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Ian Gow

PRIME MINISTER

LONRHO/HOUSE OF FRASER

You are meeting Edward du Cann tomorrow morning, 18 December; no doubt he will want to discuss the Monopolies and Mergers Commission report on Lonrho and House of Fraser, and the decision which I reached not to allow the merger.

Following a meeting which I held on 15 December with Lord Duncan-Sandys, accompanied by Edward du Cann and Mr Rowland, Lonrho have given undertakings not to proceed with their proposed bid. At the meeting Edward du Cann made clear that the company had decided that this was preferable to the more controversial course (which had been canvassed in some newspapers) of challenging the Commission's findings in the ... court. I enclose a copy of the undertakings, and of my ... Department's letter of acceptance, together with a letter I ... have since had from Edward du Cann.

There is no precedent for the issues raised in this merger case, which have not been easy to deal with. There has been criticism both of the Commission's report, and of the Government - first for making the reference to the Commission and then for following the Commission's recommendation not to allow the merger. I believe that much of this criticism has been misplaced. The story needs retelling, so as to bring out some of the points which have not been raised in recent public discussion.

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Lonrho's interest in House of Fraser goes back some years, and has not been free of controversy. In 1978 a merger reference was made to the MMC covering Lonrho's proposed acquisition of Scottish and Universal Investments Limited (SUITS) and the resulting merger between Lonrho and House of Fraser (in which SUITS had a significant interest). In their report (published January 1979) the Commission concluded that the merger between Lonrho and SUITS would not operate against the public interest. But they noted that this conclusion had to be confined to Lonrho's holding of 29.7% in House of Fraser, which in the Commission's judgement, would result in Lonrho acquiring ability materially to influence the policy of House of Fraser, but not to control that policy. The Commission noted that if Lonrho were eventually to seek to control House of Fraser, diminishing House of Fraser's existing autonomy, a new merger situation would be created, and that in such circumstances a further reference could be made.

Earlier this year after a period of intense boardroom controversy and open rows between Mr Rowland and Sir Hugh Fraser, Lonrho launched a full bid for House of Fraser. The Deputy Director General of Fair Trading made a firm recommendation to me that despite the virtual absence of conventional competition issues this merger proposal raised issues of public interest which it would be appropriate for the Commission to examine. Besides risks to House of Fraser's managerial freedom, he instanced a number of specific points for concern. These included the risk that House of Fraser resources might be diverted to Lonrho subsidiaries overseas, the risk that Lonrho might need to sell House of Fraser assets, Lonrho's lack of retailing expertise, and the different management philosophies of Lonrho and House

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of Fraser. In accepting his recommendation I identified additional issues which seemed to me to merit examination. These included Ionrho's conglomerate character, and the real doubts which might be felt about the likely benefits of a merger promoted by a cash-rich overseas company in patent need of United Kingdom assets. I also gave considerable weight to the issues of management efficiency, bearing in mind the importance which the Commission had attached to these in an earlier conglomerate merger case (Rank and De la Rue).

The Commission completed their report on 12 November. They concluded that intra-group trading of goods to be retailed by House of Fraser would result in some prejudice to fair competition between textile manufacturers and potentially to competition over a wider range of manufactures. More seriously they also concluded (with one member dissenting) that there was in their view a very real and substantial risk that the efficiency of House of Fraser would deteriorate as a result of the merger. They saw no advantages to the public interest arising from the proposed merger to offset these adverse effects, and they did not consider that the adverse effects could be removed (eg by undertakings from Ionrho). They therefore recommended that the merger should not be allowed. The Director General concurred in this recommendation.

Evenso in making his recommendation to me the Director General pointed out that some of the Commission's arguments might be regarded as weak. I did not - and do not - consider however that there was a case for rejecting the Commission's recommendation and allowing the merger. There has been no case in the past in which the Government has rejected the Commission's analysis of the likely consequences of a merger and has allowed a merger to take place in circumstances where there would have been powers

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to implement the Commission's recommendation to stop it. I saw no grounds for rejecting the report in this case; and, although Edward du Cann and others have naturally expressed intense disappointment that I did not take the exceptional course of rejecting the Commission's report, I am sure that any decision to reject it would have led to even greater controversy than the report has produced, and would have been widely seen as little other than an imprudent step by the Government effectively undermining the Commission's standing as an arbiter of the public interest in merger cases. Difficult though the issues were, I do not think that any other option was realistically open to the Government.

The undertakings given by Ionrho cover requirements which I should otherwise have imposed by order. In the nature of things they are limited to not proceeding with the bid earlier proposed by Ionrho. They do not (and could not) cover the future of Ionrho's existing 29.7% shareholding in House of Fraser, which was endorsed by the MMC in the Ionrho/SUITS report. Nor do they deal with the circumstances which could arise if Ionrho in combination with other shareholders (eg institutions) voted their shares together, with the result that de facto control effectively passed to Ionrho. For these reasons, and given Ionrho's apparent determination to renew their bid at some future stage, the undertakings cannot be regarded as more than a temporary settlement of the issues. Ionrho will remain by far the largest and most influential shareholder in House of Fraser.

At my meeting with them on 15 December Edward du Cann and Mr Rowland made plain that Ionrho would seek to be released from the undertakings if and when they considered that the

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circumstances on which the Commission reported had been changed; and Mr Rowland went so far as to suggest that the company might re-open the question as early as March 1982. I did no more than note this statement. If Edward du Cann raises this point I think you should make plain that while the Government will listen (as it must) to any representations made next spring, we are very far from having given Ionrho any ground for thinking that we shall accept arguments that circumstances by then will have significantly altered.

If, over months or years, circumstances did change, and Ionrho wished to renew their bid, it might be justifiable to release them from their undertakings. If so, it would of course remain to be considered whether any fresh bid made by the company should be referred to the Monopolies Commission. I find it difficult to anticipate what my conclusions would be in such hypothetical circumstances.

A handwritten signature in dark ink, appearing to be 'WJB' with a flourish.

Department of Trade  
1 Victoria Street  
London, SW1H 0ET

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

17 December 1981

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LONRHO LIMITED HEREBY UNDERTAKES to the Secretary of State that it will not either by itself or through its subsidiaries or bodies corporate controlled by it

- (i) Acquire any additional part of the equity share capital of House of Fraser Limited which would result in Lonrho Limited holding or having an interest in 30% or more of such equity share capital;
- (ii) Do anything with the intent that a person associated with Lonrho Limited will acquire equity share capital of the House of Fraser Limited with the result that the aggregate of the shares which Lonrho Limited, its subsidiaries, companies controlled by it and any person associated with Lonrho Limited hold or in which they have an interest will be 30% or more of such equity share capital;
- (iii) Acquire the whole or any part of the undertaking or assets of the business of House of Fraser Limited;
- (iv) Do anything which will result in Lonrho Limited and House of Fraser Limited becoming interconnected bodies corporate within the meaning of Section 137 (5) of the Fair Trading Act 1973.

In the above undertakings "associated person" has the same meaning as in Section 77 (4) of the Fair Trading Act 1973; "equity share capital" has the same meaning as in Section 154 (5) of the Companies Act 1948; "controlled" shall be construed in accordance with the construction of "control" prescribed by Section 77 (5) (b) of the Fair Trading Act 1973; and "subsidiary" has the same meaning as in Section 154 of the Companies Act 1948.

*Duncan - Sandy*  
signed .....  
for and on behalf of  
LONRHO LIMITED



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The Rt Hon Lord Duncan-Sandys PC CH  
Chairman  
Lonrho Limited  
Cheapside  
House  
138 Cheapside  
London  
EC2V 6BL

14 December 1981

*Dear Lord Duncan-Sandys,*

I am writing to thank you for the undertakings by Lonrho Limited to the Secretary of State not to proceed with its proposed acquisition of House of Fraser Limited. The undertakings will be made public in the near future and the Director General, in accordance with section 88(4) of the Fair Trading Act 1973, will keep them under review.

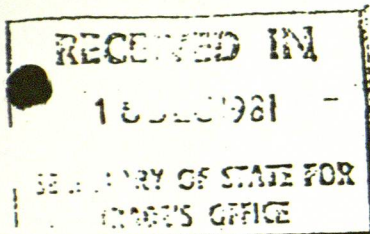
I can confirm that the undertakings do not affect the normal rights of Lonrho Limited as a shareholder of House of Fraser Limited.

I also confirm that the Government will be prepared to consider at any time representations from Lonrho Limited that in the light of new circumstances Lonrho should be released from the undertakings or that the undertakings should be changed.

*Yours sincerely,*

*John Cooke*

J A COOKE



B

HOUSE OF COMMONS  
LONDON, SW1

December 15, 1981.

*By de B.*

Thank you for your courtesy in seeing Lord Duncan-Sandys, Chairman of Lonrho Limited, Mr. Rowland, the Chief Executive, and myself this afternoon.

I was anxious, as I explained, that we should leave you in no doubt how shocked we have been by the findings of the Monopolies and Mergers Commission in its Report into the proposed acquisition of the House of Fraser Limited by Lonrho. It is significant that the Report and its conclusions have been so strongly and universally criticised in the newspapers and in the City of London.

I was sorry also to tell you how much I regretted your decision to accept the majority verdict of the members of the Commission. It seemed to me that the minority Report more reasonably expressed what should be done and was more in keeping with what I had assumed and hope would be the philosophical approach of the Government.

I am personally very pleased that we have been able to agree undertakings on the part of Lonrho, and my colleagues and I appreciate your letter. It is very much better that we should proceed in this way rather than there should be litigation of any sort, as the Financial Times and others in fact recommended. It was most helpful to have your acceptance of the fact that we shall want to reply to the various criticisms made in the Commission's Report. We are quite clear that these are specious and can be dealt with, and in these circumstances it was also helpful to have your understanding of the fact that we shall wish to re-open the subject before next March, having disposed of the criticisms.

\*

*Best wishes  
Yours*

Rt. Hon. John Biffen, MP,  
Secretary of State for Trade,  
1 Victoria St, SW1

*Edward*