On 17 October 2017, the Department for Business, Energy & Industrial Strategy published a Green Paper setting out proposals to give the Government greater scope to intervene in takeovers that raise national security concerns. In the short-term, the proposals would give the Government the power to block the foreign takeover of smaller companies in the defence and technology sectors that would currently fall outside of its jurisdiction. Longer-term, the consultation considers changes to the way in which foreign investment in certain sectors is reviewed, with proposals for greater “call-in” powers under the current voluntary notification regime, or the introduction of a mandatory notification requirement.

Introduction

The Green Paper questions whether the Government’s existing powers to intervene in foreign investment in the UK are sufficient to ensure that takeovers raising national security issues receive the right level of scrutiny, and whether it has the necessary powers to step in to ensure the national security of the UK. While the vast majority of foreign investment into the UK raises no such concerns, the Government highlights that foreign ownership of critical businesses and infrastructure comes with risks of espionage, sabotage or the ability to exert inappropriate leverage. The proposals come in the wake of the Government’s intervention in the deal for the Hinkley Point nuclear power station last year, and the increased appeal of UK companies to foreign investors due to the weakening of sterling following the Brexit vote.

Current powers

The Government’s current powers to scrutinise takeovers for national security and other public interest concerns are contained in the Enterprise Act 2002 (“Enterprise Act”), as part of the UK merger control regime. The UK operates a voluntary (rather than mandatory) merger notification system - there is no requirement to notify mergers to the Competition and Markets Authority (“CMA”) even if the relevant thresholds are met. The CMA can review a takeover if the thresholds are satisfied, i.e. if the target business has UK turnover of more than £70 million or where the share of UK supply increases to 25% or over.
For takeovers where the merger control thresholds are satisfied, the Secretary of State can intervene in merger decisions where a strictly defined public interest ground is at stake - either national security, the plurality of the media or press freedom, or the stability of the UK financial system.¹ There have only been seven interventions on national security grounds since the Enterprise Act was enacted almost 15 years ago.

By contrast, where the thresholds are not satisfied, the Government’s existing powers are very limited. The only exception is for takeovers involving businesses covered by the special public interest regime under the Enterprise Act, being only certain newspaper and broadcasting companies, and certain government defence contractors.

**Government proposals**

To address these limitations on its powers to scrutinise and intervene on national security grounds, the Government has published a set of short- and long-term proposed reforms. The Green Paper sets out the proposals for short-term reforms that aim to bring transactions involving smaller companies in certain sectors into the jurisdiction of the current merger control regime. The long-term reforms are aimed at substantively addressing the way in which foreign investment is scrutinised in certain sectors of the UK economy.

**Short-term reforms**

The Government sees the current merger thresholds in the Enterprise Act as representing the most pressing issue, requiring urgent amendment so that transactions with smaller targets are no longer beyond Government reach. The proposals target two sectors of the UK economy: the military and dual-use sector, and the advanced technology sector (discussed below).

This consultation will last 4 weeks and the deadline for comments is 14 November 2017.

*Amendments to the turnover thresholds for these two sectors*

The Government proposes to lower the thresholds to ensure that mergers in these key sectors that could raise national security concerns can be called in by the Secretary of State for review. Specifically, the Government proposes amending both the turnover threshold and share of supply tests for mergers in the two relevant sectors by:

> lowering the turnover threshold from £70 million to £1 million; and

> removing the current requirement for an *increase* in the share of supply so that the test will be satisfied by acquiring an existing share of supply of 25% (without an increment).

The Government considers that lowering the turnover threshold is a proportionate step to address national security risks in these sectors while leaving micro-businesses outside the scope of the Enterprise Act regime.

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¹ Similar public interest provisions exist under the European Union Merger Regulation which, if applicable, allow Government intervention in takeovers reviewed by the European Commission.
Similarly, the Government concludes that the proposed amendment to the share of supply test is an important step to address national security concerns that may arise from the acquisition of businesses by buyers with no current presence in these sectors.

**The military and dual-use sector**

This first key sector identified by the Government is the military and dual-use sector. This covers the design and production of military items (such as arms, military and paramilitary equipment) and “dual-use” items which could have both military and civilian uses. As well as military and defence businesses, there are also businesses that design or produce items, or have technical expertise relating to activity or items, which are primarily for civilian uses but could also have military applications.

In the Government’s view, expanded powers are needed in this sector as, currently, mergers involving relevant businesses often fall below the existing thresholds and/or the relevant businesses do not meet the strict criteria of a government defence contractor that would currently allow for intervention under the special public interest regime.

**The advanced technology sector**

Advanced technology is the other sector in which the Government proposes the new thresholds should apply. Mergers related to businesses that undertake activities in this sector have the potential to give hostile actors knowledge or expertise that could be used to undermine national security.

The key areas within this sector are businesses active in:

- **multi-purpose computing hardware** – meaning enterprises that own or create intellectual property rights in the functional capability of multi-purpose computing hardware, or design, maintain or support the secure provisioning or management of roots of trust of multi-purpose computing hardware; and

- **quantum-based technology** – meaning enterprises that research, develop, design or manufacture goods for use in, or supply services based on, quantum computing or quantum communications technologies. This would include the creation of relevant intellectual property or components.

**Long-term reforms**

The second part of the Green Paper focuses on longer-term and more substantial reforms to the way in which foreign investment is scrutinised in the UK for national security concerns. The consultation considers two major proposals (which it observes are not mutually exclusive):

- the expansion of the current “call-in” powers to allow the Government to review a broader range of transactions for national security concerns, within a voluntary notification structure; and

- the introduction of a mandatory notification regime for foreign investment in parts of the economy which are critical for national security.
The consultation on the options for longer-term reforms will last for 12 weeks and the deadline for submitting comments is 9 January 2018.

Expanded “call-in” powers

The Government’s proposals entail a separate expanded version of the "call-in" power specifically for national security concerns, modelled on the existing power within the Enterprise Act. This would allow the Government to separately scrutinise a broader range of transactions for national security concerns within a voluntary notification regime, and impose conditions on a transaction or to block it altogether if necessary.

Under this option, the Government would be able to make a special "national security intervention" if national security risks were raised by the acquisition of control over any UK business by any investor (either domestic or foreign). Alongside this would be a second test to cover any alternative means by which an investor could obtain (directly or indirectly) significant influence or control over that business in the UK. This could include, for example, an investor obtaining unrestricted access to sensitive sites or data.

Significantly, the Government notes that this would, in effect, remove the requirement for there to be a relevant merger situation (that is, two enterprises ceasing to be distinct and the thresholds in the Enterprise Act being met). It would also more clearly separate national security vetting processes from normal merger control assessments, which would retain the current threshold tests. In the United States, for example, the CIFIUS foreign investment review process runs alongside but separately to the merger control assessment.

The proposals also consider further extending the Government’s "call-in" powers to cover the acquisition of new projects / start-ups and the sale of bare assets (standalone machinery or intellectual property) if they can reasonably be expected to, in the future, become businesses whose activities may have national security interests. The Green Paper notes this would be a significant extension of the Government's current powers.

Mandatory notification

The second proposal for long-term reform is for the mandatory notification of all foreign investment into sectors of the economy that the Government views as critical to the national security of the UK.

The key sectors in question would include, as a minimum, civil nuclear, defence, energy, telecommunications, and the transport sector. The Government would also expect to include the manufacture of military and dual-use items, advanced technology, and the government and emergency services sectors. The Green Paper also notes that the powers could be expanded in the future to include key new projects / start-ups, specific assets, and even the purchase of particular plots of land (if in proximity to a national security-sensitive site).

Under the proposals, all foreign investment in the specified sectors would require the Government’s approval before the transaction could take legal effect. The Government would have the ability to impose conditions on a deal
or to block it altogether and, if necessary, to unwind transactions that complete before its review (as the CMA can under the current merger control regime).

The Government estimates there would be fewer than 100 transactions a year involving significant foreign investment that would come under the scope of the mandatory regime.

Comments

These proposals form part of a wider trend in developed economies towards greater powers of intervention in foreign investment. This type of regulation is well established in several parts of the world, such as the United States, Australia and Canada, and is becoming increasingly relevant to businesses operating in Europe. Indeed, just last month the European Commission announced similarly themed proposals to boost its foreign investment review powers. The proposals detailed a new framework for scrutinising foreign investment in sectors of national importance such as technology, cybersecurity, nuclear power, and financial services.

The short-term changes proposed by the UK Government (which are separate from the proposed reforms to the Takeover Code recently published by the Takeover Panel) would be the first substantive changes to the merger control thresholds of the Enterprise Act since it came into force nearly 15 years ago. These short-term proposals are narrower in scope than some had predicted and amount to a fairly small and incremental change to the Government’s powers to intervene on national security grounds.

On the other hand, the longer-term proposals are more substantial and, whichever of the reforms (or combination of them) are adopted, would involve a significant revision of the Enterprise Act. In doing so, the Government states that it would retain an independent CMA and a clear separation between competition and national security-related assessments. The proposals also make clear that the Government does not wish to amend the process for other public interest-related assessments, in relation to financial stability or media plurality.

These assurances are welcome and, at least on the face of it, the Government’s powers appear more narrowly targeted than the EU proposals, which are both wider in scope (catching, for example, financial services) and more uncertain in application (affecting projects of “Union interest”). However, the concept of “national security” is not defined precisely in the Green Paper and it remains to be seen how widely the test would be interpreted in the future, in particular once the UK has greater freedom to set its own approach to such issues outside of the EU. The changes could foreshadow an appetite on the
Government’s part to adopt a more protectionist approach in the future and raise the risk of greater political interference in a range of sectors, leading to greater uncertainty and complexity for businesses.