on MMC

By Jeremy Warner
Business Correspondent

ROWNTREE faces an uphill struggle in obtaining the Monopolies and Mergers Commission reference which stockbroking analysts believe offers it the only realistic hope of remaining independent.

There appear to be no competition grounds for referring Nestlé's £2.1bn bid.

Rowntree's only chance of getting the Nestlé bid referred hinges on the fact that British companies do not have the same opportunity to make acquisitions in Switzerland that the Swiss have in Britain.

The Swiss government is reluctant to allow any takeovers by foreign interests of Swiss companies — a lack of reciprocity that may sway the British Government in favour of putting a block on Nestlé's bid.

However, there appears to be little sympathy for the company among ministers. There is still a tendency for Rowntree to be viewed as one of the few enclaves of corporate Britain which is fundamentally hostile to Thatcherite aims.

One source close to Downing Street thinking described the company as "just a lot of pinkos", a perception which seems to be based on Rowntree's association with the liberal Quaker tradition.

The company's left of centre image also stems, misleadingly, from its apparent connection with the Rowntree trusts that fund a variety of political and pressure groups.

For instance, the Joseph Rowntree Social Service Trust gave £150,000 to the SDP/Liberal Alliance at the time of the last election and it is also known for backing organisations connected with the Labour Party.

In addition, the two Rowntree charitable trusts fund what is sometimes seen as politically motivated research into the causes of perceived social ills.

However, the trusts own no more than 6.8 per cent of the company's shares and they have had no direct influence on Rowntree's affairs for many years.

Indeed the last time one of the trusts attempted to interfere with the company it was able to do no more than protest about the refusal of Rowntree's South African offshoot to recognise the black trade union, SAAWU.

Rowntree is also heavily involved directly in charitable activities and as a member of the "Per Cent Club" gives away 1 per cent of its UK profits a year to local community projects.

The Per Cent Club cannot, however, be described as anti-Thatcherite having been launched in 1986 at a reception hosted by the Prime Minister.

Outlook, page 25

Diamond prices to go up by 13%

THE PRICE of uncut diamonds is going up by 13.5 per cent on Tuesday in response to booming demand worldwide, De Beers announced yesterday.

It is the second increase in six months; last October prices of uncut stones were increased by 10 per cent.

A spokesman for the group, which controls 80 per cent of the world diamond market, said the the increase reflected strong demand rather than the weakness of the dollar, the currency in which diamonds are priced. However, currency effects have helped sales.

Over the past two years, taking into account this latest increase, uncut diamond prices will have risen by 38 per cent, showing a strong recovery from the slump of the early eighties.

Bank plans two more gilt auctions

By Peter Wilson-Smith
Financial Editor

THE BANK of England is to hold two more auctions of gilt-edged stock this financial year, with the first likely to be in July or August and the second early in 1989. They will be similar to the experimental auctions held during 1987-88, although technical changes to the bidding procedure are still being considered.

The decision to persist with auctions as an element in the funding programme has been taken after deliberations within the Bank and Treasury and discussions with market participants.

The Bank raised £2.8bn in 1987-88 using auctions. Stock was allotted to participants at the price at which they bid, although the Bank reserved the right in certain circumstances not to allot all the amount up for auction.

The official view is that the experiments were a success, although the reaction in the gilts market was mixed. The third auction was only narrowly covered by bids and a recent survey conducted by stockbrokers Capel-Cure Myers suggested that institutional investors were unenthusiastic about the system.

With about £8bn of gilts maturing and a government budget surplus forecast at £3bn, the Bank will have to sell about £5bn of gilts during 1988-89.

The two auctions will be for amounts up to £1bn and details will be announced in two stages. The date of the auction and maturity of the stock will be announced at least a month in advance and the fine details not less than seven days ahead.

WORLD MARKETS

...ares failed to hold ...s. By the close the ...ndustrial average ...oints at 2,047.9. ...rices edged up in ...There was some ...erest and institu- ...g. The all-share ...ose by 0.1 points to

Share prices closed ...l trading as inves- the release of the ...stitution for Hong China resumes con- ...97. The Hang Seng ... at 2,592.02, an in- ...5. ...market fell back af- record high. Trad-

Sydney: Prices closed higher although brokers said it was a disappointing performance considering the continued strong gains on Wall Street and in London. The All Ordinaries index closed up 2.2 at 1,443.4.

Brussels: Belgian shares ended higher as market activity picked up a little. Petrofina, the oil giant, attracted attention, gaining 125 francs to finish at 11,075 francs.

Stockholm: In moderately active trading shares closed higher after a slow opening. The Veckans Affarer all-share index closed 1.14 per cent higher.

Paris: Shares ended the continuous session slightly higher in active trading. The CAC index

ITC 'morally obliged' to repa

THE COURT of Appeal yester- ... appeals brought by 17 creditors ... brokers and six banks — who

ps3/2T

CCBS

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

29 April 1988

The Rt Hon Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster
1 Victoria Street
LONDON
SW1

NBPM
RPC
29/5

Dear Kenneth

MONOPOLIES AND MERGERS COMMISSION:
1988 PROGRAMME OF NATIONALISED INDUSTRY REFERENCES with agreed of regret

You have seen the correspondence arising out of our discussion in E(NI) in January, culminating in Tom King's 12 April letter to me.

Having seen the arguments put forward by Nick Ridley and Paul Channon I do not believe there is anything to be gained from going over this ground again in E(NI). Accordingly, I suggest we should now announce the four references which have been agreed - British Rail (provincial sector), London Underground, the UK Atomic Energy Authority, and the Northern Ireland Transport Holding Company. As Tom says, the precise terms of reference can be sorted out when the individual references are made. I hope therefore, that our officials can now agree quickly on the text of an announcement.

I am copying this letter to other members of E(NI), Tom King and Sir Robin Butler.

Yours ever
NIGEL

NIGEL LAWSON

Goût Machinery / Pt 3

Monopolies Mergers

CONFIDENTIAL

010

cc BJ

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

NBPM
RRC6
rab

21 March 1988

Dear Nigel

MONOPOLIES AND MERGERS COMMISSION: 1988 PROGRAMME

Will REQUEST IF REQUIRED

Thank you for your letter of 7 March, about my arguments for excluding Thames Water and English Heritage from the MMCs 1988 programme.

So far as Thames is concerned, I am not in principle against referring a body which is to be privatised. I should not have conceded that Thames was a possibility otherwise. What concerns me, on reflection, are the practical difficulties in this particular case. We won't have 18 months from report to privatisation as with BAA, but possibly only 12 months. With water privatisation we are not simply selling an existing business. Thames' management have to restructure their organisation completely to reflect activities which are to pass to the NRA. The regime of charges control, reporting on levels of service and asset maintenance is all new. They have to adapt themselves to it credibly before flotation. This is all quite different from any other previous privatisation case.

While there is room for improvement by Thames' management I propose to pursue this with the Chairman and in more detail at official level. We have already had a number of meetings to follow up the Corporate Plan discussions, to cover areas which had been of concern to us. We have also used our contacts with the auditors to that end. (They of course do expect some value for money work as part of the audit). I would not expect really serious criticisms to emerge from a MMC scrutiny. I am convinced that it would divert resources from successful flotation, jeopardising Thames' position in the queue, and that it would expose me to answer unnecessary speculation and doubts in the City as analysts examine the fine print of whatever the MMC reported. These arguments apply equally to all of the other water authorities.

I am grateful for your acceptance that English Heritage should be excluded, because of possible dual scrutiny with NAO. But I would like to pick up Cecil Parkinson's point, about dual scrutiny of

the United Kingdom Atomic Energy Authority. I do not think the two cases are really on all fours. The UKAEA is unusual in that its Chairman is an Accounting Officer, in his own right, and so it is quite proper that NAO should want to investigate the Agency; on the other hand, it is also close to a trading industry and so suitable for MMC investigation. There is no read across to the much smaller scale bodies which I had in mind, since those are concerned more with management and activity in a specific policy area, such as the countryside, sport, or heritage, and do not have significant trading activities. NAO scrutiny is quite sufficient, and to introduce MMC would muddy the waters far more. Moreover, so far as I am aware both NAO and the MMC have been content to accept their dual roles in the UKAEA case, without seeking to use it as a precedent elsewhere.

There is one reflection on the recent programme discussion which I would like to leave with you and colleagues, and that is whether it is any longer appropriate for us to try and find a specific number of references each year. When we had lots of nationalised industries, it might have been reasonable to suggest 6 references a year. But now that we have successfully privatised so many, there seems quite a strong case for getting away from an absolute number of references each year, and instead seeking to decide how <u>often</u> the whole or a part of a nationalised industry or Government controlled body should be referred to the MMC. (You will appreciate the parallels with the Financial Management and Policy Reviews of NDPBs which we carry out). We could explicitly exempt bodies which are on the point of privatisation, or radical reorganisation of part or the whole of the industry. The benefit of this approach would be that we would have a regular programme of references for public sector bodies, and each body would know roughly when it was going to be scrutinised, without the very difficult efforts we all have to make each year to achieve the target of a particular number of references.

I am copying this letter to other members of E(NI), Tom King, Norman Lamont and Sir Robin Butler.

Yours ever

Nicholas

NICHOLAS RIDLEY

dti

the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
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Direct line 215 5147
Our ref
Your ref
Date 21 March 1988

Dear Nigel.

MONOPOLIES AND MERGERS COMMISSION: 1988 PROGRAMME OF NATIONALISED INDUSTRY REFERENCES

I have been following with interest your recent exchange of letters with Nicholas Ridley and other E(NI) colleagues' comments on the content of the next programme of section 11 references (which I should like to announce as soon as the current batch is completed with the referral of British Rail's provincial services, scheduled for 11 April). In particular I was interested in your views on the question of NAO and MMC "double" scrutiny.

I agree that, when the Competition Bill was debated in 1979/80 this question was probably not considered. However, as you know, since the pool of section 11 candidates has been reduced by privatisation we have tried to cast the net wider than originally envisaged in order to maintain programmes of sufficient substance to sustain the argument against NAO/PAC access to the nationalised industries. We have now identified a range of bodies eligible for section 11 scrutiny to which NAO also has access. While I accept that referral does not necessarily advance our arguments against NAO scrutiny of nationalised industries, I do not believe that judicious referral would necessarily undermine our position. As Comptroller and Auditor General, Sir Gordon Downey is recorded as saying that NAO should not be regarded as a management

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the department for Enterprise

consultancy; their role is only to identify and bring to public notice evidence of weakness or unsatisfactory performance. In using section 11 we have come to expect more than this from MMC. As well as undertaking a full and impartial assessment, we expect them to identify and where possible quantify improvements, particularly those of a priority nature. The public interest question which we include in most references is an additional and important sanction and the trigger to statutory remedial action following an unfavourable finding.

Because of the broader remit which section 11 allows I do not think that, as a matter of principle, we should exclude all NAO bodies from its scope. I agree that the NAO bodies should not be tied to a published target of scrutiny once every four years but I also think that where a need is perceived for an external scrutiny, section 11 should be considered more routinely perhaps as an alternative to employing outside consultants. Selective use of the provision in these cases would help to demonstrate that we believe section 11 fulfils a useful purpose and that the Government is willing to use these statutory powers where we believe there is a need.

On the question of antagonising the NAO, I note that in Appendix 1 of their report on section 11 published in 1986, the NAO lists the bodies then being actively considered for section 11 referral. These included the UKAEA and the Welsh and Scottish Development Agencies which are, of course, NAO accessible. The NAO have not however sought to raise questions about the principle of double scrutinies and if they did so, I think we could reasonably put forward the points mentioned above without undermining our own argument that the principal objection to NAO access in other areas is that it would constitute a major and as yet unjustified constitutional change, since NAO access to the nationalised industries would either necessitate detailed control by Departments or create a line of accountability that would not pass through Ministers to Parliament.

With regard to individual future candidates for the reference programme, I am content for English Heritage to be dropped as Nicholas Ridley has no strong reasons at present for referring it. I am quite sure however that we cannot afford to lose any others if we are to maintain the momentum of what I envisage as a solid and worthwhile programme in 1988/89.

Copies of this letter go to the recipients of yours.

KENNETH CLARKE

ISlABN

888-273

CONFIDENTIAL

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

11 MAR 1988

Dear Nigel

MONOPOLIES AND MERGERS COMMISSION: 1988 PROGRAMME

Your letter of 7 March to Nicholas Ridley invites me to agree that the Civil Aviation Authority should be referred later this year if a Water Authority is not included in the 1988 programme. Despite the arguments in your letter I remain strongly opposed to a CAA reference this year. As I said in my earlier letter I only accepted at E(NI) that CAA might be referred this year with great reluctance, and events since then have very much strengthened my original view that a reference of the Authority would be more appropriate next year.

Of course I entirely accept that CAA should be subject to MMC Scrutiny, particularly since it is, as you say, in many respects a monopoly supplier; that is why I am willing to see a CAA reference in next year's programme. My earlier letter was not seeking to suggest that the investigation by the Transport Select Committee was a substitute for an MMC investigation. The current intense Parliamentary and media interest in air safety has simply reinforced the existing pressures on the CAA's management in carrying through the major initiatives they have in hand, to modernise and develop the air traffic control system to meet the rapidly growing levels of demand. I am concerned that management should be able to concentrate on getting these initiatives well under way before their attention is diverted by preparations for an MMC investigation. An MMC investigation this year would be counter-productive and premature.

I am copying this letter to other members of E(NI), Tom King, Norman Lamont and to Sir Robin Butler.

Yours, Paul

PAUL CHANNON

CONFIDENTIAL

GOUT MACH. Monopoles and
Mergers pt 3

CONFIDENTIAL

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

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

7th March 1988

Dear Nigel,

MONOPOLIES AND MERGERS COMMISSION: 1988 PROGRAMME

I have seen a copy of Nicholas Ridley's letter of 22 February, in which he suggests that bodies subject to NAO scrutiny should not also be subject to MMC reference.

My concern is that we decided at E(NI) to refer the UK Atomic Energy Authority, another body subject to NAO oversight. The Authority is coming under very close examination by the NAO on a number of fronts this year: indeed it was in recognition of this, as well as of the other considerable and growing pressures on the Authority, that we decided to refer no earlier than the end of 1988. I am not seeking to reverse that decision, but suggest that if we are to apply the 'double scrutiny' argument we must do so consistently; otherwise it will serve only to strengthen the NAO's case.

The total exclusion of bodies subject to NAO scrutiny would, moreover, hamper our efforts to secure a credible counter to PAC criticism that the MMC programmes are running out of steam, which we know the PAC still have very much in mind: to this end we need to ensure both full and balanced future programmes. Paul Channon's letter of 25 February illustrates the difficulties which external events can cause in this context, particularly when the success of our privatisation policy is, as Nicholas Ridley's letter also underlines, progressively shrinking the pool of major candidates.

I am copying this letter to those who received Nicholas Ridley's.

Yours ever,

CECIL PARKINSON

CONFIDENTIAL

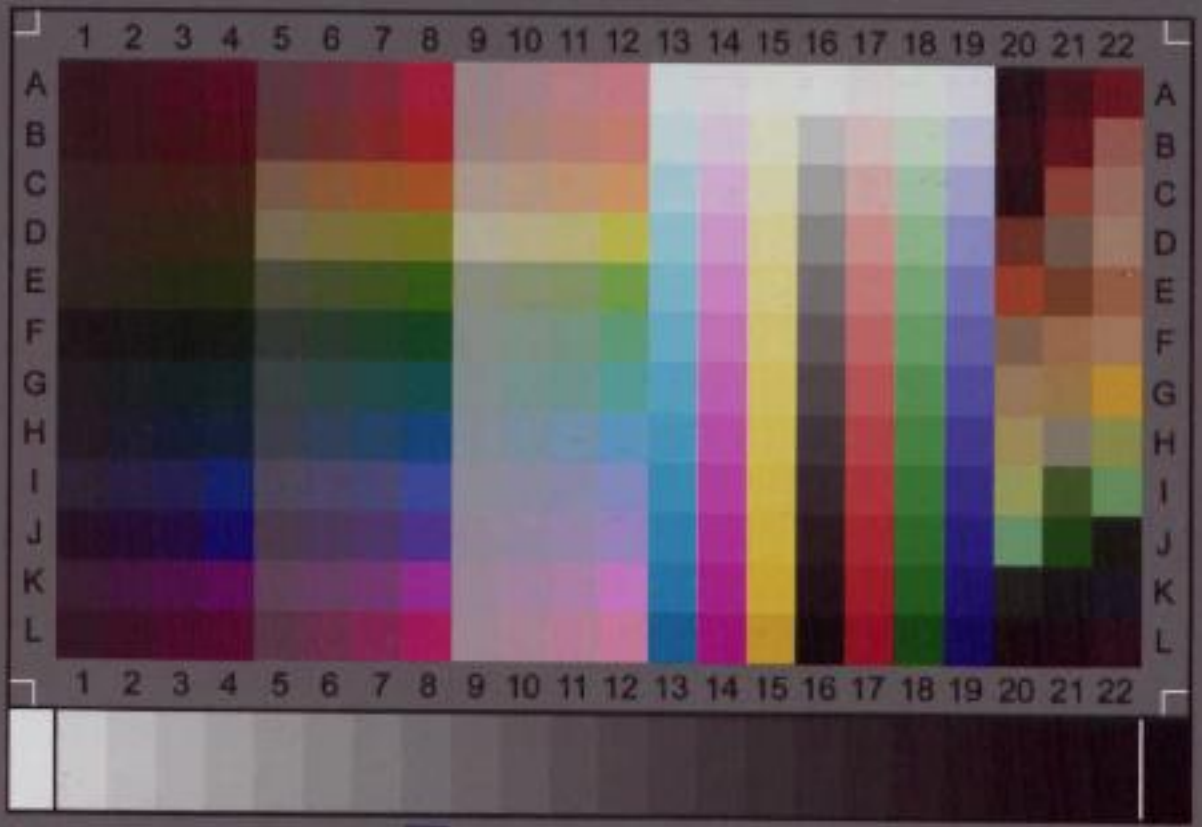
GOVT MACH: Monopolies and Mergers Pt2

PART Two. ends:-

SS/TRANSPORT to SS/DTI. 29.2.88

PART THREE. begins:-

SS/ENERGY to CH.EXCH. 7.3.88



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