

CALCULATION OF TURNOVER OF
A WATER ENTERPRISE

Consultation document on
calculation of turnover of a
water enterprise for the
revised water merger
regime.

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dti

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**Consultation document on calculation of turnover of a water enterprise
for the revised water merger regime**

This consultation document seeks views on proposals for how to calculate the turnover of a water enterprise. This will be required for the water merger regime set out in the Water Industry Act 1991 (“WIA 91”) when it is amended by the Enterprise Act 2002 and the Water Act 2003. In this new regime turnover needs to be calculated for the purposes of determining whether the Office of Fair Trading has a duty to make a merger reference to the Competition Commission. Turnover is also relevant to the fee payable for regulatory scrutiny of a merger. The intention is that this statutory instrument should be placed before Parliament at the same time as other instruments needed to bring the Enterprise Act water merger provisions introduced by the Enterprise Act 2002 into force around the end of 2004.

Issued: 29 July 2004
Respond by: 28 October 2004
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EXECUTIVE SUMMARY

The Water Industry Act 1991 (WIA91) put in place a special merger regime for mergers between water enterprises. The Enterprise Act 2002 made changes to how all mergers are regulated, and included provisions (not yet in force) to make amendments to the WIA91 merger provisions. These changes will align the water merger regime provisions more closely with the Enterprise Act general merger provisions (with independent competition authorities being determinative on merger cases). The changes include changing the qualifying threshold for a merger to be the subject of a mandatory reference to the Competition Commission. The current threshold, based on value of assets acquired, will be replaced by one based on UK turnover.

It is intended that the amendments to the WIA91 will be brought into force around the end of 2004. A statutory instrument is needed to set out how the UK turnover of water enterprises should be calculated.

A draft order is attached at **Annex B**. The draft draws heavily on the method by which turnover of an acquired entity is determined under the general merger provisions of the Enterprise Act 2002¹. The statutory instrument for calculating turnover for non-water enterprises includes many of the concepts included in the draft instrument for consultation here – for example, the concept of linked transactions, and the discretion given to the OFT to count or discount certain turnovers. It does, however, also include provisions needed for calculating the turnover of the acquiring water enterprise, as, unlike the general merger regime, the water merger regime has two turnover thresholds: one based on the turnover of the target water enterprise, and the other based upon the turnover of water enterprises already belonging to the person making the takeover. Views are welcomed on any aspects of the draft, and in particular on the following issues. Wherever possible, please provide evidence to support your comments.

Basis for calculation

Question 1: Do you agree that the turnover should be calculated based upon the sale of products and the provision of services made by the appointed business (as defined in the draft Regulations attached), as set out in paragraph 3 of the Schedule to the draft order?

Modification of turnover to take account of significant recent transactions

Question 2: Do you agree that, as in the general mergers turnover legislation, the OFT should have discretion to decide whether or not to take account, in their calculation of turnover, of significant transactions or events which have occurred since the end of the relevant business year which may affect the turnover of the business?

¹ [The Enterprise Act 2002 \(Merger Fees and Determination of Turnover\) Order 2003 \(SI 1370/2003\)](#)

Calculation of turnover for the purposes of section 33(1)(b) of the Water Industry Act 1991

Question 3: Do you agree that paragraphs 4 – 9 of the Schedule to the draft Regulations should only apply when determining the turnover of a water enterprise to see whether the test in section 33(1)(a) of the WIA91 is met?

Combination of the turnover of linked water enterprises

Question 4: Do you agree that the turnover of linked water enterprises should be aggregated for purposes of calculating turnover?

Addition of turnover of water enterprises over which only material influence is held

Question 5: Do you agree that the turnover of a water enterprise over which material influence is held should be taken fully into account when calculating the total turnover for the purposes of section 33(1)(a) of the WIA91?

Sales or services between water enterprise under common control

Question 6: do you agree that the calculation of applicable turnover should take account of goods or services provided to water enterprises under common control or ownership with the water enterprise to be divested?

How to respond

This consultation paper sets out a number of specific questions relating to the draft legislation attached. Responses to these questions, and comments on any other aspects of the draft legislation are most welcome.

When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

Copies of this consultation document and the draft legislation are available from the DTI's website.

Please send responses by email, post or fax by **28 October 2004** to:

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Confidentiality

Your response may be made public by the DTI. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT

system or included as a general statement in your fax cover sheet will be taken to apply only to information in your response for which confidentiality has been requested.

We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1998.

Help with queries

If there are specific policy questions to be explored, please contact:

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If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

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A copy of the Code of Practice on Consultation is in **Annex A**.

CHAPTER 1 – INTRODUCTION

1 Sections 32-35 of the current Water Industry Act 1991 (WIA91) include provisions requiring the mandatory reference to the Competition Commission of mergers between two or more water enterprises. A qualifying merger is one where the value of the relevant water assets being taken over and those of the acquirer each exceed £30 million.

2 The Enterprise Act 2002 provides for changes to the merger regime in the WIA91 to bring it more in line with the general merger regime put in place by the Enterprise Act. Many concepts stay the same: for example the regime still deals with mergers between two or more water enterprises. Water enterprises are water only undertakers and water and sewerage undertakers; the Office of Water Services - Ofwat - has responsibility for appointing such undertakers.

3 The most important change in the regime for the purposes of this consultation is a change from an assets threshold to a turnover threshold for determining whether a merger between water enterprises qualifies for a mandatory reference to the Competition Commission. Two turnover thresholds are set in the new Section 33 of the WIA91: one the turnover of the water enterprise being acquired, the other the turnover of the water enterprises already owned by the person making the takeover. The turnover threshold for each is set at £10 million, which is expected to catch the same number of water enterprises as the £30 million assets threshold.

4 A statutory instrument is required in order to determine how the turnover of a water enterprise should be calculated. The turnover to be calculated is referred to in the draft Regulations attached as the “applicable turnover”.

5 No Regulatory Impact Assessment for this statutory instrument has been prepared, as it will have no significant financial impact either on business or on the public purse. Regulatory Impact Assessments were made for all the provisions in the Enterprise Act 2002.

6 Public consultation on this Order will last for [13] weeks. It is being aimed primarily at those who currently own a water enterprise and at legal practitioners. Views from these constituencies, and from anybody else with an interest, would be welcomed.

Other information

7 This consultation document and the associated draft order, is available on the DTI website. Further information on the implementation of the water merger regime will be available from the Competition Commission.

CHAPTER 2 – THE CALCULATION OF TURNOVER OF A WATER ENTERPRISE

8 *The Government would welcome views on the method proposed for calculating turnover of a water enterprise, as reflected in the attached draft order. A series of questions feature throughout this document, to facilitate the submission of consultee views.*

Basis for calculation

9 All water enterprises are required by their Licence to provide accounting and other financial information to Ofwat covering their activities in the previous financial year. This includes information on the turnover of the appointed business. The draft Order proposes that the calculation of the turnover of a water enterprise should be based on the turnover of the appointed business, subject to some possible modifications as set out below.

Question 1: Do you agree that the turnover should be calculated based upon the sale of products and the provision of services made by the appointed business (as defined in the draft Regulations attached), as set out in paragraph 3 of the Schedule to the draft order?

Modification of turnover to take account of significant recent transactions

Paragraph 3 of the draft Order sets out which year's turnover should be used for the purposes of the calculation. Paragraph 3(3) sets out that where something has happened since the end of that year which the OFT considers may have a significant impact on the turnover of the water enterprise (for example, an acquisition or divestment) the OFT has the ability to take it into account if it considers it appropriate to do so

Question 2: Do you agree that, as in the general mergers turnover legislation, the OFT should have discretion to decide whether or not to take account, in their calculation of turnover, of significant transactions or events which have occurred since the end of the relevant business year which may affect the turnover of the business?

Calculation of turnover for the purposes of section 33(1)(b) of the Water Industry Act 1991

11 Our view is that section 33(3)(b) requires that the turnover of each water enterprise is to be taken into account in determining whether the test in section 33(1)(b) is met. As a consequence paragraphs 4 to 9 of the Schedule to the draft Regulations do not apply when determining whether the turnover test in section 33(1)(b) of that Act has been met.

Question 3: Do you agree that paragraphs 4 – 9 of the Schedule to the draft Regulations should only apply when determining the turnover of a water enterprise to see whether the test in section 33(1)(a) of the WIA91 is met?

Combination of the turnover of linked water enterprises

12 Paragraph 4 of the Schedule to the draft order deals with the situation where (a) an organisation owns or has control of more than one water enterprise and (b) the test in section 33(1)(a) of the WIA91 is being applied. Paragraph 4 sets out that, subject to exceptions in paragraphs 8 and 9 of the schedule, in such circumstances the applicable turnover shall be calculated by adding together the respective applicable turnover of each of the water enterprises under common ownership or control. This mirrors the procedure adopted in the general merger regimes, as set out in paragraph 4 of the Schedule to The Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003 and is consistent with section 33(2) of the WIA91.

Question 4: Do you agree that the turnover of linked water enterprises should be aggregated for purposes of calculating turnover?

Addition of turnover of water enterprises over which only material influence is held

13 Paragraphs 6 of the Schedule to the draft Regulations states that “a person or group of persons able, directly or indirectly, to control or materially influence the policy of a body corporate, or the policy of any person in carrying on a enterprise but without having a controlling interest in that body corporate or in that enterprise, may for the purpose of paragraph 4, be treated by the OFT as having control of it”. When read in combination with paragraph 4 of the schedule this allows the OFT to add the turnover of a water enterprise over which only material influence can be exercised to the turnover of a water enterprise over which control is exercised, in order to determine the total turnover for the purposes of the test in section 33(1)(a) of the WIA91. This mirrors the procedure adopted in the general merger regimes, as set out in paragraph 6 of the Schedule to The Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003. At the time this was considered the most appropriate way of considering the turnover; in particular, attributing a proportion of the turnover of the enterprise over which material influence was held did not seem an appropriate way forward, as this does not recognise the economic reality of the situation, namely that material influence is held over the entire enterprise, and hence over the entire turnover of the enterprise.

Question 5: Do you agree that the turnover of a water enterprise over which material influence is held should be taken fully into account when calculating the total turnover for the purposes of section 33(1)(a) of the WIA91?

Sales or services between water enterprise under common control

14 Paragraph 8 of the schedule to the draft Regulations provides that in the calculation of the applicable turnover, amounts resulting from the sales of goods or provision of services between the appointed businesses of water enterprises under common ownership or control should not be taken into account. The purpose of this is to ensure that the applicable turnover calculated only covers the water enterprise’s dealings with enterprises or consumers to which it is not linked

The provision mirrors the procedure adopted in the general mergers regime, as set out in paragraph 8 of the Schedule to the Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003.

Paragraph 9 of the draft schedule to the draft Regulations deals with the situation where a water enterprise was under common control with other water enterprises before the merger but will be separated from them after the merger. Paragraph 9 sets out that if there were any sales of goods or provision of services between the water enterprise being transferred and those remaining with the vendor, the turnover attributable to those sales or services should be added to the applicable turnover – and that the OFT may attribute a turnover to them which it considers appropriate if no turnover was attributed to them, or if the turnover attributed to them does not, in the view of the OFT, represent an open market value. This might be relevant if there were several water enterprises under common ownership and the one to be sold off was providing, for example, call centre facilities for the whole group. Again, the provision mirrors the procedure adopted in the general mergers regime, as set out in paragraph 9 of the Schedule to the Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003. Again, paragraphs 8 and 9 of the Schedule to the draft Regulations only apply when calculating turnover for the purposes of the test contained in section 33(1)(a).

Question 6: do you agree that the calculation of applicable turnover should take account of goods or services provided to water enterprises under common control or ownership with the water enterprise to be divested?

What happens next

15 Once this consultation exercise is complete, the Government will analyse replies, and then publish an overall response to the consultation within three months. It is anticipated that the order will be made and laid before Parliament in the autumn of 2004 and will come into force around the end of 2004.

ANNEX A

The Consultation Code of Practice Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's [website](#).

Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to

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2004 No.***

COMPETITION

**The Water Mergers (Determination of Turnover) Regulations
2004**

<i>Made</i> - - - -	<i>2004</i>
<i>Laid before Parliament</i>	<i>2004</i>
<i>Coming into force</i> - -	<i>15th November 2004</i>

The Secretary of State, in exercise of the powers conferred upon her by sections 33(4) and (5) and 213 of the Water Industry Act 1991⁽¹⁾ hereby makes the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Water Mergers (Determination of Turnover) Regulations 2004 and shall come into force on [15 November 2004].

Interpretation

2. In these Regulations:

- (a) “the Act” means the Water Industry Act 1991;
- (b) “applicable turnover” means the turnover of a water enterprise in the preceding business year, or in a case to which regulation 3(4) applies, in the period referred to in that regulation, determined in accordance with the Schedule to these Regulations; and where a business year or a period under regulation 3(4) does not equal 12 months the applicable turnover shall be the amount which bears the same proportion to the applicable turnover during that business year as 12 months does to that period;
- (c) “appointed business” means the business of carrying out the activities which are necessary for a water enterprise to fulfil the functions and duties imposed on it by section 2 of the Act;
- (d) “business year” means a period of more than six months in respect of which a water enterprise or, if applicable, the business of which it forms part, prepares or is required to prepare its regulatory accounts;
- (e) “regulatory accounts” means regular accounting and other information supplied by the water enterprise to the Director General for Water Services to enable him to compare the financial position and performance of the appointed businesses of all water enterprises.

¹ 1991, c. 56, as amended by section 70 of the Enterprise Act 2002 c. 40

Determination of turnover in the United Kingdom of a water enterprise

3.—1. This regulation shall apply for the purposes referred to in section 33(4) of the Act.

(1) The turnover in the United Kingdom of a water enterprise shall be, subject to paragraph (3), the applicable turnover for the business year preceding –

- (a) where the question whether it is or may be the case that arrangements are in progress which, if carried into effect, will result in the merger of two or more water enterprises is being determined, the date when the decision in relation to a possible reference has been or is to be made, or such earlier date as OFT considers appropriate;
- (b) where the question whether a merger of two or more water enterprises which has taken place otherwise than as a result of the carrying into effect of arrangements that have been the subject of a reference by virtue of sub-paragraph (a) above, the date when the water enterprises concerned ceased to be distinct water enterprises or such earlier date as the OFT considers appropriate.

(2) Where an acquisition or divestment or other transaction or event has occurred since the end of the preceding business year which the OFT considers may have a significant impact on the turnover of the enterprise, that acquisition or divestment or other transaction or event may be taken into account if the OFT considers it appropriate to do so.

(3) Where in the application of this regulation there is any period in respect of which there is no preceding business year then the applicable turnover shall be the turnover for that period.

Name
Parliamentary Under Secretary of State for Competition, Consumers and Markets
Department of Trade and Industry

2004

SCHEDULE

APPLICABLE TURNOVER

Article 2

Interpretation

1. In this Schedule “aid” means aid within the meaning of Article 87 of the EC Treaty.
2. Save in paragraphs 4-9, the provisions of this Schedule shall be interpreted in accordance with accounting principles and practices that are generally accepted in the United Kingdom.
3. The applicable turnover of a water enterprise shall be limited to the amounts derived from the sale of products and the provision of services falling within the appointed business of the water enterprise to businesses or consumers in the United Kingdom after deduction of sales rebates, value added tax and other taxes directly related to turnover.
4. Subject to paragraphs 8 and 9, where an enterprise comprises two or more water enterprises which are under common ownership or control the applicable turnover shall be calculated by adding together the respective applicable turnover of each of the water enterprises under common ownership or control.
5. For the purposes of paragraphs 4 and 7-9, water enterprises shall in particular be treated as being under common control if they are—
 - (a) enterprises of interconnected bodies corporate;
 - (b) enterprises carried on by two or more bodies corporate of which one and the same person or group of persons has control; or

(c) an enterprise carried on by a body corporate and an enterprise carried on by a person or group of persons having control of that body corporate.

6. A person or group of persons able, directly or indirectly, to control or materially influence the policy of a body corporate, or the policy of any person in carrying on an enterprise but without having a controlling interest in that body corporate or in that enterprise, may for the purpose of paragraph 4, be treated by the OFT as having control of it.

7. Section 127 of the Enterprise Act 2002 shall apply to the determination of whether enterprises are under common control for the purposes of paragraphs 5 and 6 as it applies, for the purposes specified in section 127, to section 26 of that Act.

8. Subject to paragraph 9, applicable turnover shall not include amounts derived from the sale of products or the provision of services between the appointed businesses of water enterprises under common ownership or control.

9. Where, as a result of the merger situation, one or more enterprises ceases or will cease to be under common ownership or control with the enterprise being taken over, the OFT may treat amounts derived from the sale of products or the provision of services between the enterprise being taken over and any enterprises ceasing to be under common ownership or control with that enterprise as applicable turnover and if such sale of products or provision of services has not resulted in any turnover or the OFT considers that the turnover attributed to them does not reflect open market value, the OFT may attribute such value to them as it considers appropriate and include them in the calculation of applicable turnover.

10. Paragraphs 4 – 9 above shall have no application when determining turnover for the purposes of section 33(1)(b) of the Act.

Aid granted to businesses

11. Any aid granted by a public body to the appointed business of a water enterprise shall be included in the calculation of turnover if the business is itself the recipient of the aid and if the aid is directly linked to the sale of products or the provision of services by the business and is therefore reflected in the price.

EXPLANATORY NOTE

(This note is not part of the Regulation)

These Regulations specify how the turnover of a water enterprise is to be determined for the purposes of section 33 of the Water Industry Act 1991 (“the Act”). The Office of Fair Trading is prohibited from making a merger reference to the Competition Commission under section 32 of the Act where the turnover of either the water enterprise being taken over or the turnover of the water enterprises owned by the person making the takeover fall within the limits set by section 33 of the Act.

End

Department of Trade Industry
Consumer and Competition Policy Directorate

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