Inside the Glaxo Wellcome and SmithKline merger

The merger last year by scheme of arrangement between Glaxo Wellcome and SmithKline Beecham has created the world’s largest drug company by market share. Kirsten BIRKETT examines the legal structure adopted by the parties and the process of obtaining clearance for the merger in the EU and the US

Glaxo Wellcome (GW) and SmithKline Beecham (SB) flirted with the idea of merging in 1998, but it was not until two years later that the talks were revived and a firm agreement reached. The companies finally joined forces at the end of 2000, although the union could have come several months sooner if it had not been for a major delay to US competition clearance.

The commercial rationale for the merger held firm throughout that time. Rapid advances in scientific discoveries and technology and increased competition in the pharmaceutical industry meant that it made economic sense for these two powerhouses to combine skills and resources. The £114 billion merger has created a giant with an estimated global market share of 7% of the world pharmaceutical market.

The transaction was structured as a nil-premium merger (see “Glossary”) of equals. It was effected by way of a scheme of arrangement in which a new holding company, GlaxoSmithKline, was put in place over the merger parties. On completion, GW shareholders held approximately 58.75% of the issued ordinary share capital of GlaxoSmithKline and SB shareholders held approximately 41.25%.

Merger parties
GW was formed in 1995 when Glaxo plc acquired Wellcome plc. Its products include Flixotide (for the treatment of asthma), Beconase (for hay fever), Relenza (for flu), Zantac (for peptic ulcer disease and a range of gastric acid related disorders) and Betnovate (for eczema). GW’s shares were listed on the London Stock Exchange (LSE) and the Paris Stock Exchange. GW’s American depositary receipts (ADRs) were listed on the New York Stock Exchange (see box “American depositary receipts”).

SB was formed in 1989 through the merger of SmithKline Beckman Corporation, a Pennsylvania corporation, and Beecham Group p.l.c., an English public limited company. Its products include Seroxat/Paxil (for the treatment of depression and anxiety), Augmentin (an antibiotic), Nicorette (an anti-smoking product), Panadol (pain relief) and Ribena and Lucozade (drinks). SB’s shares were listed on the LSE. SB’s ADRs were listed on the New York Stock Exchange.

Transaction structure
The blueprint for the merger structure was chosen in early 1998 when a merger between GW and SB was first proposed. Although the initial attempt at merging did not proceed, the merger structure favoured at that time was chosen as the method by which the two companies would unite two years later when the merger plans were revived.

As both companies are constituted under English law, the two main alternatives considered were a recommended takeover or a merger
American depositary receipts

An American depositary receipt (ADR) represents ordinary shares or other securities of a non-US company which have been deposited by the non-US company or its shareholders or security holders with a bank in the US that is referred to as the depositary. The depositary issues ADRs which each represent an agreed number of ordinary shares or other securities in the non-US company. The main purpose of ADRs is to facilitate trading in shares of non-US companies in the US markets and, accordingly, ADRs are in a form suitable for holding in US clearing systems and settle in three business days in accordance with US practice.

by scheme of arrangement under section 425 of the Companies Act 1985 (1985 Act) (see box “Schemes of arrangement”). The parties chose a scheme of arrangement, involving reductions of share capital of both GW and SB, in which the two companies merged under a new holding company. This particular arrangement had three main advantages over a takeover:

- A substantial stamp duty saving. Stamp duty is payable by the purchaser on the transfer of shares at a rate of 0.5% of the consideration. The scheme did not involve the transfer of shares and there was therefore no stamp duty. Assuming that SB would have been the target company, stamp duty (calculated on the basis of its market capitalisation at the time of the announcement) would have amounted to over £200 million. If GW had been the target company the stamp duty cost would have been even greater.
- It supported the concept of a merger of equals, which would not have been the case if one company (say, GW) had purchased the shares of the other. Also, a nil-premium merger is more commonly effected by a scheme of arrangement than by a takeover.
- It benefited from the exemption from the registration requirements provided by section 3(a)(10) of the US Securities Act of 1933. As a result, it was not necessary to file a registration statement with the US Securities and Exchange Commission to effect the merger.

GW and SB were acquired by a newly formed English holding company, GlaxoSmithKline, by means of a scheme of arrangement of each of GW and SB. Under the scheme GW and SB shares were cancelled in return for the issue of GlaxoSmithKline shares to the former public shareholders in those two companies. GW and SB became wholly owned subsidiaries of GlaxoSmithKline when the scheme became effective (see box “The scheme of arrangement in detail”). As the scheme involved the cancellation of the merger parties’ share capital, it is known as a cancellation scheme (see “Schemes of arrangement: Using them in a recommended takeover”, PLC, 1992, III(1), 17).

Shareholder approvals

The merger required the approval of shareholders of both GW and SB, first at court convened meetings to approve the scheme and secondly at extraordinary general meetings (EGMs) to approve the reductions of capital.

Scheme. A scheme must be approved by a majority in number representing three-fourths in value of the shareholders or class of shareholders voting, whether in person or by proxy (section 425(2), 1985 Act). A meeting to seek this approval is convened at the direction of the court. Once the scheme has been sanctioned by the court, all shareholders (or class of shareholders), and not just those who voted in favour, are bound by the terms of the scheme.

Reduction of capital. As the scheme involved a reduction of capital, it was necessary for both GW and SB to hold an EGM to approve the reduction and the steps required to be taken in connection with it. The special resolutions (requiring a 75% majority of shares voted) put to shareholders were:

- That the share capital of the companies be reduced by cancelling and extinguishing all the shares then in issue.
- That on the reduction taking effect, the share capitals of the two companies be increased to their former amount by the creation of new ordinary shares equal to the number of scheme shares cancelled and that the reserve arising as a result of the cancellation of shares
be applied in paying up in full at par the new ordinary shares.

- That the new shares be allotted and issued credited as fully paid to GlaxoSmithKline.
- That the directors of the companies be authorised under section 80 of the 1985 Act to allot the new ordinary shares.

The four meetings (a court convened meeting and EGM for each of GW and SB) were held on the same day. As is customary, each company held the court convened meeting first and this was followed shortly afterwards by the EGM. At each of the meetings the resolutions required to implement the merger were passed by substantial majorities.

**Overseas shareholders**

Approximately 15% of the share capital of the combined companies is held by non-UK shareholders, and of that just over 10% is owned by US shareholders. For historic reasons, SB had a slightly higher level of US ownership than GW. Issuing GlaxoSmithKline shares to overseas shareholders might have breached securities regulations in certain jurisdictions or entailed complying with special requirements. The scheme therefore provided that GlaxoSmithKline shares could be issued to the nominee of an overseas shareholder and then sold, or issued to the overseas shareholder and sold on his behalf. In either case the net proceeds of sale were sent to the overseas shareholder.

A number of overseas GW and SB shareholders held shares in the form of ADRs. The underlying GW and SB shares were subject to the scheme of arrangement and were therefore cancelled and replaced with the appropriate number of GlaxoSmithKline shares in accordance with the agreed ratio (see box “Consideration”). An adjustment to the number of ADRs held by each former SB ADR holder was necessary because each GlaxoSmithKline ADR represents two GlaxoSmithKline shares, whereas each SB ADR represented five SB shares.

**Conditions**

The conditions to the scheme were set out in the scheme document posted to shareholders of GW and SB (see “Documents” below). The main conditions were:

- Approval of the scheme by GW shareholders at the GW court meeting.
- Approval of the scheme by SB shareholders at the SB court meeting.
- Approval of the resolutions required to implement the scheme being passed at the GW EGM and the SB EGM.
- Sanction of the scheme by the UK High Court and confirmation of any reduction of capital by the court.
- Delivery of the court’s order to the Registrar of Companies (section 425(3), 1985 Act) and registration of the order confirming any reduction of capital involved in the scheme with the Registrar of Companies (section 138(2), 1985 Act).
- Admission of the GlaxoSmithKline shares to the Official List and trading on the LSE.
- Approval of the GlaxoSmithKline ADRs for listing on the New York Stock Exchange.

Each of these conditions was fundamental to the effectiveness of the scheme or the listing of the new GlaxoSmithKline securities and therefore could not be waived by either GW or SB.

The scheme was subject to a number of other conditions, such as receiving relevant competition clearances (see “Competition” below) and there having been no material adverse change in the businesses of either of the merger parties since the date of the latest audited report and accounts. These conditions were reciprocal, in that they related...
equally to GW and SB and both companies were granted equal powers of waiver.

**Competition**
The merger was notified to anti-trust regulators in the US and EU and approximately 16 other countries.

**US Federal Trade Commission.** The merger was subject to the requirements of the US Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, which prevents specified transactions from being completed until notified to the Department of Justice and the US Federal Trade Commission (FTC) and specified waiting periods are terminated or expire.

Clearance by the US authorities took much longer than hoped and led to a couple of revisions of the expected date of completion of the merger.

When the merger was announced in January the parties said that it was expected to become effective in the summer of 2000. A later announcement specified that this would be August. Another announcement moved the date back to September and in September a further announcement said completion was expected by the end of December 2000.

One factor in the delay was the FTC requesting additional information about smoking cessation products in early September 2000. In the US, GW markets the prescription product *Zyban* and SB markets the over-the-counter products *Nicorette* (nicotine gum) and *NicoDerm* (transdermal patches). The FTC was concerned whether the combination of the smoking cessation products of both companies would raise competition issues in the US.

On 12th December, 2000 the parties announced that they had agreed the terms of a consent decree with the staff of the FTC. This was subject to approval by the Commissioners, given on 18th December, 2000. Under the terms of the consent decree SB agreed to divest *Kytril*, for the treatment of emesis (vomiting), *Famvir*, for the treatment of herpes and *Vectavir/De- navir* (anti-viral products).

The consent decree did not contain any provisions regarding smoking cessation products although the FTC indicated that it would continue its review of that product area after completion of the merger. This is thought to be an extremely rare step for the FTC to have taken. GW and SB proceeded to complete the merger on 27th December and the investigation closed at the end of January 2001.

(For more information about the future of US merger review procedure and policy, see www.lawdepartment.net/global “US merger review: changing at the edges” GC, 2001, VI (2),16).

**Consequences of delay.** In accordance with usual practice, the scheme contained a back-stop date (31st December, 2000 in this case). The date was six months after the initial expected date of completion. The scheme provided that unless it became effective on or before 31st December, 2000 it would not become effective unless an extension was agreed by GW and SB and approved by the court. Although the parties came perilously close to having to agree an extension.
and requesting the court’s permission to do so, completion occurred four days before that became necessary. The opinion of the parties’ advisers was that if GW and SB were able to provide sworn evidence that certain factors remained unchanged, the court would have been very likely to agree an extension. Those factors would have included the following:

- There had been no material change to the respective financial and trading positions of GW or SB.
- The directors of GW and SB (having taken appropriate financial advice) continued to believe the terms of the merger to be fair and reasonable for their respective shareholders.

As a result of the delay four sets of supplementary listing particulars were required (see “Documents” below).

**European Commission.** The merger was also caught by the EC Merger Regulation (ECMR). Given the size of the companies involved, the ECMR’s thresholds were easily satisfied. It therefore could not take effect until the European Commission (Commission) had given its approval. Once the parties to a merger have made their formal notification on Form CO, the Commission will investigate whether the concentration created by the merger is compatible with the European common market.

A concentration will not be compatible with the common market if it creates or strengthens a dominant position as a result of which competition is likely to be significantly impeded within the common market or a substantial part of it.

Investigation usually lasts for one month but can be extended to six weeks if the parties offer remedies such as divestitures. If the Commission considers that there are serious doubts as to the compatibility of the concentration, the first phase investigation may be followed by a longer second phase investigation that may last up to four months.

In the US the initial notification is generally relatively short, usually consisting of a form of about 15 to 20 pages plus attachments, with the bulk of the information being provided to the FTC at a later date. In the EU, by contrast, the process is front-end loaded. Form CO can be a very substantial document and in a case such as this it can run to as much as 200 pages plus files of supporting documents.

The information gathering exercise was extremely demanding as it covered 50 product markets across 15 EU member states. The analysis was aimed at determining which of GW and SB’s products overlapped, within each product market. It involved considering the overlaps between existing GW and SB products, between GW pipeline products and SB existing products (and vice versa) and between GW and SB pipeline products. Categorising products in their respective markets is always difficult where the companies class their products differently and in respect of pipeline products, which by their nature are still in the development phase.

A draft CO was filed at the end of February 2000, to allow the Commission time to identify concerns before the formal filing. The formal notification was made on 20th March, 2000. In the EU, unlike the US, the approval process ran smoothly and quickly. Areas of overlap between GW and SB’s products were identified early on and agreement was reached as to which divestitures would be made. The Commission completed its investigations within Phase I and approved the merger on 8th May, 2000.

SB undertook to out-license *Kytril* and *Famvir* in the European Economic Area (EEA) and (in Spain only) its anti-tibiotic product *Monocid*. This was because in Europe *Kytril* and *Famvir* compete with GW’s anti-emetic *Zofran* and systemic anti-virals *Zovirax* and *Valtrex* for the treatment of herpes simplex (cold sores), respectively, which are being retained. GW and SB undertook to out-license one of either of their topical anti-virals, *Zovirax* (a GW product) or *Vectavir* (an SB product). SB also agreed to out-license in the EEA *Ariflo*, a potential product to treat chronic obstructive pulmonary disease, if all competing pipeline products fail their clinical trials.

**Other countries**
The process of obtaining competition clearance in other countries was a major logistical effort involving, for example, the translation of documents into the local language and the production of information specific to the local markets. The merger was not, however, conditional upon these approvals. In granting approval the regulators were generally guided by whether the merger had received competition clearance in the EU and the US.

**Documents**
The principal documents produced in relation to the merger were listing particulars, supplementary listing particulars and a document setting out the scheme of arrangement.

**Listing particulars.** Listing particulars were required by the *Listing Rules* in respect of the *introduction* of GlaxoSmithKline to the Official List (Rule 5.1(b), *Listing Rules*). Application was made to the UK *Listing Authority* for the GlaxoSmithKline shares to be admitted to the Official List and to the LSE for the shares to be admitted to trading.

The listing particulars contained the following:

- Information on GlaxoSmithKline covering, for example, the reasons for the merger, regulatory clearances and the structure of the merger.
- Financial information on the GlaxoSmithKline group.
- Information on the GW group.
- Information on the SB group.
- Information on GlaxoSmithKline ADRs.

---

**Consideration**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>For each GW share</td>
<td>1 GlaxoSmithKline share</td>
</tr>
<tr>
<td>For each SB share</td>
<td>0.4552 GlaxoSmithKline shares</td>
</tr>
<tr>
<td>For each GW ADR</td>
<td>1 GlaxoSmithKline American depositary receipt (ADR) (each ADR representing 2 GlaxoSmithKline shares)</td>
</tr>
<tr>
<td>For each SB ADR</td>
<td>1.138 GlaxoSmithKline ADRs</td>
</tr>
</tbody>
</table>
Supplementary listing particulars. Supplementary listing particulars are required under the Listing Rules if, at any time after particulars have been formally approved by the UK Listing Authority and before dealings commence, the issuer becomes aware that:

- There has been a significant change affecting any matter contained in the particulars; or
- A significant new matter has arisen, the inclusion of information in respect of which would have been required to be mentioned in the particulars if it had arisen at the time of their preparation (Rule 5.14, Listing Rules).

Completion of the merger took about six months longer than expected because of the delay in receiving US competition clearance. As SB reported interim financial results on a quarterly basis, this gave rise to a need to issue two sets of supplementary listing particulars containing those results. GW produced interim six month results during the period of delay, which also had to be communicated to shareholders. Glaxo SmithKline was also required to report regularly on the progress of the regulatory clearance process, the impact of the delay on arrangements for financial reporting and dividends and the expected timetable to completion. All of these matters constituted significant changes affecting matters contained in the listing particulars.

In total four sets of supplementary listing particulars were published, the first in August, second in September, third in November and fourth in December 2000.

Scheme document. The circular setting out the scheme of arrangement was known as the scheme document. It contained:

- A joint letter from the chairmen of GW and SB.
- The explanatory statement required by section 426(2) of the 1985 Act (see box “Schemes of arrangement”).
- The conditions to the scheme.
- The scheme of arrangement.
- Additional information for overseas shareholders.
- Notices of the court meeting and EGM for each of GW and SB.

Shareholders received a pack containing the scheme document, listing particulars and a joint cover letter from the chairmen of GW and SB. The letter set out in a question and answer format fundamental information for shareholders and ADR holders about the merger, consideration and voting procedures.

Kirsten Birkett is Corporate Finance Editor, PLC magazine.

The author would like to thank Jim Beery, General Counsel, Rupert Bondy, Legal Operations (Manufacturing and Corporate) and Brian Cahill, Legal Operations (Europe), GlaxoSmithKline; Robert Stern, partner, Slaughter and May; Stephen Boughton, partner, corporate finance and Gavin Robert, partner, Competition, Regulatory and Trade Department, Linklaters & Alliance; and George Cary, partner, competition law, Cleary, Gottlieb, Steen & Hamilton.

Slaughter and May advised Glaxo Wellcome and Linklaters & Alliance advised SmithKline Beecham.

For details of the merged company’s legal department structure, see “Putting people first” GC, 2001, VI(2), 13.

(c) 2001 Legal & Commercial Publishing Limited. Subscriptions +44 (0)20 7202 1200