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## INSIGHT: Reform on the Horizon for the U.K.'s National Security Regime



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### Introduction

On July 24, 2018, the UK government's Department for Business, Energy and Industrial Strategy released a white paper titled "National Security and Investment" (the "White Paper") that sets forth the UK's latest proposal for dealing with investments and acquisitions that may present national security concerns. The White Paper describes a regime designed to install regulatory safeguards to protect the UK's national security while simultaneously ensuring that the UK economy remains open to foreign investment. If enacted, the reforms proposed in the White Paper will bring the UK's foreign investment regime closer to that of other countries (such as the United States, Germany, Australia, and Japan), and will provide the government with more extensive tools to address national security risks.

After providing a brief background on the existing regime, this article highlights some important features of the new national security regime proposed by the White Paper.

### 1. How Does The UK Currently Address National Security Concerns That Arise In Mergers And Acquisitions?

#### a. Enterprise Act 2002

At present, the ability of the UK government to intervene in transactions that may present national security concerns is contained in the Enterprise Act 2002 ("Act"). Overseen by the Competition and Markets Authority ("CMA"), the Act is the UK's primary merger control legislation, governing the review of mergers and acquisitions from an anti-trust perspective.

Section 42(2) of the Act authorizes the Secretary of State to issue an intervention notice to the CMA if he believes that one or more public interest

considerations—which include national security—are relevant to a merger situation. Historically, intervention in mergers on public interest grounds only has been possible for transactions that qualified for review by the CMA, where: (1) the target's UK turnover exceeds £70 million; or (2) the transaction results in the combined entity having a 'share of supply' of goods or services of at least 25 percent in the UK (or in a substantial part of the UK). For this second test to be met, the transaction must give rise to an increment in the "share of supply" above 25 percent; therefore, where the merging parties do not have any overlapping activities in the UK, this test would not be met.

In the past, the Secretary of State has rarely intervened due to national security concerns. There have only been twelve public interest interventions since the Act came into force, of which only seven have been on national security grounds.

#### b. Revision of the Enterprise Act 2002

In June 2018, the UK government amended the Act to lower the thresholds applicable to mergers of "relevant enterprises," which are defined as companies active in the development or production of items for military or dual use goods, quantum technology, and computing hardware.

Under this modified regime, the jurisdiction of the Act is extended to any merger involving "relevant enterprises" where: (1) the target's UK turnover exceeds £1 million; or (2) the transaction results in the combined entity having a "share of supply" of goods or services of at least 25 percent in the UK (or in a substantial part of the UK). Importantly, for the second test to be met, there is no requirement for there to be an increment in the share of supply, so the test would be met if the target business alone held a share of supply of 25 percent or more.

Significantly lowering the turnover threshold for mergers of “*relevant enterprises*” means that a greater number of mergers and acquisitions are potentially subject to review by the Secretary of State. If the Secretary of State elects to intervene, he will issue a Public Interest Intervention Notice. The Secretary of State will then decide whether to make an adverse public interest finding based on national security considerations or any other relevant public interest factor (i.e., financial stability or media plurality), which is separate and apart from the CMA’s competition analysis. The Secretary of State will also determine what remedies, if any, are necessary to address the public interest/national security concerns.

## **2. What Is The New UK National Security Review Regime?**

The changes to the Act described above are only intended to be an interim measure while the UK government designs and establishes a more robust national security regime. During the last year, the UK has taken steps to initiate this new regime. Following the publication of a Green Paper in 2017, the UK government issued both a White Paper and Draft Statutory Statement of Policy (“Statement of Policy”). In these documents, the UK government proposes a new framework that will transform how the UK assesses and manages national security risk arising from certain types of investments and acquisitions.

Key points of the proposed regime include:

**Trigger Events:** The government will have the authority to review transactions involving certain “trigger events.” There are no monetary or market share thresholds, instead trigger events will include any investment or activity that involves the acquisition of:

- more than 25 percent of an entity’s shares or votes;
- significant influence or control over an entity; or
- further acquisitions of significant influence or control over an entity beyond the above thresholds.

The proposal authorizes the UK government not only to scrutinize investments in companies or businesses, but also acquisitions of assets that have national security implications. The definition of “asset” is broad and includes real and personal property, contractual rights and intellectual property rights. In certain circumstances, acquisition of interests in new projects and loans may also give rise to national security concerns. Trigger events in relation to such assets would be:

- acquisition of more than 50 percent of the asset; or
- significant influence or control over the asset.

**Trigger Events Are Not Limited To Foreign Investments Or Acquisitions:** The trigger event criteria do not necessarily apply exclusively to investments or acquisitions made by non-UK persons. Indeed, under the proposed regime, investments, or acquisitions solely involving entities that are owned, controlled, and domiciled in the UK could be subject to national security review.

**Trigger Events Are Applicable To Entities / Assets Outside the UK:** This new regime is designed to safeguard UK national security, so trigger events involving UK-based entities and assets are most likely to present UK national security risk. However, the White Paper expressly states that trigger events involving overseas entities and assets could still threaten UK national security. To address this possibility, the proposed regime would allow for the “call in” of triggering events that

occur outside of the UK, provided that the trigger event meets a UK “nexus test.” More specifically, to initiate a “call in” of a trigger event, the UK government must determine that the relevant overseas: (1) entity carries on activities or supplies goods/services to persons in the UK; or (2) asset is used in connection with activities or the supply of goods/services to persons in the UK.

**No Safe Harbor Provision:** Unlike other national security regimes, the current proposal does not contain a carve-out for certain types of transactions. For example, historically the CFIUS regime in the United States has excluded transactions for review in which foreign persons make purely passive investments that result in the foreign person obtaining less than ten percent of the outstanding voting interest in a US business. No such limitation exists in the proposed UK regime.

**Risks Arising From “Trigger Events”:** The Statement of Policy provides guidance regarding the circumstances in which trigger events could give rise to national security concerns. In particular, three categories of potential risk are described:

■ **Target Risk**—Targets involved in “core areas” of the economy are more likely to present a national security risk than target companies operating in other industrial sectors. For example, companies involved with national infrastructure (i.e., nuclear, defense, communications, energy, and transport), certain advanced technologies, critical direct suppliers to the government, and emergency services, and dual-use technologies and suppliers to those sectors are considered to be higher risk;

■ **Trigger Event Risk**—The nature of the transaction at issue is also significant. Trigger events that would give a party the means to use the entity/asset to undermine the UK’s national security through disruption, espionage or inappropriate leverage would present an elevated national security risk; and

■ **Acquirer Risk**—The acquiring party can present national security risk as well. For example, acquiring entities, whether UK or non-UK based, that are hostile to UK government and may seek to use their acquisition to undermine the UK’s national security would be viewed as higher risk.

**Voluntary Reporting:** The proposed regime would not require parties to notify the government of investments and other acquisitions that may present national security concerns, but rather parties could elect to do so voluntarily. However, if the parties choose not to make a notification, the government could still “call in” the transaction for review. If intervention occurs prior to the closing of a transaction, the parties would be prohibited from concluding the transaction until the review process is completed. Should the transaction have been completed, the government would have the authority to “call in” the transaction within six months from the closing date.

**Informal Guidance:** Parties will have an opportunity to obtain guidance and have informal discussions with the UK government to establish whether it has concerns in relation to a specific trigger event.

**Screening Process:** After receiving a notification of a trigger event, a Senior Minister (i.e., a Cabinet-level minister) will have 15 working days (extendable by a further 15 working days for complex cases) to carry out a preliminary review to decide whether or not to “call in” the trigger event and to screen out transactions that do not have national security concerns.

**“Call In” Test:** The White Paper states that the government will develop and apply a “clear and circumscribed legal test” to determine when the government will “call in” a trigger event for a full national security assessment. However, this test has not yet been articulated.

**Reviews for “Call Ins”:** If the government “calls in” a trigger event for a national security review, it will have 30 working days to assess any national security concerns, which is potentially extendable by a further 45 working days. At the conclusion of this 45 working day period, the UK government and the parties may agree to a “voluntary period” that further extends the review period. Furthermore, the time periods described above would be “paused” for any periods during which the government “awaits information it has requested” from the parties involved with the triggering event.

**Mitigation:** Should the government conclude that a trigger event poses a national security risk, it can impose “conditions” in order to prevent or mitigate risk. An Annex to the White Paper sets forth an illustrative list of conditions, which include access conditions, information/operations conditions, and intellectual property conditions. In addition, the government will have the power to block a transaction prior to closing or even force the parties to unwind a transaction after completion in order to address national security risks.

**Expected Number of National Security Reviews:** The government anticipates approximately 200 notifications will be submitted each year. Of that total, the government estimates that roughly 100 will have “no national security concerns” and thus will not be “called in” for a further review. Of the remaining 100 trigger events, the UK government expects to impose some type of mitigation to address national security concerns in roughly half of these transactions. By way of contrast, the CMA typically reviews 60–70 transactions under its merger control regime, so the national security regime proposed in the White Paper would affect more than three times as many transactions.

**Sanctions for Non-Compliance:** The UK government proposes to introduce stringent sanctions, both civil and criminal, on individuals and businesses that violate the new legislation by breaching a mitigation condition imposed or not complying with information gathering requests. The sanctions vary from prison sentences (of up to five years), director disqualifications (up to 15 years), and financial penalties for both individuals (up to 10 percent of total income or £500,000 which is higher)

and businesses (up to 10 percent of worldwide turnover).

**Removal of National Security Considerations from the Existing Merger Control Regime:** The proposed reforms would remove national security considerations from the Act and the revised thresholds introduced in June 2018. Transactions that raise both national security and competition and/or public interest elements, would be subject to review by both the CMA for competition purposes, and by the government department/agency responsible for national security reviews (it is unclear what governmental department or agency would be responsible for carrying out the national security reviews). Further, the White Paper envisages that in certain situations the CMA could be asked to pause its merger review pending the outcome of the national security review.

### **3. What Is The Expected Timetable For The New Regime To Come Into Effect?**

It is unclear when the UK government will implement these measures. The consultation period on the White Paper will end on October 16, 2018, and it is likely that a draft bill will be produced thereafter. The focus on Brexit-related legislation may delay the passage of a bill but the issues that the bill is designed to address will not fall away after Brexit, and it seems likely that legislation will be introduced in 2019.

**Conclusion** The national security review regime described in the White Paper represents a new approach to dealing with investment risks in the UK. If enacted, the national security review regime would have far reaching implications for UK and non-UK based companies alike seeking to make investments and purchase assets that have a UK nexus.

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