

UK Government consults on new powers to control foreign investment

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The UK Government recently published its long awaited green paper on control of foreign investment (the Green Paper).¹ It proposes measures to increase Government scrutiny of foreign investment but only in relation to national security and not on the broader political grounds previous public statements have hinted at. Specifically, the Green Paper sets out two proposals: (1) urgent changes to the existing system to allow the Government to intervene in more mergers in the military, dual-use and parts of the advanced technology sectors; and (2) options for more extensive and long-term reform of the existing system. Recognising the importance of foreign investment to the UK - particularly given the UK's impending departure from the EU - the Green Paper has as one of its central aims the need to ensure that the UK remains attractive to inward investment.

This briefing considers the rationale for increased scrutiny of foreign investment, why and how the Government proposes to reform the existing regime and how the Government is seeking to ensure that it does not deter foreign investment at this critical time for the UK.

Rationale for increased Government scrutiny of foreign investment

Expansion of the Government's ability to review mergers on non-competition grounds has been mooted since at least 2016 when Theresa May [described](#) her desire to develop an industrial strategy that would enable the Government to defend domestic firms against foreign takeover: referring to Pfizer's aborted takeover of AstraZeneca she said, "A proper industrial strategy wouldn't automatically stop the sale of British firms to foreign ones, but it should be capable of stepping in to defend a sector that is as important as pharmaceuticals is to Britain". In doing so, she suggested that the UK might develop a more politically interventionist approach to merger control. Although the [industrial strategy green paper](#) published in January 2017 made no such proposals, [comments](#) made by the Prime Minister just prior to publication of that green paper suggested that the issue was still on the agenda. There were, however, signs that the focus had shifted from a broad approach to intervention to a focus on national security and particular sectors ("*[The Government] will be looking at how we develop ideas I've already talked about on national security and critical national infrastructure*" (emphasis added)).

This narrower approach is reflected in the Green Paper with the Government stressing that the reforms are designed to increase its ability to scrutinise foreign investment for reasons only of national security ("*All reforms that the Government makes in this area will only be the necessary and proportionate steps to protect national security*"), albeit that the proposals are not limited to critical national infrastructure. Indeed the Green Paper appears implicitly to criticize the recently published EU proposals for screening foreign investments (the [Proposed EC Regulations](#)) for having protectionist motivations.² This is in addition

¹ See Green Paper published on 17 October 2017 [here](#). Reforms in this area were promised in the [Queen's Speech](#) in June 2017.

² Concluding a brief discussion of the Proposed EC Regulations, paragraph 70 of the Green Paper states that "*screening to prevent [national security threats] merit special treatment but this should not be conflated with screening to control market access for*

to the Government's more explicit denouncement of the Proposed EC Regulations for placing "additional burden and uncertainty on prospective investors, which is at odds with the UK's stance as an open and liberal investment destination" in an [Explanatory Memorandum](#) published on 5 October 2017.

Existing foreign investment regime

The Government can call in foreign investment for review on grounds of national security where: (1) the transaction qualifies for merger control review under the EU Merger Regulation or the UK merger control regime; or (2) where the transaction does not qualify for merger control review under either of the EU or UK regimes but involves a "relevant government contractor" (current and former government contractors holding confidential information relating to defence). Where concerns arise the Government can seek remedies and ultimately can block the transaction.

So why does the Government believe it needs to expand these existing powers and how does it propose to do so?³

Proposal 1: Urgent changes in relation to the military, dual-use and advanced technology sectors

The Government believes the existing regime leaves an enforcement gap in so far as transactions which do not qualify for EU or UK merger control review and do not involve a "relevant government contractor" cannot be called in for review on national security grounds. The Green Paper identifies a particular concern in relation to acquisitions of small UK businesses with products, IP and expertise in key parts of the military and dual-use and advanced technology sectors which it says pose "clear and immediate risks to the UK" and "raise legitimate and significant national security concerns for the country as a whole".⁴

To plug this gap the Government proposes to amend the UK merger control rules so as to bring more transactions in these specific sectors within scope and thereby to give itself jurisdiction to review them on national security grounds. Specifically, the Government proposes to reduce the turnover threshold so that mergers in these sectors would qualify for review under the UK merger control rules where the target has over £1m of UK turnover (compared to £70m under the normal rules) and to amend the share of supply test so that mergers in these sectors will qualify for review under the UK merger control rules where the target has a 25% share of supply of goods/services of a particular description in the UK (compared to the normal rules which require the transaction to create or increase a share of supply of 25%).⁵

Underlining the urgency described in the Green Paper (and considering that these changes are expected to impact only a small number of transactions), the Government has provided for just four weeks (ending 14 November 2017) for the consultation on Proposal 1.⁶ The Green Paper also makes clear that the

protectionist reasons. The UK is committed to free trade and investment, which must remain a priority for both a successful UK and European economy."

³ The Government has no plans to change its powers to review transactions on grounds of financial stability and media plurality.

⁴ The dual-use sector refers to the design and production of items that could have both military and civilian uses, and which are on the Strategic Export Control List. The relevant parts of the advanced technology sector are multi-purpose computing hardware and quantum-based technology.

⁵ The existing UK merger control rules will continue to apply to transactions outside these specific sectors.

⁶ The Green Paper notes that only around 4% of UK businesses are above the £1m threshold and past public interest interventions for national security purposes have been extremely low (only seven times since the introduction of the existing regime).

Government intends to implement Proposal 1 immediately after consultation. We can therefore expect the new thresholds to apply to mergers in the relevant sectors (i.e. military and dual-use and key parts of the advanced technology sectors) within the next few months.

Beyond these sectors, the Government wishes to consult more extensively (see below) before making any changes.

Proposal 2: Longer term substantive changes

The Green Paper notes that, in contrast with other countries (e.g. Australia, Canada, US and France), the UK's approach to national security review "appears less well developed [...] to deal with the potential risks to national security that we face, and the scale of investment our national infrastructure will require". In particular, the Government believes the existing regime is ill suited to combat risks of espionage, sabotage or the ability to exert inappropriate leverage.

This is principally because the existing regime is limited to transactions which involve businesses and which qualify for review under the EU or UK merger control regimes. Whereas national security concerns may also arise in relation to transactions which do not involve a business per se - for example, new projects, land sites near sensitive locations and acquisitions of bare assets (non-business entities such as machinery or intellectual property) - or which do not meet the merger control tests. The Green Paper also identifies the voluntary nature of the existing system as a potential risk in that it may mean that the Government is not aware of transactions that could raise national security concerns, as well as a potential source of uncertainty for transaction parties since they cannot be certain which transactions the Government may or may not call in for review.⁷

The Government proposes to address these concerns by either or both of:

- (i) expanding the existing call-in power to capture any acquisition of a UK business entity by any investor which the Government reasonably believes raises national security concerns (i.e. removing the turnover and share of supply tests as limits on the Government's ability to call in transactions for review on non-competition grounds); and
- (ii) a mandatory notification regime applicable only to foreign investment in the provision of essential functions in certain parts of key sectors of the economy. Recognising the potential burden on business of a mandatory notification system, the Government aims to "ensure the tightest possible focus" for a mandatory regime: only an identified set of essential functions within the civil nuclear, communications, defence, energy and transport sectors are proposed to be within scope.⁸

The Green Paper also proposes to bring transactions involving new projects, bare assets and land within the Government's national security jurisdiction (consistent with the position in overseas regimes).⁹

⁷ The merger notification regime in the UK is voluntary (rather than mandatory) so there is no obligation to submit a notification for review even where the transaction meets the relevant thresholds.

⁸ These essential functions have been narrowed down from amongst the 13 sectors of UK national infrastructure and excludes parts of these sectors that either do not pose national security risks or are already sufficiently protected under existing regulations. The Government also believes that there may be a case for including emergency services and government; but that chemicals, financial services, food, health, space and water should not automatically fall within scope.

⁹ The Committee on Foreign Investment in the United States (CFIUS) for example takes account of proximity of the target's assets to sensitive governmental locations when assessing national security risks. The Australian and Canadian regimes capture investments in new businesses and investments in assets.

SLAUGHTER AND MAY

Impact on the UK as a destination for foreign investment

Although the Green Paper proposals seek to tighten up regulation of foreign investment, there are reasons to retain some confidence in the UK's pledge to stay open to foreign investment. Certain features of the UK proposals are aimed at reducing the regulatory burden on investors.

For instance, the Green Paper proposes a well-defined call-in window for intervening in a transaction post-closing (in contrast, CFIUS for example has an indefinite ability to call in unnotified transactions); and, as discussed above, it contemplates the possibility of applying either voluntary or mandatory notification requirements, depending on the sector/type of transaction. This targeted approach should constrain the additional burden on businesses and should facilitate efficient operation of the regime by the Government, although it is clear that extra public resources will be needed.

Comment

The message that the UK remains open for business is repeated often in the Green Paper. The focus on Government intervention on national security rather than broader political grounds is welcome. By incorporating various safeguards - for instance limiting the more interventionist proposals such as mandatory notification to specific activities in specific sectors - and positioning the reforms as aiming to bring the UK regime broadly into line with those operating in other major destinations for foreign investment, the Government hopes to be seen as being genuinely focused on "protect[ing] national security without disrupting or discouraging the vast majority of foreign investment". It remains to be seen whether the eventual firm proposals, if and as adopted, strike the right balance.



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