EXPLANATORY MEMORANDUM TO

THE ENTERPRISE ACT 2002 (MERGER FEES AND DETERMINATION OF TURNOVER) (AMENDMENT) AND ENERGY NETWORK MERGERS (CONSEQUENTIAL AMENDMENTS) ORDER

2023 No. 1185

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 This instrument enables the Competition and Markets Authority (CMA) to set and collect merger fees for investigating energy network mergers. The instrument also makes amendments to reflect the new regime: it provides that an enterprise's turnover in Great Britian is used to determine fees and whether a merger is in scope of the new regime. It also makes consequential amendments to the Water Mergers (Modification of Enactments) Regulations 2004 (the "Water Mergers Regulations"), to update legislative cross-references to reflect the statutory provisions for energy network mergers.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of Parts 1 and 2 of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland. The extent of Part 3 is England and Wales.

4.2 The territorial application of Parts 1 and 2 of this instrument (that is, where the instrument produces a practical effect) is England and Wales, and Scotland. The territorial application of Part 3 is England and Wales.

5. European Convention on Human Rights

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

6. Legislative Context

6.1 Section 204 of and Schedule 16 to the Energy Act 2023 amend the Enterprise Act 2002 (the "2002 Act") to establish a special regime for relevant mergers between energy network enterprises licensed in Great Britain, building on the current UK merger regime set out in the 2002 Act for mergers which do or might substantially lessen competition in the UK. Under this new regime, the CMA, the government body responsible for competition and market regulation, will be required to refer certain energy network enterprise mergers for investigation.

6.2 Under the Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003 (S.I. 2003/1370) ("the 2003 Order"), the CMA can charge fees for reviewing mergers and their impact on competition in UK. This SI amends the 2003 Order to provide for merger fees to be payable in respect of energy network mergers assessed under the new regime.

6.3 Section 23 of the 2002 Act provides that a relevant merger situation is created if two or more enterprises have ceased to be distinct enterprises at a time or in circumstances within section 24 of that Act, and the turnover in the UK of the enterprise being taken over exceeds £70 million. Section 28 of the 2002 Act, and the 2003 Order, make provision as to how turnover is to be determined. The new regime applies in relation to energy network enterprises licensed in Great Britain. This instrument therefore provides that an enterprise's turnover in Great Britain (rather than the UK) is used to determine the fees payable under the 2003 Order for consideration of energy network mergers. Similarly, it provides that turnover in Great Britain determines whether a merger between energy networks is in scope of the new regime.

6.4 The Water Mergers Regulations refer to Part 3 of the 2002 Act, in order to modify it for the purposes of mergers between water enterprises. This instrument amends cross-references to provisions of Part 3 of the 2002 Act in the Water Mergers Regulations, to reflect the provisions for energy network mergers added to that Part by the Energy Act 2023. The Water Mergers Regulations treat certain provisions of Part 3 of the 2002 Act, which are not relevant to water mergers, as if they were omitted for the purposes of water mergers. This instrument adds the new provisions of Part 3 of the 2002 Act, which are specific to energy network mergers, to the list of provisions treated as omitted for the purposes of water mergers.

7. Policy background

What is being done and why?

7.1 Energy network enterprises are regional monopolies meaning that each serves different areas of Great Britain exclusively. As such, there is no direct competition between them. The energy regulator, Ofgem, licenses energy network enterprises operating in Great Britain and sets their price controls through 'comparative benchmarking', which involves comparing data from all energy network enterprises. The price control is the main method that Ofgem uses to regulate the amount that energy network enterprises can charge suppliers, who in turn pass the cost on to consumers. When network ownership is consolidated into fewer enterprises through mergers and acquisitions there is a potential detriment to Ofgem's ability to carry out effective comparative benchmarking when setting the price control, as there is a reduction in independent entities that can be compared. For example, if the number of independent network enterprises is reduced, then this may reduce the diversity of approaches and data sets available, impacting the way that Ofgem sets efficiencies and requires service quality improvements.

7.2 The Energy Act 2023 amends the Enterprise Act 2002 to enable the CMA to investigate energy network enterprise mergers in Great Britain effectively. The legislation will mean that, where the energy network enterprise acquired has a GB turnover of over £70 million, and it is merging with another energy network enterprise that holds the same type of license, then the CMA must refer the merger to a CMA inquiry group, comprised of CMA panel members, for investigation if

conditions are met. The main condition is that the merger has substantially prejudiced, or may substantially prejudice, Ofgem's ability to carry out its functions and to make comparisons when setting price controls. The CMA may decide not to refer if there is a consumer benefit arising from the merger that outweighs this prejudice or, for mergers that have not yet completed, if the merger is not sufficiently far advanced or sufficiently likely to proceed to justify the reference.

7.3 Ultimately, if the CMA group concludes that there has been or may be a prejudicial outcome, the CMA will be required to take action to remedy, mitigate or prevent the prejudice and any adverse impacts which have resulted or may result from the merger. In this instance, the CMA will be empowered to place restrictions on the merger, up to and including preventing it from taking place, if this action is reasonable and practicable. The CMA already has these remedial options under the existing merger regime (which assesses if a merger has or may result in a substantial lessening of competition) but the CMA cannot access these remedial options effectively for energy networks due to their unique nature as regional monopolies that do not compete for market share. There are opportunities for the merging enterprises to offer undertakings in lieu of a referral to investigation by a CMA group; for example, the enterprises could offer to guarantee no price impacts to consumers for an agreed period, or ring fence parts of the business to protect operational independence.

7.4 The merger fee funds the above procedures. Therefore, the CMA must be able to charge fees for its consideration of mergers and related arrangements. This SI therefore amends the 2003 Order to provide for merger fees to be payable in respect of energy network mergers assessed under the new regime. The instrument also makes amendments to reflect the new regime. It provides that an enterprise's turnover in Great Britian is used to determine fees and whether a merger is in scope of the new regime. It also make consequential amendments to the Water Mergers Regulations, to update legislative cross-references to reflect the statutory provisions for energy network mergers; and make clear that provisions of the 2002 Act that are specific to energy network mergers, are not applicable to water mergers.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 The Department does not intend to consolidate the relevant legislation at this time.

10. Consultation outcome

10.1 Consulting publicly was inappropriate due to market sensitivities. However, we have consulted with Ofgem (energy regulator) and the CMA (who is responsible for overseeing the mergers of large enterprises).

11. Guidance

11.1 The CMA will publish guidance about its making and consideration of references under the energy network merger regime, and how consumer benefits may affect enforcement action for such references.

12. Impact

12.1 The annual net direct impact on business from the energy network merger regime is expected to be £8.4m. This cost will largely fall to network companies through administrative costs of the scheme and foregone efficiency gains that potential future mergers would allow them via economies of scale. However, this cost needs to be balanced against the impact to consumers via lower energy prices enabled by more accurate regulation. The overall net benefit to energy consumers expected to be £420m (NPV, 10 years). There is no, or no significant, impact on charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A separate Impact Assessment has not been prepared for this instrument because the Impact Assessment published alongside the Energy Bill (as it was) when introduced into Parliament (https://bills.parliament.uk/bills/3311/publications: Annex 2.1, pages 101 to 145) covered the energy network merger regime as a whole, which was established by the Energy Act. This instrument relates to the energy network merger regime, and the Impact Assessment is still up to date.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 The instrument does not include a statutory review provision and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 Minister Andrew Bowie has made the following statement: The duty to make provision for review of certain secondary legislation has been considered to the extent applicable. A review would be disproportionate when taking into account the economic impact of the regulatory provision on the qualifying activity. Furthermore, section 204 of the Energy Act requires a review within 5 years of the new provisions of the Enterprise Act 2002 which establish the energy network merger regime, to assess in particular whether the objectives of the provisions have been achieved or remain appropriate.

15. Contact

15.1 Cynthia Pereira & Rachel Siddell at the Department for Energy Security and Net Zero email: Cynthia.Pereira@energysecurity.gov.uk & Rachel.Siddell@energysecurity.gov.uk can be contacted with any queries regarding the instrument.

15.2 Paul van Heyningen, Deputy Director for Net Zero Electricity Networks, at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.

15.3 Minister Andrew Bowie at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.