

ENTERPRISE ACT 2002

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Mergers

Summary and Background

Chapter 3: Other special cases

Special public interest cases

190. These sections provide for an exceptional category of mergers that may be referred for investigation on public interest grounds, even though they do not meet the normal qualifying thresholds (the turnover test or the share of supply test). These include mergers involving certain government contractors (or subcontractors) who may hold or receive confidential information or material relating to defence.
191. They will not be scrutinised on competition grounds, but against public interest considerations only.

Section 59: Intervention by Secretary of State in special public interest cases

192. *Subsection (1)* provides that the Secretary of State may intervene on special public interest grounds if she has reasonable grounds for suspecting that a special merger situation has been created or is in contemplation. *Subsection (2)* provides that the Secretary of State may issue a special intervention notice if she believes that the case raises public interest considerations as specified in section 58.
193. *Subsection (3)* provides that a special merger situation is one where the usual thresholds of share of supply or turnover have not been met and the conditions in *subsection (4)* are satisfied. Those conditions are that one of the enterprises is carried on in the UK, or by or under control of a body corporate incorporated in the UK and a person carrying on one of the enterprises is a relevant government contractor. *Subsections (5) and (6)* provide that for the purposes of determining whether a relevant merger situation has been created, sections 22-31 shall apply, subject to certain changes listed in *subsection (6)*. These changes clarify that certain references to the OFT shall, for the purposes of the Chapter, be read as the Secretary of State.
194. *Subsection (8)* defines a relevant government contractor as a contractor whose contract includes handling confidential information or documents. They are notified of this by the Secretary of State, or on behalf of the Secretary of State in cases where this notification is passed on from a prime to a subcontractor. This subsection also establishes that a relevant government contractor includes a former contractor whose notification has not been revoked.
195. *Subsection (9)* defines defence as having the same meaning as in section 2 of the Official Secrets Act 1989, and further defines government contractor as having the meaning given in the 1989 Act and including subcontractors.

Section 60: Special intervention notices under section 59

196. This section provides that a special intervention notice shall contain details of the case concerned, and the public interest considerations specified in section 58 which are thought to be relevant. It also provides for the circumstances in which a special intervention notice would finally be determined and the time at which it would be determined.

Section 61: Initial investigation and report by OFT

197. This section establishes the OFT's role in investigating and reporting on these cases. *Subsections (1) and (2)* establish that if the Secretary of State issues a special intervention notice to OFT, they shall produce a report within such time-limit as the Secretary of State may require. There is nothing to prevent the Secretary of State from altering the time-limit if circumstances so require. *Subsection (3)* provides that, in its report, the OFT will consider matters relevant to references under sections 22 and 33 which are also relevant to the criteria specified in section 62. This means that OFT do not need to consider whether the merger may result in a substantial lessening of competition as this is not relevant to the Secretary of State's decision in a special public interest case. This subsection also provides that the OFT's report will include a summary of representations received that are relevant to the Secretary of State's decision.
198. *Subsection (4)* provides that the OFT shall decide whether a special merger situation has been created or is contemplated. This will be a relevant merger situation without the need to meet the qualifying thresholds (share of supply or turnover test). *Subsection (5)* provides that OFT may, at its discretion, provide other advice that may be relevant to the Secretary of State's decision about whether to refer, and *subsection (6)* allows the OFT to carry out their investigations for the report as it considers appropriate.

Section 62: Power of Secretary of State to refer the matter

199. This section provides for the Secretary of State to refer the case to the CC if she believes that a special merger situation has been created, or is contemplated; a consideration specified in section 58 is relevant, and it may operate against the public interest. *Subsection (5)* provides that the Secretary of State will accept the OFT's decision as to whether a special merger situation has been created.

Sections 63 and 64: Questions to be decided on references under section 62 & Cancellation or variation of references under section 62

200. *Section 63* provides that the CC will consider whether a special merger situation has been created, or is contemplated; whether – on the basis of the considerations set out in the reference – the merger may be expected to operate against the public interest; and make recommendations as to what action, if any, the Secretary of State or others should take to remedy any adverse effects.
201. *Section 64* provides for the circumstances in which the CC or the Secretary of State may cancel or vary a reference.

Section 65: Investigations and reports on references under section 62

202. This section provides that the CC's report and investigation should contain its conclusions on whether a special merger situation has been created; whether it may be expected to operate against the public interest; and what actions should be taken by the Secretary of State or others to remedy these adverse effects.

Section 66: Decision and enforcement action by Secretary of State

203. This section provides that the Secretary of State must decide whether the merger may operate against the public interest within 30 days of receiving the report from the CC

and may take whatever remedial steps she considers necessary (from paragraph 9 or 11 of Schedule 7). The Secretary of State must accept the view of the CC as to whether a special merger situation has been created or is contemplated.

European Mergers

Section 67: Intervention to protect legitimate interests

204. This section allows the Secretary of State to intervene in cases where the competition issues (if any) would fall to be determined by the European Commission under the ECMR (i.e. cases other than those where competition issues are referred back for consideration under UK domestic law under Article 9 ECMR, which fall to be considered under Chapters 1 and 2 of Part 3). *Subsection (2)* provides that the Secretary of State may serve a European intervention notice if she believes that one or more than one public interest consideration may be relevant to the case. *Subsection (1)* ensures that the Secretary of State can only serve such a notice if she has a reasonable suspicion that there is or will be a relevant merger situation that is also a concentration qualifying for scrutiny under the ECMR and it is not a case (like a newspaper merger) that is specifically excluded from consideration under Chapter 1 of Part 3 .

Section 68: Scheme for protecting legitimate interests

205. This section provides for the Secretary of State to make regulations to provide for action to be taken to protect legitimate interests as permitted by Article 21(3) of the ECMR. Section 124 provides that regulations made under this power will be subject to the affirmative resolution procedure.

Other

Section 69: Newspaper mergers

206. This section provides that the general merger regime will not apply to mergers covered by the FTA 1973 newspaper merger regime, unless the Secretary of State is prevented from making a reference under that regime.

Section 70 & Schedules 6 and 9: Water mergers

207. *Section 70* and Schedule 6 amend the special regime applying to mergers between water enterprises (whether water or sewerage undertakings) in England and Wales, as set out in sections 32 to 35 of the Water Industry Act 1991 (WIA 1991).
208. The current WIA 1991 provisions provide for the mandatory reference by the Secretary of State of qualifying mergers between two or more water enterprises to the CC. A qualifying merger is one where the value of the relevant water assets being taken over and those of the acquirer each exceed a specified figure (currently £30 million). Once a qualifying merger has been referred, the FTA 1973 'public interest' test is applied in a way that attaches particular weight to the principle that the ability of the Director General of Water Services ('Director') in carrying out his or her functions under the WIA to make comparisons between water enterprises should not be prejudiced. If the CC makes an adverse finding, the Secretary of State is responsible for determining final remedies.
209. The purpose of the special water merger regime is to preserve the Director's ability to make use of 'comparative' or 'yardstick' regulation (i.e. the ability to compare the performance of different water companies for the purposes of setting robust price and customer service standards), except where there are strong wider public interest reasons for not doing so. In the absence of any significant competition in the water sector, yardstick regulation is regarded as a particularly important regulatory tool.

*These notes refer to the Enterprise Act 2002 (c.40)
which received Royal Assent on 7 November 2002*

210. The main purpose of the changes being brought about by this section is, while retaining a special regime for mergers between water enterprises, to bring that regime more closely into line with the general merger regime whilst also ensuring that particular weight continues to be attached to the Director's ability to make comparisons between water enterprises.
211. The changes to effect a closer alignment with the general regime include:
- a switch from an assets threshold to a turnover threshold for determining whether a merger between water enterprises qualifies for a mandatory reference;
 - transfer of the responsibility for making such references from the Secretary of State to the OFT;
 - the transfer of responsibility for final decisions on what remedies should be applied in the event of an adverse finding from the Secretary of State to the CC; and
 - in the case of a completed water merger, the time that the OFT will have to make a reference will be reduced from 6 months to 4 months from the date of the merger taking place.
212. New section 32 (duty to refer merger of water or sewerage undertaking) provides that qualifying water enterprise mergers will continue to be subject to mandatory reference to the CC, but with responsibility for making such references transferred from the Secretary of State to the OFT.
213. New section 33 (exclusion of small mergers from duty to make reference) provides that a mandatory reference shall only be made if:
- the relevant turnover of the water enterprise being taken over exceeds £10m; and
 - the relevant turnover of one or more of the water enterprises belonging to the acquirer exceeds £10m.

These sums may be altered by regulations made by the Secretary of State.

214. The purpose of this provision is to exclude small mergers from the OFT's duty to make a reference. It replaces a similar provision based on asset values, but is expected to have the same practical effect as the current assets threshold of £30m in terms of the current water enterprises that will be affected. A refinement of the present statute will enable the Secretary of State to prescribe a different turnover threshold for the target and for the acquirer for the purposes of deciding whether there is to be a reference. The regulation-making powers provided in *subsections (4), (5) and (6)* of the revised section include power to make provision for the definition of relevant turnover for these purposes. The turnover will be set independently of the qualifying turnover thresholds set for the general merger regime.
215. [Schedule 6](#) replaces section 34 WIA 1991. The new inserted Schedule 4ZA sets out the task for the CC when a water enterprise merger has been referred to it. Its first job is to determine whether a merger situation qualifying for investigation has been or will be created. If it has been or will be created, the CC has to decide whether the merger can be expected to prejudice the Director's ability in carrying out his or her functions by virtue of WIA 1991, to make comparisons between different water enterprises. Both such decisions have to be the decisions of at least two-thirds of the members of the relevant CC reporting group to be treated as valid. The Director's functions that are likely to be most relevant here and that could be prejudiced by a merger are his or her functions of setting price controls and service level targets and the related general term of reference in section 2(3)(d) of WIA 1991 to 'promote economy and efficiency on the part of water enterprises'.
216. If there is prejudice, then the CC has to decide whether to take action to remedy, mitigate or prevent the prejudice or any adverse effects that might result, and to decide what

action should be taken. In deciding what action to take, the CC may have regard to the effect of any action on relevant customer benefits. The definition of a customer benefit is set out in paragraph 7. This matches the definition of customer benefits as defined for the purposes of the general merger regime.

217. Paragraph 4(1)(a) and (b) of inserted Schedule 4ZA, however, places two constraints on the circumstances in which the CC is able to have regard to customer benefits in deciding on remedies. These constraints are unique to the water regime. They provide that customer benefits can only be considered where the taking account of those benefits would not prevent a solution to the prejudice concerned, or in circumstances where the benefits are expected to be substantially more important than the prejudice concerned. These constraints are intended to ensure that the water regime continues to operate in a way that attaches particular weight to the preservation of comparator enterprises, whilst not excluding the possibility of customer benefits being taken into account if they are important enough, or if they can be obtained in a way that does not prevent action to address the prejudice.
218. Paragraphs 1 and 2 of inserted Schedule 4ZA provide for the general merger provisions in the Act to apply to qualifying water mergers subject to modifications contained in regulations that may be prescribed by the Secretary of State. It is envisaged that this power will be used, for example, to ensure that the general duty to remedy the effects of completed or anticipated mergers in section 41 can be adapted for the special purposes of the water regime. It may also be used to adapt the arrangements for the consideration of water mergers under the special regime to circumstances where the merger also raises a defined public interest issue.
219. Paragraph 5 of inserted Schedule 4ZA ensures that no enforcement action will be taken against a completed merger of water enterprises if a reference was not made within 4 months of the later of: the merger taking place, or material facts about the transaction coming to the attention of the OFT or being made public. The current section provides for a six-month period. The change brings the special water regime into line with the period in the equivalent provision for the general mergers regime.
220. Sections 32(2) and 32(3) of the current WIA 1991 set out transitional arrangements relevant when the original Act was brought into force. They are no longer required, and are therefore repealed.
221. The amendments to sections 32–35 are concerned, as is the original Act, only with water enterprises in England and Wales.
222. The transfer of responsibility for determining and implementing remedies under the normal mergers regime following an adverse finding from the Secretary of State to the CC requires a consequential change to section 17 WIA 1991. This section currently gives the Secretary of State a power, as part of her power to order remedies, to modify the conditions of appointment of a relevant undertaking for the purpose of giving effect to or taking account of the main remedial order. Schedule 9 revises section 17 WIA 1991 to give the power to modify conditions of appointment to the CC.