GUINNESS AND DISTILLERS: SOME CURRENT ISSUES IN MERGERS POLICY

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In early June the Government announced its intention to hold a review of competition policy later this year. The announcement was particularly timely with regard to policy on mergers and takeovers, which has been subject to considerable criticism in the light of several recent very large and fiercely contested takeover bids. One of these bids, that by Guinness for Distillers, has a very strong Scottish dimension, and this is therefore an appropriate time to consider some of the policy issues raised as a result of this particular takeover.

The present framework

The present framework of mergers policy in the UK involves three main parties. As the Office of Fair Trading describes it, the Secretary of State for Industry decides, the Director General of Fair Trading advises, and the Monopolies and Mergers Commission (MMC) investigates. Despite the publicity frequently given to investigations by the MMC, the crucial role is really that played by the Director General through the Office of Fair Trading (OFT). The OFT has two main functions to perform with regard to mergers:

(i) to keep a check on proposed mergers in order to discover which are "qualifying" mergers (ie where the gross assets to be taken over exceed £30m, or where the merged companies would control 25% or more of the UK market for some good or service);

(ii) to advise the Secretary of State on whether a qualifying merger should be subject to investigation by the MMC.

Not surprisingly, therefore, companies involved in qualifying mergers may spend a great deal of time and effort in attempting to persuade the OFT that a particular bid should or should not be referred. A referred bid automatically lapses while the MMC's investigation takes place, causing a delay of up to nine months in exceptional circumstances, with the possibility of the proposed merger being blocked.

Much of the controversy raised by the Guinness merger with Distillers has a direct bearing on this key role played by the OFT. During the contested bid some fairly wide-ranging promises were made both by the Argyll Group and by Guinness about the location of head office functions and decision-making in Scotland following the merger. The precise nature of the commitments made by Guinness were spelled out in publicity material during the course of the bid as follows:

"The corporate headquarters of a new Scottish-registered holding company, with its board, will be established in Edinburgh. This will be the ultimate holding company of the Distillers Company plc, Guinness plc and all their operating subsidiaries, worldwide."
The Chief Executive, and key directors and senior executives of the expanded group will be based in Edinburgh along with a corporate support team which will include legal, personnel, financial, accounting, marketing, administration, production and research and development functions."

Already plans for the two-tier board system envisaged above have been scrapped leading to serious doubts about Guinness's other assurances. The relevant question here is whether the law and policy on mergers should be of a type which allows a bidding company to make commitments, presumably designed to influence shareholders of the merger partner and other concerned parties, then appear to renege on these commitments at the earliest possible opportunity. The Guinness argument in favour of the changed plans is simple. Ultimately, the board must act in the best interests of the shareholders on the basis of as much information as is available. With due consideration after takeover, it now becomes apparent that the original two-tier board and independent chairman (Sir Thomas Risk) would not work. What is needed, runs the argument, is for Mr Ernest Saunders to have a strong Chief Executive's role unencumbered by too much bureaucracy. Unfortunately, this requires that certain assurances cannot be fulfilled; but this is ultimately done for the benefit of the shareholders who will, after all, be able to vote on the issue at an EGM.

Emerging policy

By coincidence, in the very same week as the Guinness/Distillers boardroom changes were being made an important paper on merger policy was given by Sir Gordon Borrie, Director General of Fair Trading, at a conference organised by the Institute of Fiscal Studies. In his paper Sir Gordon touched on the new phenomenon of "plea bargaining" during major bids. This is the process by which bidding firms will negotiate with the OFT to moderate potentially anti-competitive aspects of a bid and thus avoid referral to the MMC. In the case of Guinness and Distillers the process went a stage further; the bid was effectively "de-referred" when Guinness agreed to sell off the UK rights to some of its brands to Whyte and Mackay, thus reducing (for the time being) Guinness's share of the UK market below the 25% level which constitutes a statutory monopoly.

Sir Gordon admits in his paper that, ".....divestment schemes cobbled together in haste might not in fact be conducive to the efficiency of the underlying business". But he argues that since ".....this is not necessarily the case", he is very much in favour of the plea bargaining process.

To the outside observer such an attempt at justification seems appallingly weak, and sheds no light at all on why the OFT allowed Guinness to proceed uninhibited with a "new" bid based on the flimsiest of alterations to the "old" bid. It is not clear whether Sir Gordon sought assurances from Guinness about the permanence of the arrangements with Whyte and Mackay, nor whether it was assured (or assumed) that Guinness would be unable to raise its market share above 25% with its remaining brands in the near future.

The whole process of plea bargaining, especially where a bid has already been referred to the MMC, serves to fundamentally alter the nature of the relationship between the OFT and the MMC. The whole tone of Sir Gordon Borrie's
paper appears to suggest that the role of the OFT in mergers policy ought to be strengthened, with increased discretion being allowed for plea bargaining and other discussions. In fact, as was argued earlier, the OFT already has a very considerable degree of power in recommending (and so virtually deciding) which bids shall be investigated, power which it has used to the full in the case of Guinness and Distillers.

The review of competition policy will almost certainly seek to consider the division of tasks between OFT and MMC, but it should be regarded as imperative that the Monopolies and Mergers Commission, and not the Office of Fair Trading, remains the primary plank of mergers policy. Only the MMC has the statutory obligation to consider "the public interest" and to make public its decisions and the reasons for them; this is a duty which should be jealously protected, not removed to the shadowy world of plea bargaining and private discussions behind closed doors. If this means more referred bids and delayed mergers, then so be it. The weight of academic evidence suggests that the gains from merger are, in the main, disappointing in the final analysis.

Finally, it is worthwhile reflecting on another part of Sir Gordon Borrie's paper, in which he deals with whether anti-competitive mergers ought to be allowed to proceed on the grounds that merger might improve the competitiveness of the firms concerned in overseas markets. This issue is, of course, of direct relevance in the Guinness/Distillers merger. Here, the Director General says:

"Under the Fair Trading Act the proper agency for advising Government on [this issue] is the Commission and I am not entitled to usurp their function."

This is indeed the case, and should remain so. Yet in the Distillers merger the claims made by Guinness in this direction were not allowed to be aired by an MMC investigation because of the actions of the OFT in failing to refer the "new" bid following plea bargaining. Once again Sir Gordon appears to take the view that this is a case for making his office more powerful, allowing the OFT to consider issues such as international competitiveness.

However, a more considered view might be that since the MMC is the body charged with advising the Government on this issue, then the Commission should have been given the opportunity to consider Guinness's claims. Given the importance of the whisky industry to the Scottish economy, these claims could reasonably have been regarded as being within the remit of "the public interest".

Regardless of the outcome of the merger between Guinness and Distillers, the handling of the bid reflects little credit either on the OFT or on UK mergers policy. Any attempt in the forthcoming policy review to strengthen the hand of the OFT at the expense of the MMC should be resisted; the OFT serves a useful function as a "first sift" for qualifying mergers, but it should not be allowed to develop into an alternative and more secretive, Mergers Commission.
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