

UK Introduces New Thresholds for National Security Mergers

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On March 15, 2018, the UK Government published new merger thresholds to allow greater intervention in transactions raising national security concerns. The new thresholds will apply to firms that develop or produce items for military use, computer hardware, or quantum technology. The Government will be able to intervene in mergers in these sectors where the target's UK turnover exceeds £1 million or the target has a UK share of supply of at least 25% (even where that share will not increase following the merger).

The UK Government has stated on several occasions that it intends to do more to protect strategic UK businesses from takeover. These comments have been seen, in part, as response to Brexit, which is likely to allow the UK greater freedom to determine its own merger policy than is currently permitted under EU law. They also follow the debate surrounding foreign investment in the Hinkley Point nuclear power station, the Hytera/Spura merger in 2017, where the Government required undertakings to protect sensitive information and technology used by the UK emergency services, the proposed acquisition of GKN by Melrose, and wider public concerns about national defence and cyber security.

The Government issued consultations on two sets of proposals in October 2017.¹ The first involved adjustments to the existing UK merger thresholds that could be introduced quickly and without the need for primary legislation. The second would entail more fundamental changes to the regime in the longer term. The Government has now decided to implement the short-term proposals, subject to minor amendments following its consultation. Parties will soon have to consider notifying transactions that do not currently qualify for review if they involve targets in one of the three prescribed sectors. The Government is still considering the responses to its consultation on the proposals for longer-term reform before deciding whether to introduce more significant changes.

This Alert Memorandum summarises the changes and their possible implications for businesses.

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¹ See Cleary Gottlieb Alert Memo [UK Government Proposes Greater Intervention in National Security and Infrastructure Mergers](#), October 2017.



Background

The UK has a voluntary merger control regime. Parties are not required to notify qualifying transactions but the Competition and Markets Authority (CMA) can investigate a merger if one of two jurisdiction thresholds is met:

- The target's UK turnover exceeds £70 million; or
- The parties' activities overlap and they have a combined UK share of supply or purchases of at least 25%.

Transactions falling within the scope of the EU Merger Regulation are reviewed by the European Commission under the "one-stop-shop" principle, depriving the CMA of jurisdiction, although this is likely to change after Brexit.

Since the introduction of the Enterprise Act 2002, UK merger control has been largely free from political interference. Decisions are taken on technical competition grounds by the 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 case and, other than special public interest cases, cannot intervene on public interest grounds unless the transaction also qualifies for merger review under competition law.

- **Public interest cases.** The Secretary of State can intervene in mergers that meet the UK jurisdiction thresholds and also raise public interest considerations concerning national security, plurality of the media, or the stability of the UK financial system. The Secretary of State has the power to add other public considerations to this list by order (subject to approval by Parliament).
- **Special public interest cases.** Some mergers that do not meet the UK jurisdiction 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.

These powers have been used sparingly. To date, the Government has intervened in only 12 cases under these powers, seven on grounds of national security. Following Brexit, the UK is likely to have greater freedom to intervene in cases falling within the scope of the EU Merger Regulation on a wider range of public interest grounds than is currently permitted.²

The New Jurisdictional Thresholds

The reforms announced this month are limited to the protection of national security (albeit widely defined). They are intended to address perceived deficiencies in the current regime. In particular, the Government is concerned about the threat of cyber warfare and about the ownership of companies developing technologies that could be put to military or hostile use. Since the new rules apply only to cases involving national security, they should be compatible with the EU Merger Regulation and can be implemented before Brexit.

The reforms will lower the threshold for Government intervention in mergers in three prescribed sectors. They will be introduced by statutory instrument and will come into effect following Parliamentary approval.

Under the new rules, mergers in the prescribed sectors will qualify for review on competition and public interest grounds if:

- The target's UK turnover exceeds £1 million; or

² See Cleary Gottlieb Alert Memorandum [Industrial Strategy Post-Brexit: The UK's Power To Block Mergers On Public Interest Grounds](#), July 2016.

- The target has an existing UK share of at least 25% (regardless of whether that share of supply would increase as a result of the merger).

These thresholds, which supplement the existing turnover and share of supply thresholds, will apply to firms involved in:

- The development or production of items for military use (including “dual use”);
- The design and maintenance of aspects of computing hardware; and
- The development and production of quantum technology.

Under the new rules, a merger involving one of these sectors could in principle be reviewed on purely competition grounds or for any relevant public interest consideration. The Government has nevertheless indicated that it does not expect to review transactions under the new thresholds unless they raise national security considerations. It has also published draft Guidance on how the new rules will be applied in practice.³

The CMA has similarly published draft Guidance indicating that it does not expect the new thresholds to result in any material changes to the types of cases it calls in for review on competition grounds.⁴ Cases raising horizontal competition concerns would already meet the existing share of supply thresholds and non-horizontal concerns are relatively unlikely to arise in cases where the target’s turnover is below £70 million. The CMA does not rule out the possibility of intervening in transactions under the new rules on purely competition grounds, however, and so cases could be called in for review even where they do not raise national security concerns.

The military and dual-use sector

Military and dual-use technologies cover the design and production of military items and “dual-use”

items (items that can be used for both military and civil purposes).

A firm will fall within the military or dual-use sector if it is involved in the production of goods listed on the one of the following Strategic Export Control Lists: the UK Military List; the UK Dual-Use List; the UK Radioactive Source List; or the EU Dual-Use List. These lists identify products, software and technology that are considered to carry national security risks, and which cannot be exported from the UK without a licence from the Export Control Organisation.⁵

The new provisions extend to businesses that:

- Develop or produce any of these goods or services; or
- Hold information (including information comprised in software) that is “*capable of use in connection with the development or production of these goods and the information is responsible for achieving or exceeding the performance levels, characteristics or functions*” of the good or service on one of the lists.

The new thresholds will not apply to goods that are subject to temporary export controls, nor will they apply to items that are later added to the export control lists unless until they are specifically included within the merger rules by statutory instrument.

The Government advises firms to use its online “Goods Checker Tool” to check whether their products qualify for review under the new thresholds⁶ and will also provide informal non-binding advice on a case-by-case basis.

Computing hardware

The new thresholds will apply to firms involved in:

- The ownership, creation or supply of intellectual property relating to the functional capability of

³ Draft BEIS Guidance *Enterprise Act 2002: Changes To The Turnover And Share Of Supply Tests For Mergers*, March 15, 2018.

⁴ See draft *CMA Guidance on changes to the jurisdictional thresholds for UK merger control*, March 15, 2018.

⁵ The Strategic Export Control Lists are published at: <https://www.gov.uk/guidance/uk-strategic-export-control->

[lists-the-consolidated-list-of-strategic-military-and-dual-use-items](#)

⁶ The Goods Checker Tool is available at: <https://www.ecochecker.trade.gov.uk/spirefox5live/fox/spire/> Guidance on how to use the Goods Checker Tool is published at: <https://www.spire.trade.gov.uk/docs/guidance/Goods%20Checker%20Guidance.pdf>

- (i) computer processing units, (ii) the instruction set architecture for such units, or (iii) computer code that provides low level control for such units; or
- The design, maintenance or provision of support for the secure provisioning or management of
 - (i) roots of trust of computer processing units, or
 - (ii) computer code that provides low level control for such units.

“Roots of trust” is defined as *“hardware, firmware, or software components that are inherently trusted to perform critical security functions, (including, for example, cryptographic key material bound to a device that can identify the device or verify a digital signature to authenticate a remote entity).”*

The Government is concerned that, with advances in technology, there are ubiquitous goods with the potential to be directed remotely. The new rules are intended to prevent businesses developing those technologies from falling into the control of “hostile actors” and giving access to knowledge or expertise that could be used in cyber warfare or otherwise undermine UK national security.

While potentially capturing a large number of transactions, the definition computer hardware is narrower and more focused than originally proposed. The October 2017 Green Paper proposed extending the new thresholds to all “multi-purpose computing hardware.” The Government has accepted that the original definition was too wide and was potentially confusing.⁷

Quantum technology

The Government’s proposals highlight the potential for quantum technology to give vehicles and weapons systems additional capabilities that could “transform military power.” It is also concerned about the potential for quantum technology to be used to break otherwise secure computer and telecommunications systems.

The new merger rules will therefore apply to firms involved in:

- Quantum computing or simulation;
- Quantum imaging, sensing, timing or navigation;
- Quantum communications; or
- Quantum resistant cryptography.

The revised thresholds will apply to businesses that research, develop, or produce goods designed for use in these activities, or which supply services employing these activities. They extend to firms involved in all stages of the development process, including the creation of intellectual property, as well as to firms supplying quantum technology components or offering services (such as consultancy advice, or data analysis) which use quantum-based technology. They do not extend to firms that only use quantum technologies (e.g., pharmaceutical companies that use quantum computing to develop new products).

Options for Longer-term Reform

In addition to the present reforms, the Government is considering further options for longer term reform, which would allow even greater scope for intervention in transactions on national security grounds. It is considering two broad options.

Voluntary regime with expanded “call in” power

The first option would retain a purely voluntary merger regime, but with greater scope for intervention on national security grounds. Under this proposal, the Government would be able to intervene in the *“acquisition of significant influence or control over any UK business entity by any investor (either domestic or foreign)”* in any sector, and in *“any other transaction that gives (directly or indirectly) significant influence or control over that company or over its assets or businesses in the UK.”* Any acquisition of more than 25% of a company’s shares or voting rights would qualify for review, as could the acquisition of *“unrestricted access to*

⁷ See [National Security & Infrastructure Investment Review, Government response to its consultation on short-term proposals](#), March 15, 2018.

sensitive sites or data.” The powers could also extend to new projects and the sales of bare assets.

Mandatory notification regime

As an alternative to (or in combination with) the extension to the voluntary regime above, the Government is considering introducing a mandatory notification regime for foreign investment into the provision of a focused set of “essential functions.” This could include investments in new projects or specific assets, and also the acquisition of land that is in proximity to a national security-sensitive site, where foreign ownership or control of the land, buildings or other fixed structures could give rise to a national security risk (*e.g.*, from espionage or sabotage).

A mandatory notification regime would apply to companies:

- Which undertake, or are crucial to the undertaking of, the essential functions that are critical to ensuring national security;
- Where foreign ownership or control poses a risk which there are no other reasonable means of adequately mitigating; and
- Where existing licensing or regulatory regimes are insufficient.

Of the 13 sectors that comprise the UK’s national infrastructure, there are five that the Government is “*strongly minded*” to define as “*essential functions, automatically bringing companies within the scope*” of a mandatory regime. These are:

- Civil Nuclear (*e.g.*, operation of reactors);
- Communications (*e.g.*, voice/data infrastructure, if impairment could deprive more than one million end users of network);
- Defence (companies with facilities on List X or issued with a Security Aspects Letter);
- Energy (*e.g.*, “Energy suppliers that provide energy to significant customer bases”); and
- Transport (*e.g.*, air traffic control services).

The proposed mandatory regime would also apply to the manufacture of military and dual-use items and advanced technology, and might be expanded to

cover “*certain named individual businesses or assets.*”

Comment

The new merger thresholds will inevitably create additional burdens for firms acquiring business operating in any of the prescribed sectors. Although the CMA has indicated that it is unlikely to call in transactions have not been notified on purely competition grounds, it will have to investigate cases that are notified voluntarily. It is also required to notify the Secretary of State if it believes that a merger raises public interest considerations.

Firms will therefore need to assess whether to submit a voluntary merger filing, triggering a formal merger investigation and potentially a public interest investigation, in cases where no investigation is required today. A firm that decides not to notify its transaction risks intervention after the merger has completed. In making this assessment, parties will have to consider whether any public interest considerations are likely to arise separately from any competition assessment.

The Government’s draft Guidance provides some assistance in assessing whether a transaction could raise national security concerns, but cases will inevitably turn on individual facts, including the identity of the purchaser, the rights they will acquire over the target business, and any safeguards that are in place to protect sensitive information or technology. The draft Guidance encourages parties to inform the Government of possible transactions falling within the scope of the rules in advance, to discuss any public interest considerations on a confidential informal basis:

“The Government welcomes parties’ informal notification of mergers with potential national security concerns as early as possible. This can allow it to begin its assessment process. Where relevant, it can also allow Government to say that it has no national security concerns with a deal so that parties can choose to proceed. However, such a declaration is not binding on Government as other information may come to light, or relevant circumstances may change.”

While informal guidance is to be welcomed, it will still fall to the parties to make the final decision

whether to notify transactions to the CMA or take the risk of completing without clearance.

The Government's Impact Assessment concludes that the new rules will have limited effect on the number of cases reviewed. It estimates that between five and 29 additional mergers will fall within the scope of the public interest rules each year. Of these, between two and 12 cases are expected to require at least informal investigation, and around half of these cases (one to six cases) are expected to create a sufficient risk to national security for the Secretary of State to issue a public interest intervention notice and initiate a formal investigation.

The Impact Assessment estimates the likely financial costs of these additional cases on Government, the CMA and business to be in the region of £1.1m per year, and no higher than £1.8m per year. It concludes that the enhanced ability to identify, mitigate and thereby avoid potential risks to national security outweigh these additional costs.

If these figures turn out to be correct, they suggest that the new rules will have only a fairly limited impact on business. These figures may, however, understate the potential impact of these changes if they presage a readiness on the Government's part to intervene in more merger cases on national security grounds. Transactions that already fall within the scope of the merger rules and that involve computer technology or products capable of military use can also expect greater scrutiny.

Finally, the proposals for longer terms reform still being considered by the Government suggest that a far greater number of transactions could soon be subject to review and intervention, including transactions that do not qualify for merger review under competition law.

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