

CHAPTER 4

The merger situation

Background to GEC's bid

4.1. Since the inception of the System X digital telephone exchange project in 1969 its development and subsequent production has been based on collaboration with the Post Office and subsequently BT and between the United Kingdom suppliers (currently GEC and Plessey). We have been told that since 1983 GEC and Plessey have, from time to time, held discussions on the possible methods of combining the respective public switching businesses of the two companies. (See Chapter 6 for a more detailed discussion of this subject.)

4.2. Both GEC and Plessey told us that they regarded rationalisation of their System X activities as necessary but that the discussions between them had been inconclusive and the two companies had been unable to agree on a mutually acceptable solution.

4.3. GEC told us that it had been in agreement, it believed, for some time with Plessey as to the need for a combination of telecommunications businesses. Attempts to achieve such a combination had, however, always foundered because of the understandable reluctance of Plessey to contemplate the loss of control of a business comprising more than half of that company's total activities. At the same time, however, it had become increasingly clear to GEC that, in GEC's view, it would be unsatisfactory to merge the telecommunications businesses of the two companies without merging also the semi-conductor and components activities that support those businesses; and that the weight and variety of R & D necessary to support an international telecommunications and electronics activity is more likely to be sustainable by a business which combines the systems activities of both companies than by a merger limited to GEC's and Plessey's telecommunications businesses alone.

4.4. Plessey told us that a further round of discussions on integrating GEC's and Plessey's telecommunications activities, or at least public switching activities, commenced in June 1985 and had been joined in the autumn by BT. Plessey told us that during these negotiations it had considered public switching equipment to be the most urgent area whereas GEC had preferred to discuss rationalisation of the two companies' entire telecommunications interests. Plessey said that, although it would not have been a willing seller of its public switching business, it would have been prepared to purchase GEC's System X activities and to consider purchasing other parts of GEC's telecommunications business had GEC come forward with a proposal.

4.5. GEC told us that in June 1985 there was a conversation between Lord Weinstock and Sir John Clark in which the urgent need for the integration of the two companies' telecommunications or at least public switching activities was discussed. GEC also told us that in November 1985 further discussions took place chaired by BT, but that by this stage the company felt that there

was no realistic prospect of these discussions leading to an agreement on restructuring. Therefore on 3 December 1985, after informing the Chairman of Plessey of its intention to bid, GEC announced that it had proposed to Plessey that the two companies should combine to form a United Kingdom telecommunications and electronics group that would be able to compete more effectively with the leading international companies in these industries. GEC also proposed that, in view of the relative sizes of the two companies, this objective would best be achieved by the acquisition of Plessey by GEC.

4.6. GEC told us it reached its decision to offer to acquire Plessey because it had become clear to GEC that a combination of the two businesses was the only practicable solution to the United Kingdom's widely acknowledged structural problems in telecommunications. Such a combination was also the best solution to the less widely acknowledged, but equally threatening, problems that faced the electronic components and defence systems industries in the future, and such a combination could only be brought about by GEC taking the initiative. In view of the level of Plessey's shares on the stock market towards the end of 1985 GEC was able to make its offer at a price that it considered to be justifiable.

4.7. Plessey's Board of directors rejected GEC's proposal on 4 December and at the same time announced that it was prepared, subject to further negotiation with BT, to make a firm offer for GEC's interests in System X.

GEC's bid

4.8. Plessey's offer to acquire GEC's interests in System X was rejected by GEC and on 23 December 1985 S G Warburg and Co Ltd issued an offer document on GEC's behalf to acquire the ordinary shares of Plessey containing the following terms valuing Plessey at approximately £1.2 billion:

For every four Plessey ordinary shares	320p nominal of GEC Loan Notes (or 320p in cash for Plessey shareholders electing to receive cash in respect of GEC Loan Notes issued to them) plus one new GEC share plus 160p nominal of GEC Convertible stock.
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The first closing date for receipt of acceptances was 20 January 1986.

Plessey's response

4.9. Plessey's formal defence document was issued on 13 January 1986 recommending to its shareholders the rejection of GEC's bid.

4.10. On 20 January 1986 the proposed merger was referred to this Commission and the offer automatically lapsed. During the course of the inquiry GEC made it clear to us that, if permitted to do so, it would proceed with an offer provided that the price was right.