ALERT MEMORANDUM

UK Government Proposes National Security and Investment Regime

August 10, 2018

On July 24, 2018, the UK Government published proposals for legislative reform that would give it significantly greater powers to intervene in UK transactions on national security grounds.[1]

- The national security review would be separate from review by the Competition and Markets Authority, and would go beyond merger control, applying to a wide range of "*trigger events*."
- The Government's ability to intervene would not be limited to specific sectors, although certain sectors are identified as being "*more likely to raise national security concerns*."
- If "*called in*" by the Government for detailed review (whether having been notified voluntarily for an initial "*screening*" or not), transactions could not close prior to securing approval. Completed transactions could be called in within six months.
- In-depth review would take up to 30 working days, but the Government could "*stop the clock*" while parties respond to information requests. The review period could be extended by 45 working days if a national security risk is identified and further scrutiny and consideration of remedies is required.
- Decisions would be made by a "*Senior Minister*" (Secretaries of State, the Chancellor, or the Prime Minister), with powers to impose "*such remedies as [are] necessary and proportionate.*"

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The UK Government has stated on several occasions that it intends to do more to protect strategically important UK businesses from takeovers by overseas companies. These comments have been seen, in part, as a response to Brexit, which is likely to give the UK greater freedom to determine its own merger policy than is currently permitted under EU law. They also follow the debate on foreign investment in the Hinkley Point nuclear power station, the *Hytera/Sepura* and *GKN/Melrose* transactions, where the Government required undertakings to address national security concerns, the attempted takeover of AstraZeneca by U.S. company Pfizer in 2014, and wider public concerns about national defence and cyber security.

This Alert Memorandum summarises the proposals and the possible implications.

[1] *See* https://www.gov.uk/government/consultations/national-security-and-investment-proposed-reforms.

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Current Regime

There are currently no specific controls on foreign investment in the UK. The Government can intervene on public interest grounds only if there is a merger (by which two businesses "*cease to be distinct*"). Such intervention is also restricted, in most circumstances, by revenue and share thresholds. Political interference in merger control has been limited since the introduction of the Enterprise Act 2002. Decisions are taken on technical competition grounds by the Competition and Markets Authority ("CMA," a non-executive government agency) and, in some cases, by Inquiry Groups of independent Panel Members. The Government can intervene directly in only three types of merger.

— **Public interest cases.** The Secretary of State can intervene in mergers that meet the UK thresholds and also raise public interest considerations concerning national security, plurality of the media, or the stability of the UK financial system. The thresholds are lower in respect of transactions involving firms that develop or produce items for military use, computer hardware, or quantum technology.

— **Special public interest cases.** Some mergers that do not meet the UK thresholds may still be investigated on public interest (but not competition) grounds. They are limited to mergers involving "government contractors" holding confidential information relating to defence and certain mergers in the newspaper and broadcasting sectors.

— **EU Mergers.** Certain mergers that fall within the scope of the EU Merger Regulation can also be reviewed on public interest grounds at national level. Under the EU Merger Regulation, Member States may take "*appropriate measures*" to protect public security, the plurality of the media, and prudential rules. Any other public interests must be approved by the European Commission on a case-by-case basis.

Therefore, currently the Government can intervene on public interest grounds in mergers that do not qualify for review under competition law only on *special* public interest grounds. If the transaction does not qualify as a merger, the Government's powers to intervene are even more limited (*e.g.*, the revocation of licences in regulated industries).

2017 Consultation

In October 2017, the Government published initial proposals for short-term and long-term reform.[2] The short-term reforms came into effect on June 11, 2018, lowering the jurisdictional thresholds in respect of transactions involving firms that develop or produce items for military use, computer hardware, or quantum technology.[3] As a result, the Government is now able to intervene in mergers in these sectors where the target's UK turnover exceeds £1 million (substantially lower than the £70 million threshold that applies to other sectors) or the target has a UK share of supply of at least 25% (even where the combined share will not increase as a result of the merger).

The October 2017 paper also set out a wide range of possibilities for the direction of long-term reform, including the introduction of a mandatory merger control regime. Following an initial consultation period, the Government has now published more developed proposals, focused on a voluntary notification regime that would be distinct from assessment either on competition grounds or on the public interest grounds currently set out in the Enterprise Act 2002. The proposed new regime would allow the Government to intervene on national security grounds in respect of a far wider range of transactions, in any sector, and regardless of whether thresholds for the target's turnover or share of supply are met. The current consultation period will close on October 16, 2018.

[2] *See* https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/2017/publications/alert-memos/uk-government-proposes-greater-intervention-in-national-security-10-24-17.pdf.

[3] *See* https://www.clearygottlieb.com/-/media/files/alert-memos-2018/uk-introduces-new-thresholds-for-national-security-mergers-pdf.pdf.

Overview of the Proposed New Regime

Under the proposed new regime, national security review of foreign investment would be separate from a competition assessment and would not involve the CMA. Decisions would instead be taken by a Cabinet-level minister (Secretaries of State, the Chancellor, or the Prime Minister). The new regime is similar in many ways to the U.S. inter-agency Committee on Foreign Investment in the United States ("CFIUS").[4]

National Security

The scope of "*national security*" is explained in a draft statutory statement of policy intent (the "Policy Statement") published together with the White Paper.[5] The Policy Statement states that the mechanisms described in the White Paper are limited to national security as distinct from either the national or public interest, but acknowledges that the Government does not attempt to define the term precisely. National security threats may include acts of terrorism or actions of hostile states related to:

— Cyber-warfare;

— Supply chain disruption of certain goods or services;

— Disruptive or destructive actions or sabotage of sensitive sites; and

— Espionage or leverage.

The regime is not limited to any particular sector, although the Policy Statement identifies four aspects of the UK economy as being particularly likely to give rise to national security risks:

— Core national infrastructure sectors (the civil nuclear, communications, defence, energy, and transport sectors);

— Certain advanced technologies (including computing, networking and data communication, and quantum technologies);

— Critical direct suppliers to the Government and emergency services sectors; and

— Military or dual-use technologies.

Trigger Events

As noted above, the new regime would allow the review of a far wider range of transactions than existing legislation. The "*trigger events*" that may be reviewed on national security grounds are proposed to include the following.

1. The acquisition of more than 25% of the voting rights, shares or equivalent ownership rights in an entity, whether as a single or series of transactions.
2. The acquisition of significant influence or control over an entity. This is widely conceived to include formal rights in addition to a practical ability to influence or control.
3. The acquisition of further influence or control over an entity above the thresholds in (i) and (ii), potentially at other specific milestone thresholds such as the acquisition of 50% of 75% of shares or voting rights or the acquisition of new corporate governance rights.
4. The acquisition of more than 50% of an asset, including acquisitions of land that may give rise to national security risks due to their proximity to sensitive locations.
5. The acquisition of significant influence or control over an asset (which may include licences, intellectual property rights and practical or informal exercise of control).

A loan may constitute a trigger event under item (ii) or (v) above (at agreement, default, or acquisition of collateral, depending on the circumstances) if the lender obtains significant influence or control over sensitive collateral. In addition, connected persons may be treated as one with respect to a trigger event.

The legislation would be focused on protecting the UK's national security, but the Government would

[4] For further information see, for example, Recent Revisions to Exon-Florio "National Security" Reviews of Foreign Investment in the United States (Dec. 22, 2008) and Congress Passes CFIUS Reform Bill (August 7, 2018).

[5] *See* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728311/20180717_Statement_of_policy_intent_-_shared_with_comms.pdf, pages 15-22.

have the power to call in trigger events relating to entities incorporated outside of the UK, assets located outside of the UK, and rights governed by foreign law.

Notification of a Trigger Event

If a trigger event is either contemplated or in progress, the parties to the transaction may make a voluntary notification to the Government. Parties may enter into informal discussion with the Government about specific trigger events. Where a trigger event is notified, the Government will ask for detailed information about the trigger event (including its purpose and expected date) and the acquirer (including details of other investments). The Government would undertake a preliminary "*screening*" review lasting 15 working days, which may be extended for an additional 15 days for complex cases. The Senior Minister would then decide whether to "*call in*" the trigger event or not. A decision to call in a trigger event would be made public.

Calling-in of a Trigger Event

Chapter 7 of the White Paper describes the process by which the Government would call in trigger events, either following screening after a voluntary notification or otherwise. Completed transactions could be called in within six months. Following a call-in notice, the parties to the transaction must provide any information required by the Government and the trigger event must not occur until approved (although preliminary or preparatory steps towards it make be taken). In the event that the Government is assessing a trigger event that has already taken place, once it has been called in, parties must not take any further measures that increase the acquirer's control, nor take steps that would make it more difficult for the trigger event to be unwound. The Government may impose additional interim restrictions (limited to the prohibition of either the sharing of specific information or access to specified sites) where relevant.

The Government would have up to 30 days to assess any trigger event. If it is determined that there is a risk to national security and that further consideration is necessary, the period may be extended by up to an additional 45 days.

Remedies to Protect National Security

Chapter 8 of the White Paper describes the various measures the Government may take, which could include blocking transactions, limiting access to certain sites, and carving-out divisions or assets of a business. The White Paper proposes that conditions may only be imposed if: the Government reasonably believes a national security risk is posed and it is necessary to impose a condition; the remedy is proportionate to the risk; there are no more adequate or proportionate powers available to the Government; and the Government has considered representations from the parties.

Sanctions for Non-compliance

Chapter 9 of the White Paper describes the new criminal offences and civil sanctions for breaches of requirements to be introduced by the Government, which may be in addition to more flexible administrative penalties (such as director disqualification). A maximum custodial sentence of five years will be available for most offences. Breaches of some information-gathering powers will attract lesser sanctions. Civil fines could also be imposed (up to 10% of worldwide turnover for a business, or up to 10% of total income (or £500,000, whichever is higher) for an individual).

Judicial Review

The White Paper sets out the plans for judicial review and appeal procedures in Chapter 10. It makes clear, however that judicial scrutiny of substantive decisions by Senior Ministers would be limited to strict judicial review grounds because it "*is right that decisions made to protect our national security are made by those directly accountable to Parliament. It would not be appropriate for courts to supplant ministers' decisions.*"

Interaction with Enterprise Act 2002 and EU Merger Regulation

A trigger event might also constitute a relevant merger situation under the Enterprise Act 2002 and therefore need to be assessed in relation to its impact on competition and (where relevant) specific public interest grounds, as well as its national security risks under the new regime.

In such cases, the White Paper states that the Government "*will not interfere in the CMA's deliberations on establishing a trigger event's merits on competition grounds*." The Government will, however, have the power effectively to overrule the CMA in circumstances where the decisions of the CMA and the Government are incompatible (if, for example, "*the Government concludes that a merger should go ahead notwithstanding the CMA's conclusion that it would be harmful to competition*").

The Government considers that the new regime can work within the parameters of the current EU rules. The White Paper states that the Government could block or remedy a transaction that is permitted by the European Commission, but recognises that the Government could not force through a transaction that is blocked by the Commission.

Implications of the Proposed New Regime

The next stages of the consultation process may provide additional clarity on the proposed new regime. It is already clear, though, that any regime similar to that contemplated may have important implications.

First, unless substantially amended following the consultation period, which seems unlikely given the Government's public statements on industrial strategy, the proposed new regime will introduce additional complexity and uncertainty, including the possibility of delay, remedies, or prohibition for transactions subject to CMA review, as well as transactions that would not otherwise require regulatory approval prior to closing.

Second, experience from the United States suggests that the new regime will require a sophisticated government apparatus to review transactions, particularly as national security risks often relate to complex technologies that require expert and up-to-date analysis (CFIUS, for example, has in recent years focused on the fast-moving microelectronics industry).

Third, in the immediate term, there may be uncertainty surrounding the implementation of the new regime due to the UK's withdrawal from the European Union, either in March 2019 or after an "*implementation period*" ("Brexit"). Although the Government considers that the new regime can work within the parameters of the current EU rules, it is not clear how the regime would interact with a new EU-wide foreign direct investment screening regulation proposed in September 2017.[6] The Government has stated it will "*carefully consider*" what this new regulation, which might apply temporarily to the UK if introduced prior to Brexit, would mean for the proposed new regime. Further, post-Brexit, the Government might have increased freedom to direct its own national security priorities, which are likely to be less closely aligned with the single market.

Finally, the interaction between the proposed regime and the Enterprise Act 2002, Takeover Code, and EU Merger Regulation will in any event need to be set out in greater detail. There is a risk that the proposed regime would introduce additional delay to what is already a lengthy merger control process. There is also a risk that, in case of parallel review, the Government may be tempted to put pressure on the CMA to take a decision on its competition assessment that is consistent with the Government's decision on national security. With respect to the Takeover Code, it is not yet clear whether reviews under the new regime, following a takeover transaction being called in, will be given the same special status as Phase II CMA and European Commission reviews, or will be treated in the same way as other, non-CMA or European Commission reviews. However, the Government has stated that it "*will work closely with the Takeover Panel to consider how the proposed reforms would interact with the Takeover Code. This will include exploring with the Panel whether it judges any updates are needed to the timetable and process for the completion of takeovers to ensure that the new regime works effectively with the Takeover Code*."

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[6] https://eur-lex.europa.eu/resource.html?uri=cellar:cf655d2a-9858-11e7-b92d-01aa75ed71a1.0001.02/DOC_1&format=PDF