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

ENTERPRISE ACT 2002

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Mergers

Summary and Background

Chapter 1: Duty to make references

Duty to make references: completed mergers

Section 22: Duty to make references in relation to completed mergers

94. This section provides that the OFT must refer a completed merger to the CC for further investigation if certain circumstances arise. This differs from FTA 1973's arrangements for reference, where the Secretary of State has discretion to refer merger cases. This section will not apply to cases where the European Commission has exclusive jurisdiction to consider the competition aspects of the merger under the ECMR by virtue of the first paragraph of Article 21(2) ECMR.

95. *Subsection (1)* provides that the OFT must make a reference to the CC if it believes there is or may be a 'relevant merger situation' that has or may be expected to result in a substantial lessening of competition. However, *subsection (2)* provides that the OFT can choose not to refer if it thinks either that the market involved is not of sufficient importance to justify a CC investigation, or that any substantial lessening of competition would be outweighed by benefits to customers.

96. The OFT will be required under section 106 to publish advice and information on how these provisions will operate, and how it will apply the substantive tests. The substantial lessening of competition test, and the customer benefits concept are explained in more detail in the notes on sections 35 and 30 respectively.

97. The discretion for the OFT to decide not to refer a merger because the market is of insufficient importance is designed primarily to avoid references being made where the costs involved would be disproportionate to the size of the markets concerned.

98. *Subsection (3)* provides that the OFT is prevented from making a reference in each of the following circumstances:

- the merger involves a newspaper transfer;
- the OFT has accepted (or is considering accepting) undertakings in lieu of a reference in relation to the same transaction;
- the merger was the subject of a 'merger notice' and the deadline for reference has passed;
- the merger was referred to the CC before it was completed;

- the merger raises a public interest consideration(s) and either an intervention notice is in force, or the case has been determined;
- the merger is the subject of a request by the UK under Article 22(3) of the ECMR to the European Commission, and the European Commission is either considering the request, proceeding with a case in pursuance of the request, or has dealt with the matter in response to the request.

99. *Subsection (6)* provides that the definition of UK markets includes both sub-national and supra-national markets.

Section 23: Relevant merger situations

100. This section sets out the criteria for a merger to qualify for investigation by the competition authorities, thereby making it a 'relevant merger situation'. It in substantial part reproduces sections 64 and 68 FTA 1973.

101. It provides that a 'relevant merger situation' is created if: two or more enterprises have ceased to be distinct at a time or in circumstances set out in section 24, and at least one of the following thresholds is met:

- the value of the turnover in the UK of the enterprise being taken over exceeds £70m (the "turnover test"); or
- the merger would result in the creation or enhancement of at least a 25% share of supply of goods or services in the UK, or in a substantial part of the UK (the "share of supply" test). This would cover, for example, both the case of a merger between two enterprises each having a 15% share of supply, and that between two enterprises where one which already has a 25% share of supply mergers with another having a 5% share.

102. The share of supply test is being retained from FTA 1973, but the turnover test is new, replacing an assets test. Section 123 gives the Secretary of State a power to amend the share of supply test.

103. *Subsections (3) to (8)* make further provision as to the share of supply test. *Subsections (3) and (4)* enable the test to be applied to the net share of goods or services supplied by or to the merging enterprises. *Subsection (5)* allows the authorities to apply such criteria (such as value, cost, quantity, etc) as they consider appropriate to determine whether the 25% threshold is satisfied, and *subsections (6) and (7)* allow the authorities to consider whether goods or services subject to different forms of supply should be aggregated for this purpose. *Subsection (8)* gives the competition authorities the discretion to decide whether goods or services are to be treated as goods or services of a separate description for this purpose.

104. *Subsection (9)* has the effect that the question of whether there is a relevant merger situation is to be determined immediately before the time when the reference has been, or is to be made, except in circumstances where the CC has decided to treat the reference of an anticipated merger as that of a completed merger by virtue of section 36(2), when it is to be determined as at such time as the CC may determine.

Section 24: Time-limits and prior notice

105. This section provides for the time period in which completed mergers may be treated as a 'relevant merger situation' and are therefore referable. These re-enact those applying under FTA 1973.

106. A reference to the CC must be made within four months of the completion of a merger, or (if later) material facts about the merger being made public or given to OFT.

107. For this purpose, the section defines the term 'made public' as having the meaning of 'generally known or readily ascertainable'. The intention is that OFT would reasonably be expected to have known or found out about the merger if it has not been notified about it.

Section 25: Extension of time-limits

108. This section allows for the extension of the four-month period in which a merger can be referred in certain circumstances: where the OFT and parties have agreed an extension; where parties have failed to provide information to the OFT as requested; where undertakings are being sought; or where the UK has made a request to the EC under article 22(3) of the ECMR. Where there are multiple extensions, there is provision for the extensions to run concurrently where it is sensible to count the time period in this way.

Section 26: Enterprises ceasing to be distinct enterprises

109. This section defines a merger situation. It is closely modelled on section 65 FTA 1973, with one omission to take account of the existence of CA 1998.

110. The provision in 65(1)(b) of FTA 1973 that referred to 'arrangements entered into in order to prevent competition between enterprises' has been omitted. Where such arrangements do not fall within the merger regime under the Enterprise Act 2002, it is considered they will be better suited to investigation under CA 1998.

111. *Subsection (1)* defines 'two enterprises ceasing to be distinct' by reference to whether they are brought under common ownership or common control.

112. An 'enterprise' is defined in section 129 as the activities, or part of the activities, of a business; and a 'business' is defined to include a professional practice and to include any other undertaking that is carried on for gain or reward or that is an undertaking in the course of which goods or services are supplied other than free of charge. The definition includes 'part of the activities of a business' as it is sometimes an operating division of a company that is acquired rather than the whole of the company.

113. *Subsections (3) and (4)* (which are modelled on the equivalent FTA 1973 provisions) envisage three levels of control of an enterprise. These are: material influence over policy; control of policy (often called *de facto* control); and a controlling interest in the enterprise (often called *de jure* control). What constitutes material influence or control will be considered on a case-by-case basis by the competition authorities according to the particular circumstances of the case. Under the FTA the authorities have treated the acquisition of the ability to appoint a director or having a 15% shareholding as sufficient to give material influence for these purposes. *De facto* and *de jure* control will arise at higher levels of shareholding, with *de jure* normally requiring more than 50% of the voting rights.

114. Two enterprises cease to be distinct when there is an increase in the level of control - see section 26(3), (4)(a) and (4)(b). It is thus possible for a merger situation to be investigated at any of the three points where there is an increase in the level of control if the different levels of control are acquired at different times.

Sections 27 and 29: Time when enterprises cease to be distinct & Obtaining control by stages

115. Sections 27 and 29 reproduce sections 69 and 66A FTA 1973. These provide for the application of merger control to cases where ownership or control of an enterprise is obtained over a period of time. The key rule is contained in section 27(2), namely that mergers are treated as having been completed at the moment when all the parties to a transaction are contractually bound to do so. It makes clear that no account is to be

taken of options that have not been exercised or conditional rights where the conditions have not been satisfied.

116. Section 27(5) to (8) deals with certain cases where ownership or control has been acquired incrementally over a period of time. Where this has been achieved through one or successive transactions or arrangements between the same parties or interests, the competition authorities can treat them as having all occurred on the date of the last relevant event, subject to a two-year cut-off period.

117. Section 29 allows the authorities to treat a series of separate transactions over a period of up to two years, under which a person or group of persons acquire control of an enterprise, to be treated as occurring on the date of the last transaction when considering a reference. Unlike under section 27, there is no need for the transactions to be linked, nor for them to be between the same persons.

Section 28: Turnover test

118. This section provides for how the turnover test, which will replace the current 'assets test' contained in sections 64 and 67 FTA 1973, is to be determined. The test will apply to turnover in the UK, and will be set initially at £70 million, but this figure will be alterable by statutory instrument.

119. The test will be determined by reference to the turnover of the enterprise being taken over (i.e. if the turnover of the target company exceeds £70 million, the merger qualifies for investigation). If it is the case that no enterprise will continue under the same ownership after the merger (for example, formation of a new joint venture), the turnover for the purposes of the test is to be calculated by aggregating that of all the enterprises involved, and taking away the highest. The section also provides that the OFT shall keep the figure under review, and from time to time advise the Secretary of State if it is still an appropriate level.

120. Section 28(2) provides the Secretary of State with a power to make an order with respect to how the turnover in the UK of an enterprise is to be calculated, which may, in particular, make provision for the amounts which are to be taken into account, the dates by reference to which it is to be determined and the connection of that turnover with the UK.

Section 30: Relevant customer benefits

121. This section defines the benefits to customers that the authorities can take into account. They are benefits in the form of lower prices, greater innovation, greater choice or higher quality in a UK market. Customer benefits may be relevant to decisions of the OFT and the CC in two main situations:

- the OFT has a duty to refer mergers that it believes may result in a substantial lessening of competition, with some limited exceptions. One of the circumstances where the OFT may decide not to refer is where it expects customer benefits to outweigh the substantial lessening of competition;
- if a merger is referred, the CC is required to determine whether a merger will result in a substantial lessening of competition. If the CC makes such a determination, it has a duty to apply remedies. At the stage when the CC is deciding on remedies, the Act enables it, in particular, to have regard to customer benefits (see note on section 41). The CC will have scope to apply lesser competition remedies than would otherwise be the case. This scope would extend, at one extreme, to clearing a merger without any conditions if the customer benefits are of sufficient importance and nothing can be done about the competition problems without eliminating the relevant customer benefit that the CC wishes to recognise.

122. Relevant customer benefits are narrowly defined. They are not expected to arise very often. They must be in the form of lower prices, greater innovation, greater choice or

higher quality in a UK market. This definition is related to the competition test because the benefits are ones that would normally be expected to arise in a fully competitive market.

123. The definition is further narrowed in the following ways:

- the authority has to have an expectation that the benefits will be realised within a reasonable time-frame as a result of the merger;
- the authority has to consider that the benefits are unlikely to arise without the merger (unless the only other ways of realising the customer benefit would have a similarly detrimental effect on competition);
- relevant customers are limited to the customers of the merged or merging entity. The term also extends to other customers provided they are in a chain of customers beginning with the immediate customers of the merging entity. In both cases, the term extends to future customers because in some circumstances a merger can lead to the development of new products or services and the creation of new markets.

124. Both the OFT and the CC will be required to produce information and advice respectively about the making and consideration of references. This will include information and advice about their application of the customer benefits concept. Examples of mergers that might – depending on the specific circumstances – generate customer benefits that could be taken into account by the OFT in deciding whether to make a reference, or by the CC in determining remedies, are as follows:

- a merger producing so-called 'network benefits'. A merger might give customers of one enterprise improved access to a wider network operated by the other enterprise, with the wider choice of complementary products that this brings. For example, in mobile telecommunications, the more users who join a particular mobile network, the more valuable the network becomes to those users as they can contact more people, in more locations, at lower cost as the network increases. In the transport sector, network benefits can improve service quality through strengthened hubs, better through-ticketing arrangements or better-connected services;
- mergers leading to large economies of scale where the effect of scale economies on prices is sufficient to outweigh the effect of a substantial lessening of competition. Such circumstances could lead to an overall reduction in prices and be beneficial to both consumers and business, provided that the authorities were satisfied that the economies of scale would be realised in spite of a significant reduction in competition and that prices after the merger would remain lower than they were pre-merger;
- mergers producing more innovation through research and development benefits. Investment in research and development often involves large fixed costs and there may be circumstances where critical mass is needed – in terms of research expertise or capital or both – that can only be secured through a merger.

125. These examples are illustrative only, and should not be regarded as pre-judging what may or may not be included in the advice published by the competition authorities.

Section 31: Information powers in relation to completed mergers

126. This section sets out a new procedure for the OFT to obtain information from the parties of a possible completed merger. It allows the OFT to require information by notice, and provides that the notice must tell the parties what information is required, when it is required and what may happen if the parties do not comply with such a request (i.e. a reference to the CC).

Section 32: Supplementary provision for purposes of sections 25 and 31

127. This section provides the Secretary of State with a power to make regulations about the operation of the extension of the OFT's timetable for reference or the OFT's information-gathering powers in relation to completed mergers. The section also sets out arrangements for certain notices extending the four-month period.

Duty to make references: anticipated mergers

Section 33: Duty to make references in relation to anticipated mergers

128. This section provides that the OFT must refer an anticipated merger (i.e. one that has not yet taken place) to the CC for further investigation in certain circumstances. It broadly mirrors the reference duty in section 22. However, because there may be some uncertainty in these cases about whether a merger will go ahead, the OFT is given discretion not to refer unless it believes the proposals are sufficiently far advanced or likely to proceed. The OFT will cover this point in its published guidance.

Section 34: Supplementary provision in relation to anticipated mergers

129. This section provides a power for the Secretary of State to make provision about the operation of sections 27 and 29 in relation to anticipated mergers and public interest intervention notices relating to them.

Determination of references

Sections 35–41

130. These sections set out the functions and duties of the CC once a merger has been referred to it. The sections have similarities with existing provisions in FTA 1973, but reflect the removal of Ministers from the decision-making process, the new status of the CC as the determinative body in all cases other than ones raising defined public interest considerations, and the switch from a 'public interest' test to a 'substantial lessening of competition' test for the assessment of mergers.

Section 35: Questions to be decided in relation to completed mergers

131. This section sets out the questions that the CC has to decide as part of a reference. Its first task is to decide whether a relevant merger situation has been created. In doing so, it is confirming (or otherwise) the OFT's initial belief in making a reference under section 22 that a relevant merger situation has been created. If it has, the CC has to decide whether the merger has resulted, or will result, in a substantial lessening of competition. This competition-based test will be the central provision of the new regime. It replaces the public interest test in section 84 FTA 1973. In general, under the new regime, the CC will only have grounds for remedial action if the CC finds that the merger has resulted or may be expected to result in a substantial lessening of competition. (The only exception to this will be in certain public interest cases considered under the procedure set out in Chapter 2.)

132. The term 'substantial lessening of competition' is not defined in the Act. However, it is intended that advice and information on the operation of the competition test will be provided by the CC (and the OFT) under section 106. This requires the competition authorities to publish general advice and information about how they will consider references and how the relevant provisions will operate.

133. The concept of a substantial lessening of competition and its application in the context of a reference inquiry will be for the CC to explain in detail in its guidance. Similar language is used in the legislation controlling mergers in a number of other major jurisdictions, including the US, Canada, Australia and New Zealand. The concept is an economic one, best understood by reference to the question of whether a merger will

increase or facilitate the exercise of market power (whether unilateral, or through co-ordinated behaviour), leading to reduced output, higher prices, less innovation or lower quality or choice. A number of matters may be potentially relevant to the assessment of whether a merger will result in a substantial lessening of competition. The matters may include, but are not limited to:

- market shares and concentration;
- extent of effective competition before and after the merger;
- efficiency and financial performance of firms in the market;
- barriers to entry and expansion in the relevant market;
- availability of substitute products and the scope for supply- or demand-side substitution;
- extent of change and innovation in a market;
- whether in the absence of the merger one of the firms would fail and, if so, whether its failure would cause the assets of that firm to exit the market;
- the conduct of customers or of suppliers to those in the market.

134. If the CC decides that there is a substantial lessening of competition, it is also required to decide whether to take action to remedy, mitigate or prevent the substantial lessening of competition or any adverse effects resulting from that loss of competition. Adverse effects in this context are the undesirable consequences that flow from the loss of competition such as higher prices or reduced choice for customers. In deciding what action should be taken, however, *subsection (4)* requires the CC to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and the adverse effects resulting from it. The reference to a 'comprehensive solution' will require the CC to consider remedies that address the substantial lessening of competition itself (e.g. the features arising from the merger that give rise to the creation of market power) because it is generally more effective to tackle the cause of any problems at their source rather than by tackling the symptoms or adverse effects.

135. This section is closely linked with section 41, which sets out the factors that the CC must or may in particular bear in mind in choosing remedies.

136. *Subsections (6) and (7)* allow the OFT to frame references in a way that requires the CC to limit the questions that it has to consider in deciding whether a relevant merger situation has been created. For example, the reference can be framed in a way that does not require the CC to consider whether the turnover of the enterprise being acquired is over the relevant turnover threshold. In those circumstances, it would consider only whether the share of supply test had been met. Conversely, it can be asked to consider only whether the turnover threshold has been met. The CC can also be required to limit its consideration of whether the share of supply test has been met to a particular part of the UK.

Section 36: Questions to be decided in relation to anticipated mergers

137. This section is the equivalent to section 35. It sets out the questions that the CC has to decide when an anticipated merger (a merger that is in progress or contemplation) has been referred. The questions are similar, but with a future tense used where appropriate to reflect the fact that the merger has not yet been completed.

Section 37: Cancellation and variation of references under section 22 or 33

138. The section allows the OFT to vary a merger reference once it has been made, although this does not carry with it a power to alter the period within which the CC is required to report. It is based on section 71 FTA 1973. The circumstances where this flexibility

might be required include situations where the parties have been identified incorrectly, or the grounds for the original reference were wrong.

139. The section introduces a provision giving the CC a new power to change the type of reference made, where the facts justify it. The power might be used, for example, where a merger is referred as an anticipated merger under section 32, but is subsequently completed.

Section 38: Investigations and reports on references under section 22 or 33

140. This section gives the CC an obligation to publish a report on each of its merger references within the statutory time-limit (see below). The section is closely modelled on section 72 FTA 1973 but with differences reflecting the determinative role of the CC both in relation to decisions on the competition test and decisions on what remedies to apply. The section includes a requirement for the CC to give reasons for its decision and information allowing for a proper understanding of the decisions.

Section 39: Time-limits for investigations and reports

141. Section 70 FTA 1973 currently requires the Secretary of State to set a timetable within which the CC has to report. That timetable cannot exceed 6 months. The period set is extendable for one further period of up to 3 months where the Secretary of State is satisfied that there are special reasons why the report cannot be made within the initial period.

142. Section 39 replaces section 70 FTA 1973. It requires the CC to publish its report on a reference within a statutory maximum period of 24 weeks from the date of reference. A shorter period applies if that is needed to comply with Article 9(6) of the ECMR in circumstances where a merger has been referred back for consideration by the UK domestic competition authorities.

143. The section permits the CC to extend the 24-week period for the report for one further period of no more than 8 weeks where it is satisfied that there are special reasons for a delay. The section does not further define 'special reasons', but it is anticipated that they would include matters such as the illness or incapacity of members of a reporting group that has seriously impeded its work, and an unexpected event such as a merger of competitors.

144. An important difference between the current FTA 1973 timetable and the proposed new timetable is that the CC's report will have to contain not only its decisions on the substantive question of whether there is expected to be a substantial lessening of competition, but also its decisions on remedies. At present, the CC makes the substantive finding against a public interest test, but only makes recommendations to the Secretary of State about the remedies that might be appropriate. The Secretary of State has an unlimited period within which to take final decisions on remedies.

145. *Subsection (4)* gives the CC a discretion that it does not have in the current regime to extend the period within which it has to report where one of the parties to a merger (but not third parties) has failed to comply with a formal notice (see section 109) requiring the provision of information or documents, or the appearance of witnesses. Any such extension continues until the information is provided, or the CC decides to cancel the extension.

Section 40: Section 39: supplementary

146. This section gives the Secretary of State a power by order to shorten the maximum statutory timetable of 24 weeks, and the maximum 8 week period for any extension. They can be lengthened again if necessary, but in no circumstances can the periods be extended beyond 24 weeks and 8 weeks respectively. The section also gives the Secretary of State a power to make regulations covering detailed procedural matters

connected with the provision of information and documents, such as the time at which information is to be treated as having been provided.

Section 41: Duty to remedy effects of completed or anticipated mergers

147. There are close links between this section and sections 36 and 37. The latter require the CC to decide whether a merger has or may be expected to result in a substantial lessening of competition, and to identify any action that should be taken to address it. Section 41 requires the CC to take the action that it considers to be reasonable and practicable to remedy, mitigate or prevent the competition problems that it has identified. The steps have to be consistent with the course of action included in the report on the reference, unless there has been a material change of circumstances, or the CC has a special reason for taking different steps.

148. The CC has a choice of preventing, remedying or mitigating the substantial lessening of competition or the adverse effects arising from that loss of competition. However, it has to have particular regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition itself.

149. *Subsection (5)* gives the CC an express discretion, in deciding on what action to take to address the competition problems, to have regard to the effect of any such action on any relevant customer benefits (as defined in section 30). The purpose of this subsection is to ensure that the CC has scope, if it considers that customer benefits are of sufficient importance, to impose a lesser competition remedy or no remedy at all if the only steps that the CC could take to remedy the competition problem are steps that would mean that the customer benefits could not be realised.