**EXPLANATORY MEMORANDUM TO**

# THE ENTERPRISE ACT 2002 (MERGER FEES) (AMENDMENT) ORDER 2005

**2005 No. 3558**

1. This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

## 2. Description

2.1 This order makes two amendments to The Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003 (Statutory Instrument 2003 No.1370). First, it increases the amounts of the fees payable by enterprises for the regulatory consideration of qualifying mergers – work done primarily by the Office of Fair Trading and the Competition Commission. Secondly, it removes the clause that currently excludes certain acquirers from outside the United Kingdom from the duty to pay such a fee.

## 3. Matters of Special Interest to the Select Committee on Statutory Instruments

3.1 None.

## 4. Legislative Background

4.1 Part 3 of the Enterprise Act 2002 provides for the regulatory consideration of mergers. Section 121 of the Act provides the power to make orders requiring fees to be payable in respect of this work and defining the amount of such fees and the scope of their application.

4.2 The Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003 (SI 2003 No.1370) establishes the detail of merger fees including the circumstances under which a fee is or is not payable, the amount of fees, and the persons by whom a fee is payable as well as providing an exemption from fees for small and medium sized enterprises. This order amends paragraph 5 of SI 2003 No.1370 so as to introduce new fee amounts. It substitutes the current fees of £5,000, £10,000 and £15,000 with fees set at £15,000, £30,000 and £45,000. No changes are made to the number of different fee bands (three) or to the turnover levels used to determine these. Section 121(4) of the Enterprise Act 2002 specifically permits the amount of any fee to be calculated by reference to matters that may include the value of the turnover of the enterprises concerned.

4.3 Article 1(2) contains a transitional provision. Where a reference is made, in the case of a completed merger, by the OFT or the Secretary of State under sections 22 or 45(2) or (3) of the Enterprise Act 2002 or by the OFT under section 32(b) of the Water Industry Act 1991, fees will only be payable at the new higher rate where the decision or reference relates to two or more enterprises which ceased to be distinct on or after 6th April 2006. This is because some time may elapse between the completion of the merger and the making of a reference. Section 27 of the Enterprise Act governs when two enterprises cease to be distinct..

4.4 In the case of anticipated mergers, the usual rules will apply so that, in general, fees will be payable at the new higher rate if the decision or reference is made on or after 6th April 2006.

4.5 This order also deletes paragraph 6(5) of SI 2003 No.1370, thereby removing the exclusion from the duty to pay merger fees that previously applied to persons who are not United Kingdom nationals or bodies incorporated in the United Kingdom where the merger resulted from their conduct outside of the United Kingdom.

5.1 **Extent**

5.2 This instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

## 7. Policy Background

7.1 The Government's policy is that fees for statutory services should normally be set to recover the full cost of the service provided (Full Cost Recovery). The system of charging fees to enterprises to meet the costs of carrying out merger control functions was introduced in October 1990. Fees were set at a level designed to recover approximately the full regulatory costs then incurred. Those original fee levels have not been increased since their introduction. The actual costs of merger control activity have, however, increased significantly and the income generated from fees is substantially below the actual costs incurred by the regulatory authorities with the shortfall being met from public funds.

7.2 There are presently three separate merger fee bands with different fee levels being payable according to the turnover of the enterprise being acquired. The fee bands are: £5,000 where the value of the UK turnover of the enterprises being acquired is £20 million or less; £10,000 where the value of the UK turnover of the enterprises being acquired is over £20 million but not over £70 million; and £15,000 where the value of the UK turnover of the enterprises being acquired exceeds £70 million. This order makes no change to the number of fee bands or to the turnover levels used to determine those three bands. It increases the amount of the fee payable in respect of qualifying mergers falling within each band to £15,000, £30,000 and £45,000.

7.3 The Government intends to move to fee levels that achieve Full Cost Recovery. However, we recognise that, since there has been no increase in fee amounts since 1990, an immediate move to recover the full costs of merger control functions would involve a very significant increase in fee levels. To limit the impact and give business time to adjust, we believe it is appropriate to move to Full Cost Recovery in two stages with the introduction of fees that achieve this delayed until 6 April 2009. As a transitional stage, we propose that the initial fee increase to come into effect on 6 April 2006 be set so as to recover approximately half the amount that would represent Full Cost Recovery. It is proposed that a further order will be made in early 2009 in order to complete the second stage of the fees

increase. We presently anticipate that the 2009 order will introduce fees at £30,000, £60,000 and £90,000 – fees that we judge will generate an amount approximately equivalent to the annual costs of operating the regime.

7.4 Responses to the consultation indicated support for the view that the exemption from fees currently enjoyed by certain foreign acquirers was unfair and that it should be removed. The Government agrees it is appropriate to remove this exemption and the relevant article of SI 2003 No.1370 is deleted accordingly.

## 8. Impact

8.1 A Regulatory Impact Assessment has been prepared and is attached to this Explanatory Memorandum.

## 9. Contact

9.1 Paul Bannister at the Department of Trade and Industry Tel 0207 215 5009 or e mail paul.bannister@dti.gsi.gov.uk can answer any queries regarding this instrument.

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# ORDER AMENDING THE ENTERPRISE ACT 2002 (MERGER FEES AND DETERMINATION OF TURNOVER) ORDER 2003

# REGULATORY IMPACT ASSESSMENT

## PURPOSE AND INTENDED EFFECT

The Government's policy is that fee levels for statutory services should, in most cases, be set to recover the full cost of the service (Full Cost Recovery) calculated in accordance with the Fees and Charges guide[1].

The system of charging firms a fee for the cost of merger control functions was introduced in October 1990. With limited exceptions, a fee is payable for any merger which qualifies for investigation by the Office of Fair Trading (OFT) under the Enterprise Act 2002. The costs of merger control work carried out by the competition authorities have increased year on year since their introduction but there has been no corresponding increase in fee levels. Income from fees has, therefore, consistently fallen short of the actual costs incurred. We estimate that statutory merger control functions are likely to cost around £9 million per year over the coming years.

The Government recognises that mergers contribute to an efficient economy, provided they do not undermine competition. The objective of amending the merger fees regime is to ensure the basis for charging - and the level of fees - benefit the economy as a whole, properly balancing the interests of the taxpayer and all of the businesses concerned.

There are presently three separate merger fee bands so that three different fee levels are payable depending on the turnover of the enterprise being acquired. The fee bands are: £5,000 where the value of the UK turnover of the enterprises being acquired is £20 million or less; £10,000 where the value of the UK turnover of the enterprises being acquired is over £20 million but not over £70 million; and £15,000 where the value of the UK turnover of the enterprises being acquired exceeds £70 million.

The purpose of this order is to amend the Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003 so as to increase the amounts of the fees payable in each of the three merger fee bands and to generate approximately the £9 million per year we expect merger control activities to cost. It does not make any change to the existing fee bands or the turnover levels used to determine these. It simply increases the amount of the fee payable in respect of qualifying mergers falling within each band to £15,000, £30,000 and £45,000.

[1] Section 3 of "The Fees and Charges Guide (1192) – HM Treasury

Following consultation, the Government has decided to move to fee levels that achieve Full Cost Recovery. Since there has been no increase in fee amounts since 1990, an immediate move to recover the full costs of merger control functions would necessarily involve a very significant increase in fee levels. To limit the impact and give business time to adjust, the Government considers it appropriate to move to Full Cost recovery in two stages providing a transitional stage before the full increase comes into effect. Accordingly, fees that achieve Full Cost Recovery will not be introduced until 6 April 2009. The initial fee increase (to come into effect on 6 April 2006) will be set so as to recover approximately half the amount that would represent Full Cost Recovery. A further order will have to be made in early 2009 in order to complete the second stage of the fees increase. We presently anticipate that the 2009 order will introduce fees at £30,000, £60,000 and £90,000.

This order also removes the exclusion from the duty to pay a merger fee that presently applies to persons who are not United Kingdom nationals or bodies incorporated in the United Kingdom where the merger results from their conduct outside of the UK.

## CONSULTATION

The Government published a consultation document on 4 August 2004 setting out the options for amending merger fees[2]. A summary of responses received to the consultation was published in March 2005[3]. We received twenty-six responses to the consultation, covering the views of 32 organisations - 11 from competition law firms, 3 from law societies/ associations, 9 from individual businesses and 3 from representative organisations.

Most respondents accepted the need for an increase in fees although, on the whole, there was opposition to a move to Full Cost Recovery. There was a general consensus against charging for special merger situations and Article 21(4) cases. Opinions varied on whether fees should be charged in material influence cases. Most respondents favoured the retention of a banded fee structure, with banding based on the size of the enterprise being acquired. Respondents also raised some additional issues that were not directly covered in the consultation document – including the appropriateness of the current exemption from the duty to pay a fee for certain foreign acquirers. There was no particular divergence of views between the business community and other respondents on any of the options

## OPTIONS, BENEFITS AND COSTS

Options for change to the merger fees regime fall into three broad areas: whether or not to move to full cost recovery; whether to extend the scope

[2] See www.dti.gov.uk/ccp/consultpdf/watermergecon.pdf
[3] See www.dti.gov.uk/ccp/consultpdf/feesresponse.pdf

for charging fees; and whether to adjust the structure of the fees charged. The specific options are set out below.

***Issue (1) - Whether to move to full cost recovery***

Option 1(a): To make no changes to the basis for charging, so that current charges would apply

Option 1(b): To move to greater cost recovery, but not full cost recovery

Option 1 (c): To move to full cost recovery in a phased approach

Option 1(d): To move straight away to full cost recovery

The actual annual cost of merger control is difficult to predict and will vary from year to year dependent on the merger activity that takes place. However, in every year since 1993/94, income derived from merger fees has been below the costs incurred by at least £940,000. None of the options involve a significant net cost but affect the degree to which the cost of merger control work is funded by the general taxpayer rather than the parties to the merger.

**Option 1 (a),** the status quo, means the Government continues to incur the majority of the costs of merger regulation and the merging parties do not pay a fee that reflects the true cost of their activities.

**Option 1(b)** offers a reduction in the degree to which the costs of merger regulation are borne by the general taxpayer.

**Option 1(c)** means the merging parties will pay a fee that covers the full costs of merger regulation but there will be a transition period before the full fee increase is introduced during which the general taxpayer will continue to meet a proportion of the costs.

**Option 1(d)** would mean merging parties immediately being required to pay fees that are expected to generate the full costs of conducting merger control activities with no transitional period.

The Government considers no case has been made for making such a deviation from the standard policy of recovering the full costs of providing statutory services through the fees charged. We do, however, consider it appropriate to phase the introduction of Full Cost Recovery by raising fees in two stages. The first stage of the increase will take effect from April 2006 with the full increase delayed until April 2009.

Merging parties will normally incur a number of costs in completing a merger. As well as the purchase price, these may include costs for legal advisers, PR advisers, economic advisers, management time and also a merger fee. Acquiring companies do not publish a breakdown of costs

which will vary greatly from case to case. A recent study on the costs to business of multi-jurisdictional merger reviews[4] confirms this wide variance in costs. We judge merger fees will generally continue not to represent a large element of the costs involved.

***Issue (2) whether to extend the scope for charging fees***

Option 2(a): Charging for material influence cases[5]

Option 2(b): Charging for special merger situations[6] and cases considered under Article 21(4) of the EC Merger Regime[7]

A further option identified by respondents to the consultation is to remove the current exemption from fees enjoyed by certain foreign acquirers[8].

**Option 2(a)** The Government considers companies considering a transaction should have legal certainty on whether they would incur a merger fee. While there is now greater understanding of what represents material influence, we see a number of practical difficulties in establishing a framework that would provide sufficient clarity as to when changes in circumstances affecting the ownership of an undertaking may be judged to amount to control having been gained. Given the scope for significant uncertainty and the relatively low number of such cases (meaning charging a fee would generate limited additional money), the Government does not consider it appropriate at this time to move to charging a fee for regulatory oversight of such cases.

**Option 2(b)** Most respondents to the consultation opposed the introduction of a fee for such cases. Such cases are rare and usually involve a more limited amount of work for the competition authorities. The Government has decided not to introduce a fee at present for such cases but will review the situation in three years. This will give business more time to see the new regime settle down and to understand how the published guidance on intervention is being implemented.

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Further details on what constitutes a relevant merger situation are given in the OFT guidance *"Mergers Substantive Assessment Guidance"*, Chapter 2.

[4] *A tax on mergers? Surveying the time and costs to business of multi-jurisdictional merger reviews June 2003.* A study commissioned by the International Bar Association and the American Bar Association.

[5] Acquisition of less than a controlling interest where a merger notice has not been submitted by the parties to the OFT in relation to that acquisition

[6] The Enterprise Act allows the Secretary of State to intervene in mergers which do not meet the qualifying thresholds for the standard merger regime if he believes that any of the public interest considerations are relevant.

[7] The Secretary of State is also able to intervene on public interest grounds in cases falling for consideration under the EC Merger Regime through the use of Article 21(4) of the EC Merger Regulation.

[8] This would involve deleting paragraph 6.5 of the Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003.

**Removing the exemption for certain foreign acquirers**: The Government agrees with the respondents to the consultation who commented that the exemption from merger fees currently provided by the 2003 fees order to certain foreign acquirers provided an unfair advantage to those businesses it benefits. The order deletes the relevant paragraph, removing the exemption.

***Issue (3) Adjusting the fee structure***

Option 3(a): Flat fee for all qualifying mergers.

Option 3(b): Banded fee based on the turnover of the enterprise acquired, using turnover bands currently in place.

Option 3(c): Banding of fee based on turnover of the enterprise acquired, using new bands with greater differentiation between smaller and larger acquisitions.

Option 3(d): Flat fee for all qualifying mergers, with an additional fee for those mergers referred to the Competition Commission for further investigation.

Option 3(e): Banding of fee based on turnover of the enterprise acquired, with an additional banded fee for those cases referred to the Competition Commission for further investigation.

**Option 3(a):** The flat fee option would provide clarity to the acquirer of the costs involved, and a simple charging structure for the OFT to administer. However, it would remove any differentiation between the fee payable when acquiring a smaller enterprise and that payable when acquiring a larger one. The Government considers such a move could place disproportionate costs on smaller mergers and may discourage some smaller transactions.

**Option 3(b):** The Government is satisfied that the existing turnover bands remain appropriate – providing for an appropriate level of differentiation between smaller and larger mergers.

**Option 3(c):** The Government does not consider it appropriate to increase significantly the degree of differentiation between fees for mergers involving enterprises with smaller and larger turnovers as turnover makes limited difference to the actual costs of merger regulation work.

**Option 3(d): and Option 3(e):** The Government considers the introduction of a two-stage fee with the second stage being payable for those mergers that are referred to the Competition Commission would be more complicated, would introduce greater uncertainty about the costs to be incurred and might jeopardise the economic rationale of some mergers

that are referred – with the possibility of more cases being abandoned at reference stage. An additional fee at reference stage might also appear unfair on parties in cases where a merger is subsequently cleared by the Competition Commission.

## RISK ASSESSMENT

The disparity between the costs of operating the merger control regime and the amount recovered from fees has resulted in the Exchequer incurring significant annual deficits. The impact of inflation and changes to the way mergers are considered under the new Enterprise Act regime mean this disparity is increasing significantly. Without a move towards full cost recovery, the Exchequer – and in turn the taxpayer – will continue to meet the resulting shortfall.

A decision not to charge a fee for material influence cases, special merger situations and cases considered under Article 21(4) of the EC Merger Regime means no recovery of the costs of regulatory consideration of such cases. Previous experience suggests that there might be a total of around 6 such cases each year[9], with an average cost per case for regulatory consideration of £15,900.

## BUSINESS SECTORS AFFECTED

Merger activity takes place across virtually all business sectors. Subject to some limited exceptions, a fee is payable to the OFT for any merger, regardless of business sector, which qualifies for investigation under the Enterprise Act 2002[10]. Fees are also payable on the making of a merger reference under the Water Industry Act 1991. It remains the case that a fee is not payable where a merger is investigated and found not to qualify (does not meet the thresholds in Section 23 of the Enterprise Act to qualify as a relevant merger situation).

## SMALL BUSINESSES IMPACT

[9] In, the OFT investigated three material influence cases in 2002/03, [x] cases in 2003/04 and one case in 2004/05. There has been one special merger situation in which the Government has intervened since the Enterprise Act came into force on 20 June 2003. The number of Article 21(4) cases has varied over time, but on average there might be around two per year.

[10] A merger must meet all three of the following criteria to constitute a relevant merger situation:

- two or more enterprises must cease to be distinct;
- either the merger must not yet have taken place or have taken place not more than four months before the reference is made, unless the merger took place without having been made public and without the OFT being informed of it; and
- either:
    - the UK turnover of the enterprise which is being acquired exceeds £70 million, or
    - the enterprises which cease to be distinct together supply or acquire at least 25 per cent of all those particular goods or services in the UK or in a substantial part of it.

Enterprises that qualify as small and medium sized enterprises (SME) are exempt from paying merger fees and there are no plans to change this. This means the only impact that might occur is if a larger enterprise was deterred from acquiring a small business because of the higher fee levels involved. There are likely to be few transactions each year that could potentially be affected. The thresholds for qualification as an SME are set out in the Companies Act 1985, as amended by SI2004/16. These thresholds were recently increased.

## MONITORING AND REVIEW

Before implementing the second stage of the fee increase in April 2009 the Government will undertake a review. This will provide an opportunity to assess practical experience of operating under the higher fees to be introduced in April 2006 and to consider whether we remain satisfied that the planned fee levels are appropriate to achieve Full Cost Recovery. Thereafter, the Government plans to review the level of merger fees every three years – a periodicity that should provide a reasonable basis for judgements about actual costs incurred and whether these are properly being recovered from fees.

## ENFORCEMENT

The OFT is responsible for the collection of merger fees and does not report any problems with doing so. There seems no reason to change this arrangement

## CONCLUSIONS

The Government believes the policy of Full Cost Recovery should apply in respect of the costs of merger control and that fees should be increased accordingly to better reflect the true costs incurred by the regulatory authorities. We are satisfied that the existing three fee bands relating to the turnover of the enterprise being acquired provide for a reasonable degree of distinction between the fees payable when acquiring smaller or larger enterprises.

The Government does not propose to extend the charging regime to include material influence cases. Nor do we propose to extend fees to special merger situations and cases considered under Article 21(4) of the EC Merger Regime although this will be considered again in three years time.

The Government proposes to remove the current exemption from paying merger fees that applies for certain foreign acquirers.

## DECLARATION AND PUBLICATION

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

**Signed** *Gerry Sutcliffe* **Date 19th December 2005**

Gerry Sutcliffe
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