

dti

Government Response to Consultation

**Changing the System of Charging for the Costs of
Merger Control**

06 January 2006

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CHANGES TO THE SYSTEM OF CHARGING FIRMS FOR THE COSTS OF MERGER CONTROL

GOVERNMENT RESPONSE TO SUBMISSIONS RECEIVED ON THE CONSULTATION BETWEEN 4 AUGUST AND 3 NOVEMBER 2004.

1. Introduction and Background

1.1 Between 4 August and 3 November 2004, the Government undertook a formal consultation on possible changes to the system of charging firms for the costs of merger control. A copy of the consultation document at <http://www.dti.gov.uk/ccp/archive/consultations.htm>. A summary of responses to the consultation was published in March 2005 (URN05/1036) and can be found on the DTI website <http://www.dti.gov.uk/consultations/files/publication-1480.pdf>.

1.2 Government policy is that where a statutory service is provided, fee levels should generally be set to recover the full cost of that service. The original charging system for merger control functions was introduced in 1990 on the basis that the amount recovered in merger fees should broadly equate to the costs the competition authorities incurred in carrying out their merger control. Fee levels have not been increased since their initial introduction and income from merger fees now falls significantly below the costs actually incurred by the regulatory authorities - the Office of Fair Trading and the Competition Commission. The financial shortfall is currently met through general taxation.

1.3 Section 121(4)(c) of the Enterprise Act 2002 provides that the amount of fees may be calculated by reference to matters which may include the value of the turnover of the enterprises concerned. There are, at present, three fee bands. These are:

- £5,000: payable where the value of the UK turnover of the enterprises being acquired is £20 million or less;
- £10,000: payable where the value of the UK turnover of the enterprises being acquired is over £20 million but not over £70 million; and
- £15,000: payable where the value of the UK turnover of the enterprises being acquired exceeds £70 million.

1.4 The Government invited views from business and other interested parties on a range of options for change. The issues for consideration included:

- whether an increase in fees should seek to achieve recovery of the full costs incurred by the competition authorities or just a greater proportion of those costs;
- whether there should be a phased approach to any increase in fees;
- whether fees should be charged in material influence cases, special merger situations or cases considered under Article 21(4) of the EC Merger Regulation; and/or
- whether the fee structure should be based on one or more of the following: a flat fee; a banded fee based on turnover of the company being acquired; or an additional fee where a case is referred for further investigation to the Competition Commission.

1.5 The figures used in the consultation document to illustrate the different fee options were based on the income fees would need to generate to cover the chargeable costs the Government incurred during the most recent year for which figures were available - 2002/2003. The consultation document indicated that the actual costs of operating the new mergers regime established under the Enterprise Act were, in fact, likely to be higher meaning the total amount to be generated from fees would also need to be higher than the figures used in that document.

2. Responses Received

2.1. Twenty-six responses to the consultation were received representing the views of 32 organisations. These included a total of 11 responses from competition law firms and 3 responses from law societies/ associations. Responses have also been received from the business community, including 9 responses from individual businesses and 3 responses from representative organisations. A list of the relevant organisations and details of how to view their responses is provided at Annex A.

2.2. The Government has considered all representations very carefully in deciding the way forward and is most grateful to everyone who took the time to submit views.

2.3. Most responses 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 cases where the Government decides to intervene on specified public interest grounds in cases that are being considered by the EC Commission. 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 a number of additional issues that were not

directly covered in the consultation document. There was no particular divergence of views between the business community and other respondents on any of the options.

2.4. Below is a detailed summary of responses to the questions asked in the consultation and to the additional issues raised by respondents - together with details of the changes we propose to make to the fees structure.

3. Responses by Question

Questions 1 and 2

Would an increase in fees be appropriate and, if so, should this be to achieve (a) full cost recovery straight away or in a phased approach or (b) merely greater cost recovery?

If a phased approach to the introduction of full cost recovery is taken, how best might this be done?

3.1. Eighteen respondents opposed a move to full cost recovery. They gave a range of reasons including that such a move would: discourage some merger activity; ignore the public good element to merger control; result in a higher fee payable in the UK than elsewhere, and disadvantage UK business.

3.2. In addition, two respondents suggested that the element of cross-subsidy involved in the system becomes increasingly unfair where the fees are high and one referred to the need for accurate cost data covering a sufficiently long period to justify more than limited changes to the present structure.

3.3. Eight respondents supported a move to greater cost recovery, given that no increase had taken place since 1990.

3.4. On the issue of phasing the introduction of any fees increase, eight respondents supported a phased approach, with two suggesting an increase each year by inflation plus a specified amount would provide certainty to business about future fee levels. Two respondents said there was no need to phase any increase provided sufficient notice was given.

Government Response

3.7. The Government appreciates there are concerns about a move to full cost recovery. However, we consider that no compelling evidence has been identified to justify a deviation from the standard policy of charging so as to recover the full cost of the statutory regulatory functions undertaken from

users rather than to meet those costs through general taxation. In particular, there is no direct evidence from the consultation to suggest that anything but the most marginal cases might be deterred by a significant fee increase, or that business could not adjust to the increase over a relatively short period of time.

3.8. Merging parties will normally incur a number of costs in completing a merger. As well as the actual purchase price, these may include costs for legal advisers, PR advisers, economic advisers, management time and a merger fee. Acquiring companies do not publish a breakdown of costs, and these will vary greatly from case to case depending on such things as the profile of the companies, and the complexity of legal and economic issues arising. A recent study on the costs to business of multi-jurisdictional merger reviews¹ confirms this wide variance in costs. Our informal discussions during the consultation with those involved in the process would suggest that merger fees do not generally represent a large element of these costs. Accordingly, we propose to increase fees in order to generate a total sum approximately equivalent to the actual costs we expect the regulatory authorities to incur in carrying out those functions.

3.9. Having made no increase to merger fee levels since their first introduction in 1990, amending fees so as to recover the full cost of the service from users will involve a significant increase in fee levels. In recognition of this, and to allow business time to adjust, the Government proposes to phase the increase in fees so as to delay completing the move to full cost recovery until 6 April 2009. Initially, with effect from 6 April 2006, we propose to increase fees to levels that we consider will recover approximately 50% of that total amount we consider necessary to recover the full costs of the regulatory function. Phasing introduction of the increase in this way will provide a chance to assess what impact the higher fees introduced on 6 April 2006 appear to be having on merger activity. It will also give the Government an opportunity, before finally completing the increase in 2009, to assess whether practical experience of operating the system in the period from 2006 to 2009 supports our estimate of the costs we expect the regulators to incur and - should it appear necessary - to make appropriate adjustments before completing the increase.

Question 3

Should fees be charged for material influence cases?

3.10. Just over half of all respondents commented on this, with ten broadly in favour of a charge being introduced. They considered that sufficient

¹ *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.

legal certainty now existed on what represented material influence, given that case law had now built up and the OFT had published detailed guidance. Six respondents argued that certainty did not exist, particularly at the edges of material influence, and that either no fee, or a lower fee, should be charged. Concern was expressed by three respondents that there was potential for multiple fees to be incurred by the same purchaser given that a new merger situation may arise on an increase from one level of control to another. One respondent commented that the introduction of a fee might discourage the acquisition of material influence as a possible way of investing in relatively new companies.

Government Response

3.11. The Government's policy is that companies considering a transaction should have legal certainty on whether they would incur a merger fee. The Government recognises there is now greater understanding of what represents material influence. We also appreciate the point that it seems reasonable to charge a fee in cases where OFT devotes resource to considering an investment resulting in material influence over a company. However, 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. We are concerned that there remains scope for significant uncertainty over such cases and undue potential for disputes to arise as to whether or not a particular case should be considered to incur a fee. Given the low number of such cases, charging a fee would generate limited additional money and would not affect the level at which merger fees need to be set to achieve full cost recovery. Accordingly, the Government judges that the difficulties involved in operating a fees system for material influence cases appear to outweigh the benefits and does not consider it appropriate at this time to move to charging a fee for regulatory oversight of such cases.

Question 4

Should fees be charged in special merger situations or cases considered under Article 21(4) of the EC Merger Regulation?

3.12. Most respondents – 16 out of 18 that commented on this issue – opposed charging in such cases. Reasons included that this was essentially a political process, intervention was unpredictable and the introduction of a fee would discriminate further against those industries where a public interest existed. In addition, it was noted that chargeable case costs would be low as most work at the first stage of investigation would be undertaken by MoD or Ofcom. Two respondents were in favour of charging, noting

that it removed the potential for normal cases having to cross-subsidise the costs of work undertaken.

Government Response

3.13. The Government does not accept the proposition that use of the special public interest regime constitutes a political process divorced from competition law. The competition test is the way the Government looks after the public interest, except in those cases where competition is not in itself enough, such as special merger situations. However, there is a case for saying that a fee should not be introduced yet for such cases, allowing business time to see the new regime settle down and to understand how the published guidance on intervention is being implemented. The Government has therefore decided not to introduce a fee at present, but to review the situation in three years.

Question 5

What merits and drawbacks do you see with the following options for a possible future fee structure, and which would be your preferred option?

- **Option 1 - Flat fee**
- **Option 2 - Banded fee based on the turnover of the enterprise acquired, using turnover bands currently in place.**
- **Option 3 - Banding of fee based on turnover of the enterprise acquired, using new bands with greater differentiation between larger acquisitions.**
- **Option 4 - Flat fee for all qualifying mergers, with an additional fee for those mergers referred to the Competition Commission for further investigation**
- **Option 5 - Banding of fee based on turnover of the enterprise acquired, with an additional banded fee for those cases referred for further investigation to the Competition Commission.**

3.14. The majority of responses favoured the retention of a banded fee structure, such as Options 2 or 3 or a variant thereof, arguing that such a structure would be more equitable as it would give differentiation between small and large merging companies, and avoid disproportionate costs falling on small businesses.

3.15. Option 1, based on a single flat fee, was favoured by two respondents, on the basis that it provided certainty for business in terms of regulatory costs and was straightforward to administer.

3.16. Four respondents favoured the introduction of an additional fee for those mergers referred to the Competition Commission (Options 4/5). This is seen as the most cost reflective approach, with CC costs being recovered

only from those parties whose mergers are in fact referred. One respondent favoured a variant of Options 4 and 5, with a flat fee charged at phase 1 consideration of a case and a banded fee in place for those cases that progress to phase 2 with the second stage fee being determined by the Competition Commission, possibly based on factors such as turnover, amount of work undertaken and whether an adverse finding was reached. A similar approach is taken in Germany.

3.17. Nine respondents specifically opposed Options 4 and 5 arguing, amongst other things, that they would: lead to more cases being abandoned at reference stage; reduce the required predictability of what costs would be incurred, and be unfair to parties whose cases are subsequently cleared by the CC, particularly as they will face large additional time and legal costs where a reference is made.

3.18. Rather than applying fee bands based on turnover, four respondents favoured moving to a structure of fees based on the consideration paid which they felt was a more accurate measure of the transaction's value. Two respondents said this approach could present difficulties: for example, there may be commercial sensitivity about revealing the price paid; it might be open to manipulation; and it was not always clear what the acquisition price is (e.g. final price may be dependent on performance of the acquired enterprise over time).

3.19. One respondent suggested that the current approach towards defining the turnover of the enterprise acquired should be amended so that it was limited to those entities which form part of the target's group for Companies Act purposes.

Government Response

3.20. It remains the Government's aim to keep the fee structure simple to operate. With this in mind, we propose to continue to charge set fees so as to recover approximately the overall costs of operating the regime with the amount of fees reflecting the value of the turnover of the enterprise acquired (as provided for in Section 121(4)(c) of the Enterprise Act 2002). We consider that attempting to charge fees individually to reflect the actual costs incurred in considering each individual case would present significant practical difficulties.

3.21. We propose to select Option 2: retaining the current structure of three separate fee bands at the current levels of turnover of the enterprise acquired. This decision reflects the following considerations:

- Moving to a flat fee (Option 1) would remove altogether any differentiation between the fee payable when acquiring a smaller enterprise and that payable when acquiring a larger one. We consider this could place disproportionate costs on smaller mergers and may discourage some smaller transactions.
- The turnover of the enterprise being acquired may make limited difference to the actual costs that competition authorities will incur when carrying out their regulatory functions in considering a merger. Accordingly, it appears unjustifiable to introduce a significantly greater degree of differentiation between the fee bands based on turnover (Option 3).
- The introduction of a two-stage fee with the second stage being payable for those mergers that are referred to the Competition Commission (Options 4 and 5) 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.

3.22. Retaining the current turnover levels will mean:

- the top-level fee is payable for mergers that qualify for regulatory consideration by virtue of meeting the turnover test threshold of £70 million set out in Section 23(1)(b) of the Enterprise Act 2002;
- lower fee levels are payable in respect of cases that qualify for consideration because they meet the share of supply test (25% of the UK market or a substantial part of it);
- the lowest fee level will be payable in cases that qualify for consideration under the share of supply test and involve the acquisition of enterprises with an annual turnover of £20 million or less.

3.23. Whilst a number of respondents proposed the introduction of a fee structure based on consideration paid, the Government believes that turnover of the enterprise acquired remains the best way of determining fee bands. Turnover is a widely-used and well understood measure of economic value, and helps to provide a mechanism which is straightforward to administer. In addition, the Government agrees with those respondents who identified practical difficulties in determining fee levels using consideration paid.

Question 6

Are there any other ways in which the merger fees regime might be improved?

3.24 Responses also raised several issues relating to the merger fees regime which were not directly covered in the consultation document:

(i) Foreign acquirers

Three respondents said that it appeared unfair that an overseas acquirer of a UK company should be exempt from paying a merger fee. They were not aware of other jurisdictions where merger fees were not payable by a foreign acquirer, and failure to charge in the UK would therefore put UK enterprises at a disadvantage.

Respondents also argued that there should not be practical difficulties with recovering the amount due: foreign acquirers were not expected to avoid paying a fee as it seemed unlikely they would wish to create hostility to their organisation from the merger control authority in a significant jurisdiction.

Government Response

The Government agrees that the exemption from merger fees currently provided by the 2003 fees order to certain foreign acquirers provides an unfair advantage to those businesses it benefits. The Government proposes to delete the relevant Article in the 2003 order, removing this exemption.

(ii) Charities

One respondent suggested that the OFT should have discretion to waive the merger fee where the parties concerned were, for example, non-profit making organisations. They noted that the merger between the Imperial Cancer Research Fund and Cancer Research Campaign was a qualifying merger and that a fee had, therefore, been paid.

Government Response

The Government considers it right that competition law should apply to mergers involving organisations that have the status of charities in the same way as it does to other enterprises. Any enterprise that qualifies for investigation is in some sense carrying on a business. Charities and non-profit making bodies may, for example, have research or commercial functions that give rise to competition issues.

Any exemptions could be seen as giving an unfair advantage to enterprises that have this status. In addition, it should be noted that such cases are extremely rare and would only involve the very biggest charities.

(iii) End the practice of charging fees for merger clearances where the parties have not submitted a notification

Where the OFT investigates a merger that was not pre-notified and subsequently clears the merger, a fee may be charged under the current arrangements. Two respondents argued that, as notification is voluntary and the parties had correctly assessed in advance that there were no significant competition issues, the charging of a fee appeared unjust and could be considered to have undermined the principle of voluntary notification.

Government Response

The Government does not agree with this proposal. All qualifying cases require some consideration of the competition aspects by the competition authorities and it is therefore right to charge a fee. In addition, the proposal would be likely to deter notification of cases and, assuming the same level of fee income was to be recovered, would lead to a prohibitively high fee level for notified cases.

(iv) Higher fee for cases considered under a merger notice

One respondent suggested that it could be appropriate to charge a higher fee for cases that are formally notified to the OFT under a Merger Notice. The benefit for the parties of formal notification is that the OFT is required to reach a decision within a statutory timeframe and it would not be unreasonable for the parties to have to pay an extra fee for that benefit.

Government Response

The Government does not agree with this proposal. Whilst the formal notification of cases does provide the benefit for parties of greater certainty in timing of decisions, the difference in timescales between these and other cases is not dramatic. It therefore seems likely that an additional charge would deter formal notification of cases, effectively ending the system. The introduction of an extra tier of charges would also lead to an overly complex charging system.

(v) Transparency of costs

One respondent said that any fee increase should be accompanied by greater transparency and accountability on the part of the competition authorities in relation to the costs incurred in carrying out merger investigations.

It was also suggested that, in calculating costs, no account should be taken of costs related to the role of the competition authorities in non-chargeable cases, and more general merger policy work.

Government Response

Both the OFT and the CC are required under the Enterprise Act to prepare and publish annual reports as soon as practicable after the end of each financial year on their activities and performance during that year. The OFT report sets out the total costs of the competition authorities in taking forward merger work, whilst the CC now tracks and publishes the average cost per month of its inquiries. This should help ensure the fees are set at an appropriate level to provide for the recovery of those costs to which a charge applies.

The Government confirms that the costs of dealing with non-chargeable cases and general merger control policy work done by the competition authorities are not taken into account in calculating fee levels.

4. Revised Merger Fee Bands

4.1. As outlined above, we believe the policy of Full Cost Recovery may best be achieved through the application of merger fees set at three separate bands that relate to the turnover of the enterprise being acquired and which provide for a reasonable degree of distinction between the fee payable when acquiring smaller or larger enterprises.

4.2. The costs involved in administering the new merger control regime under the Enterprise Act 2002 have yet to stabilise and there is no clear track record on which we can base estimates of the likely total annual costs going forward. In estimating what costs may be attributable to mergers regulation in future, we have considered factors such as the likely balance of the Competition Commission's work-load (between market investigations and mergers work) and the scope for efficiencies and cost savings to be achieved. Taking these factors into account, our assessment is that the total sum we will need to recover annually through fees in order to achieve Full Cost Recovery is between £8-9 million.

4.3. The actual figure that is generated from fees in any one year will, of course, vary: the total being dependant both on how much merger activity takes place during the year and on the turnover band into which the enterprise being acquired falls. In estimating how much might be recovered through fees charged to merging parties it has been necessary to make assumptions about merger activity based on the most recent available data on annual numbers of acquisitions of enterprises at different turnover levels. We aim to avoid setting fees at a level that would generate more than the actual costs of operating the regime. We judge that approximately £8-9 million might be generated annually by charging fees at the three separate fee bands set out in Table 1 below.

Table 1

Turnover per annum of the enterprise acquired	Fee level required to recover 100% of chargeable costs (WEF 6 April 2009)	Current fee level
>£20 million	£30,000	£5,000
£20 – £70 million	£60,000	£10,000
<£70 million	£90,000	£15,000

4.4. As indicated at paragraph 3.9 above, we propose to move to full cost recovery in two stages with the first stage of the increase proposed to take effect from 6 April 2006. For this initial move towards the full fee increase, we aim to recover around half of the £8-9 million estimated annual costs. Accordingly, the fee levels will initially be set at 50% of those set out in Table 1 and which will apply from 6 April 2009. This means the initial increase coming into effect on 6 April 2006 will be as set out in Table 2 below.

Table 2

Turnover per annum of the enterprise acquired	Initial fee level to recover 50% of costs (WEF 6 April 2006)	Current fee level
>£20 million	£15,000	£5,000
£20 – £70 million	£30,000	£10,000
<£70 million	£45,000	£15,000

5. Next Steps

5.1. The Government will now prepare and introduce a statutory instrument that will amend the existing merger fees order - the Enterprise Act 2002 (merger fees and determination of turnover) order 2003 (SI number 2003/1370). The effect of the amendment will be to replace the existing fee bands with those set out in Table 2 above. A further statutory instrument will then be introduced in early 2009 to implement the second stage of the fees increase and achieve Full Cost Recovery. At present we expect this will increase the fees to the levels set out in Table 1 above. However, for the reasons set out in paragraph 3.9, final decisions on the fee levels to be introduced at that stage will only be made following a further assessment drawing on practical experience of operating the regime.

6. Further review and monitoring

6.1. The Government proposes to review the level at which merger fees are set at intervals of every three years. Merger activity will vary year on year. Intervals of three years between reviews should provide a reasonable period of experience on which to base judgments about likely future merger activity, as well as about the costs of operating the regime, so that decisions can be made about the level of fees necessary to achieve Full Cost Recovery over the next three year period. Accordingly, the first review of fee levels will be due in 2012, following implementation of the final stage of this fees increase in 2009.

Annex A

Responses to the consultation on possible changes to the system of charging firms for costs of merger control were received from the following organisations. (Please note: this list excludes responses made in confidence). Copies of responses may be viewed by appointment in the DTI, 1 Victoria Street, London. Please contact Jonathan Cook on 020 7215 5514 for further information on viewing the responses.

Allen & Overy LLP
Archant
Ashurst
Baker & McKenzie
Capital Radio Group*
CBI
Centrica Plc
Chrysalis*
Clifford Chance LLP
CMS Cameron McKenna
Competition Law Association
Competition Law Sub-Committee City of London Law Society
Commercial Radio Companies Association*
CVC Capital Partners
EMAP*
GWR*
Joint Working Party of the Bars and Law Societies of the UK
Macfarlanes
Martineau Johnson
The Newspaper Society
Northumbrian Water Ltd
Norton Rose
Richards Butler International Law Firm
Scottish and Southern Energy
Simmons & Simmons
SMG*
South West Water Ltd
Tindle Radio*

* Views were given during a meeting, with the notes of that meeting representing the views of those present

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