bvca The voice of long-term investment

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Response to consultation on options for reform: a competition regime for growth

Dear Mr Lawson,

I am writing on behalf of The British Private Equity and Venture Capital Association ("BVCA") to the consultation document issued by the Department for Business Innovation & Skills ("BIS") on 16 March entitled, "A Competition Regime for Growth: A consultation on Options for Reform". For ease of reference, I refer to this document as "the Consultation", and references to paragraphs are to paragraphs of that document.

The BVCA is the industry body for the UK private equity and venture capital industry. With a membership of over 450 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms and their advisers. This submission has been prepared by the BVCA's Legal & Technical Committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

I estimate that the private equity and venture capital members of the BVCA together undertook approximately 150 transactions in each of the 2010 and 2009 calendar years that could be considered as "mergers" under the UK merger control system.

The BVCA welcomes the open approach being adopted by BIS in its consultation exercise and would welcome the opportunity to discuss with BIS its thinking once the public consultation period has ended. There are the following aspects of the Consultation on which I would like to comment specifically on behalf of the BVCA.

The BVCA has consciously limited its scope in this letter to commenting on the merger control regime aspects of the Consultation (and it has not commented on the other proposed changes to the competition rules being considered) because merger control is the most significant aspect of the Consultation likely to affect the BVCA's membership as a whole.

1. INSTITUTIONAL REFORM

1.1 The BVCA would encourage BIS to approach the issue of institutional reform from the perspective of trying to ensure that the UK's principal competition authorities operate as efficiently and transparently as possible, and in a manner consistent with the Government's Growth Agenda.

1.2 In this context, the BVCA would welcome institutional reform if that is likely to lead to more efficient, effective and transparent decision-making and enforcement in relation to the competition rules. The BVCA would not however encourage institutional reform if it would undermine those objectives or if the changes were made simply in order to reduce administrative costs.

1.3 The BVCA would also urge caution to ensure there is no adverse impact on those aspects of the current competition system that are undoubtedly working especially well. In this context, we would draw particular attention to the following:-

1.3.1 The current Panel system of the Competition Commission ("CC"), including for the in-depth review of mergers;

1.3.2 The speed and effectiveness of the judicial scrutiny currently exercised by the Competition Appeal Tribunal ("CAT"), especially in relation to its judicial review of merger decisions and its "On the Merits" reviews of competition enforcement decisions.

1.4 By contrast, for market studies and market investigations the BVCA believes that there is considerable scope, if approached on an open-minded basis, to streamline and accelerate the current system, especially in relation to the stages of fact-finding and consideration of possible remedies. Institutional reform could play an important part in reducing the very onerous burden on business of fact-finding and accelerating the speed of overall decision-taking.

1.5 In all of the above, the BVCA would however be concerned to ensure that any institutional reform is not at the expense of ensuring due process and does not undermine the rights of defence of parties dealing with the competition authorities.

1.6 In conclusion, the BVCA's members do not believe it is necessary to merge the OFT and CC but if it is decided to proceed with a merger of these bodies, the BVCA would urge you to take account of the key principles under which the Competition and Markets Authority ("CMA") should operate as set out above.

2. MERGER CONTROL

2.1 Mandatory vs voluntary notifications: The BVCA's members consider that the current voluntary system of merger notification in the UK works effectively, in ensuring that potentially problematic mergers are reviewed appropriately by the Office of Fair Trading ("OFT"). In our opinion, there is very little evidence to suggest that there are material numbers of potentially problematic mergers that are not subject to review by the OFT. The current voluntary system of merger control is, in the opinion of the BVCA's members, generally flexible, efficient, timely and proportionate.

2.2 In fact, we would highlight that, contrary to a supposed drawback of a voluntary merger notification system as identified in the Consultation, for many of the BVCA's members, who have a fiduciary duty to protect investor monies, the potential downsides of completing an anti-competitive merger without prior notification are immense with the risk, should fire sales be ordered, of significant financial loss and reputational damage. We consider that, for similar reasons, most UK listed companies would also be likely to pre-notify potentially difficult mergers to the OFT. Accordingly, in our opinion, the UK's voluntary notification system does not encourage or facilitate the BVCA's members (or other companies) to undertake non-notified anti-competitive mergers.

2.3 Moving to a system of mandatory pre-notification (or even the hybrid system considered in the Consultation) would introduce unnecessary delay and cost (in terms of management time and advisers' fees in drafting notifications and securing merger clearances), and impose an additional burden on the parties involved. The overall impact of such a move would likely be needlessly to complicate and delay the process of efficient rationalisation amongst businesses. The need to create a CMA sufficiently well-resourced to cope promptly with a significant increase in the number of merger notifications (the great majority of which would be unlikely to raise any competition aspects) would of course lead to additional costs that business would in turn be required to pay for through the merger fees.

2.4 Proposed thresholds for mandatory notifications: One proposal being considered (paragraph 4.27) is that there should be mandatory pre-notification of mergers where the target's UK turnover exceeds £5m and the world-wide turnover of the acquirer exceeds £10m. These thresholds would be exceptionally low compared with other European merger control regimes and would capture a very large number of "no issues" acquisitions. In the BVCA's opinion, such a mandatory pre-notification regime would impose delay and heavy costs on doing business in the UK (which would undoubtedly adversely affect the BVCA's members), for little obvious public benefit.

2.5 A mandatory pre-notification system would also disadvantage the BVCA's members compared to the current voluntary notification system, including because:-

2.5.1 companies would lose their current competitive advantage of being able to close acquisitions quickly if there is no competitive overlap between them;

2.5.2 it would dampen businesses' incentives to undertake pro-competitive mergers (for example, transactions that would be efficiency-enhancing);

2.5.3 there would be commercial and financial risks to businesses arising from the mere fact of additional delay, especially in those cases where there is an injection of monies due to take place into distressed businesses.

2.6 Proposed "hybrid system": An alternative proposal ("option 1") is that there should be mandatory pre-notification of mergers where the target's UK turnover exceeds £70m but the CMA would retain the ability to investigate mergers satisfying the share of supply test. Such a proposal incorporates many of the negative features of a mandatory regime (e.g. the additional delay and costs for business) without achieving any of the benefits that such a system could potentially generate (e.g. clarity and certainty on the scope of the competition authority's jurisdiction). Such a hybrid system would not be welcomed by the BVCA's members who need upfront clarity and certainty about when the UK's merger control rules will apply.

2.7 Retain voluntary system but strengthen interim measures: An alternative option ("option 2") considered in the Consultation (paragraphs 4.10-4.16) is to retain, but improve, the current voluntary merger control system (under which there are no automatic bars to completing a merger). For all of the reasons discussed above, of the options considered in the Consultation, option 2 is the strong preference of the BVCA's members. The BVCA's members would consider aspects of this option to be the most proportionate and effective of the merger control options considered in the Consultation provided that in its final form it is discretionary, proportionate and targeted. A blanket restriction of the kind contemplated in option 1 is not proportionate or targeted and should not be imposed.

2.8 The BVCA's members would suggest the following as areas in which the current voluntary system's effectiveness could be improved:-

2.8.1 Granting the CMA the power to require the production of information and documents from the merging parties and interested parties (including customers and competitors), which would allow the CMA to verify the accuracy of comments being made to it by interested parties;

2.8.2 Changing administrative practice so that the CMA engaged in a much more interactive process of seeking to conclude undertakings in lieu of an in-depth investigation;

2.8.3 Removing the share of supply test. The current test is very unclear and leads to upfront legal uncertainty about whether a particular transaction may be subject to the UK's merger control regime. Removing the share of supply test (or even replacing it with a market share test) would help to create clearer, bright-line, jurisdiction tests and would also bring the UK's merger

system into closer alignment with the approach taken to merger control in other OECD countries.

2.9 The BVCA would however suggest (contrary to paragraphs 4.12-4.15) that the CMA should have a discretion to determine whether hold separate undertakings are necessary, rather than there being an automatic statutory bar on integration during a phase 1 investigation. Although hold separate undertakings may obviously be merited in certain cases, there will undoubtedly be many cases where it is equally obvious that they are unnecessary. An example of the latter would be an investment by a private equity or venture capital fund in a company, when there is no horizontal overlap or vertical relationship between the company and other entities in which the fund has investments. To have an automatic statutory bar on integration during a phase 1 investigation for these latter situations would seem disproportionate and unnecessary, and would not be welcomed.

2.10 If the CMA were to retain discretion in relation to hold separate undertakings, the BVCA would not be opposed to the introduction of reasonable and proportionate measures to strengthen the CMA's powers. This could be achieved by giving the CMA the ability to suspend all integration steps where merited pending negotiation of tailored hold separate undertakings (the alternative proposal at paragraph 4.13) and/or implementing the proposals at paragraph 4.15 to clarify the legislation to make clearer the type and range of measures that the CMA could take. Giving the CMA discretion to apply these powers (rather than an automatic statutory bar) should alleviate the concern raised by BIS that parties will be discouraged from notifying a completed deal until a level of integration has already taken place.

2.11 Proposed exemptions for small mergers: There is a suggestion that "small mergers" be exempted from the merger control regime. However, it is proposed (paragraph 4.41) that this exemption would only cover transactions involving a target with UK turnover below £5m and an acquirer with a worldwide turnover not exceeding £10m. The BVCA welcomes the suggestion that there should be a small mergers exemption, because the great majority of the smaller acquisitions undertaken by the BVCA's members do not raise any material competition issues. However, in practice, because these thresholds would be set at such a low level the exemption would be unlikely to benefit a substantial number of mergers involving members of the BVCA, and we would encourage higher thresholds to reduce unnecessary administrative burden and associated costs.

3. MERGER FEES

3.1 The BVCA notes the intention to set merger fees at a level sufficient to recover the full costs of the merger control regime (paragraph 11.9). In certain cases (paragraphs 11.11 and 11.12) this would involve very significant increases in merger fees, to levels that the BVCA would consider to be unreasonable and excessive. Under a mandatory notification system it is envisaged that merger fees would be set at lower levels (paragraph 11.15), but these would be significantly outweighed by the management time and advisers' fees involved in the preparation of notifying and securing clearance for mergers that had to be pre-notified.

3.2 I would also point out that there is no obvious correlation between the UK turnover of the target and the administrative effort required to ascertain whether the transaction merits an in-depth merger review. Consequently, setting merger fees by reference to UK turnover is a blunt and not necessarily fair means of trying to achieve the principle of full cost recovery.

3.3 Finally, the BVCA would in principle support the introduction of statutory timetables for phase 1 and phase 2 reviews, and the periods specified at paragraphs 4.45-4.47 of the Consultation appear reasonable. The BVCA would however be concerned to ensure that the introduction of statutory timetables did not compromise the quality or robustness of the CMA's decisions, especially for clearance decisions at phase 1. An

important aspect of this will be to ensure that the CMA has, in practice, appropriate levels of experienced and high-quality staff and that its internal procedures and dealings with the business community are efficient and properly focused.

The BVCA would of course be willing to discuss further this response or BIS' intentions following completion of the public consultation exercise.

Yours sincerely,

Simon Witney
Chairman – BVCA Legal & Technical Committee