

UK Adopts New Powers To Investigate Smaller Transactions Raising National Security Concerns

The expansion of the UK government's foreign investment review powers will require additional scrutiny of potential deals for the early identification of additional steps in the regulatory approval strategy.

Key Points:

- The new UK rules are part of a wider global trend, with heightened scrutiny of foreign investment control increasing in a number of other jurisdictions.
- The UK government may further expand its powers in the longer-term as a result of its ongoing review of its foreign investment control regime.

On 11 June 2018, the UK government gained new powers to review M&A transactions raising potential national security issues if the target business is active in the production of military or dual-use goods, computing hardware, or quantum technology for supply in the UK. The government may intervene if the target business' UK turnover is as low as £1 million, or if the target business has a share of supply of goods or services within the relevant areas of at least 25%. While these powers will apply to only a limited subset of transactions and do not give rise to mandatory notification requirements, the application of the new powers will require careful scrutiny during the due diligence phase of transactions that are potentially within scope. The new thresholds are the result of the government's ongoing review of its foreign investment review powers, which may result in a further expansion of governmental powers in the longer-term.

This expansion of the UK government's powers aligns with recent global trends. The US, Canada, Germany, and the European Union have all begun expanding and/or more aggressively enforcing their foreign investment review powers. Companies pursuing transactions in cross-border deals that implicate potentially sensitive business areas should carefully consider whether the transaction is or may be subject to foreign investment review, and prepare an appropriate engagement strategy with relevant regulatory stakeholders in the pertinent jurisdictions.

Background

According to the current UK foreign investment control or "public interest" regime under the Enterprise Act 2002 (the Enterprise Act), the UK government can review transactions that involve a change of control and that raise potential public interest concerns if:

- Either of the following conditions are satisfied:
 - The target business' UK turnover exceeds £70 million
 - The parties have a combined share of supply of goods or services in the UK of at least 25%
- The transaction raises a public interest concern as specified in the Enterprise Act, namely:
 - National security
 - Media plurality
 - The stability of the UK financial system

More exceptionally, the UK government may also review transactions that fall below the jurisdictional thresholds outlined above, if the target business is a government contractor that holds or receives confidential defence-related information, or if the transaction falls within the European Commission's jurisdiction but raises specific public interest concerns within the UK.

The UK's Competition and Markets Authority (CMA) administers the current UK public interest regime on behalf of the UK government. The CMA carries out its own merger control review, but reports to the relevant Secretary of State—who is the ultimate decision-maker on the public interest aspects of the transaction. The current regime will continue to apply to transactions falling outside the three areas to which the new rules apply.

The New Rules: What Will Change?

Following the recent amendments to the Enterprise Act, the UK government will gain new powers under the UK public interest regime to review smaller transactions that involve a change of control—but do not fall within the current regime—if the following conditions are met:

- The target business is a “*relevant enterprise*” defined under the new section 23A of the Enterprise Act as a business that carries out one of the following three activities:
 - Development or production of items for military use or for military and civilian use
 - Design and maintenance of aspects of computing hardware
 - Development and production of quantum technology
- If either of the following conditions are satisfied:
 - The UK turnover of the target business exceeds £1 million
 - The target business has a share of supply of goods or services within the one of the relevant areas in the UK of at least 25%
- The transaction raises potential national security concerns

The definition of the activities of a relevant enterprise under the new section 23A of the Enterprise Act is complex and potentially broad. Consequently, potential purchasers may need to adopt a cautious

approach in assessing the risk of intervention. In addition, the amendments to the Enterprise Act lower the current level of UK turnover required of the target business from £70 million to £1 million and dispense with the requirement that both the purchaser and the target business must supply the relevant goods or services of which they have a combined share of at least 25%. Under the new thresholds, if the target business alone has a share of at least 25% of goods or services within one of the relevant areas outlined above this will be sufficient, without the necessity for an increment from the acquirer's activities. Finally, while the government could theoretically intervene based on any of the public interest grounds under the Enterprise Act, the rationale for the new rules relates to national security concerns, and the government has said that it does not envisage intervening on other grounds.

The CMA will remain responsible for administering the UK public interest regime if the Secretary of State has raised potential public interest concerns—in particular, through the issuance of a public interest intervention notice (PIIN)—under its existing or new powers under the Enterprise Act. In parallel to its primary merger control review under the Enterprise Act, the CMA will continue to report on the public interest aspects the transaction raises. Notably, while the CMA will theoretically have expanded powers to review transactions caught by the new thresholds for potential competition concerns, the government has acknowledged that these transactions are unlikely to raise separate competition concerns.

The amendments to the Enterprise Act do not give rise to any mandatory reporting requirements, and notification under the UK public interest regime—as with the general UK merger control regime—remains voluntary. That said, the application of the new rules will require careful scrutiny during the due diligence phase of transactions potentially within scope. If a transaction involving a relevant enterprise raises potential national security issues, the purchaser will need to decide whether to approach the relevant government department prior to completion. If the purchaser decides against this, the Secretary of State will have up to four months post-closing to issue a PIIN.

While the amendments to the UK public interest regime considerably expand the government's powers to investigate transactions raising potential national security concerns, interventions under the UK public interest regime remain the exception. To date, under the current regime, the government has intervened in respect of just seven transactions on national security grounds under the Enterprise Act. Under the new rules, the government has indicated that it expects to intervene in up to six transactions per year that give rise to potential national security issues. The exact impact of the new rules remains to be seen, and an initial teething period in the application of the new thresholds is likely to be inevitable.

Broader Context

The new UK rules are part of a wider global trend towards tightening foreign investment control in a number of key jurisdictions. Some of the recent developments include:

- In July 2017, the German government introduced a mandatory notification requirement for non-EU investment, including minority investments of 25% or more, in critical infrastructure and security-related technologies. The German government also expanded the previous notification obligations for non-EU investment in defence and encryption technologies, both of which the German Federal Ministry for Economic Affairs and Energy has the power to block if the transaction raises public policy or security concerns.
- In September 2017, the European Commission proposed a new EU framework for screening and coordinating EU Member States' review of foreign investment into the EU in strategic industrial and technological industries—the exact scope of which is currently being debated—that raises security or

public order concerns. The European Council and European Parliament are currently reviewing the proposal.

- In the US, the number of transactions reviewed by the Committee on Foreign Investment in the United States (CFIUS)—which has broad powers to exercise tight control over foreign investment in US businesses that raises national security concerns—has continued to increase in recent years. CFIUS also appears to be taking a more interventionist stance under the current administration in pursuing transactions. This was exemplified by CFIUS' recent prohibition in March 2018 of Broadcom's attempted acquisition of Qualcomm, which the Trump administration asserted was a national security concern. In addition, recent proposals have been introduced in the US Congress to expand the scope of CFIUS' jurisdiction.
- In May 2018, the Canadian government prohibited the proposed acquisition of Aecon Group Inc. (Aecon) by China Communications Construction Co Ltd, in which the Chinese government is a majority investor, on national security grounds. While the Canadian government has not published any specific details about its decision, various public statements imply that Aecon supplies both the military and nuclear industries and that the Canadian government may have had concerns about intellectual property protections.

In light of the new UK rules and the similar trends towards increased foreign investment review in other jurisdictions, parties pursuing M&A transactions in sensitive industries should carefully consider the impact of potential foreign investment review on both the timing and the ultimate probability of successfully closing the transaction. In particular, parties will want to identify national security issues as early as possible in their deal analysis and affirmatively engage with counsel to develop a strategy for engaging with and (if possible) resolving the concerns of the relevant regulatory stakeholders.

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