



Department for  
Business, Energy  
& Industrial Strategy

# NATIONAL SECURITY & INFRASTRUCTURE INVESTMENT REVIEW

Government response to its consultation on  
short-term proposals



15 March 2018

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## Executive Summary

### The context

The National Security and Infrastructure Investment Review Green Paper<sup>1</sup>, published on 17 October 2017, outlined the Government's plans to take a staged approach to reforming how it scrutinises national security implications of business transactions. To this end, the Government sought input on the detail of action in the short-term to amend specific components of the current regime, as set out in the Enterprise Act 2002. A consultation on longer term proposals closed on 9 January. The Government will publish a response to this consultation in due course.

This consultation on secondary legislation took place between 17 October and 14 November 2017. This document summarises the responses to the consultation, and how it helped to develop the Government's final proposals as included in the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 and the proposed Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018.

The consultation sought views on the proposed amendments to the turnover threshold and share of supply tests within the Enterprise Act 2002 for certain areas of the economy, in order to ensure that the national security implications of mergers can be scrutinised and mitigated.

### The proposals

Specifically, the Government proposed to lower the UK turnover threshold from £70 million to £1 million and remove the current requirement for the merger to increase the share of supply to or over 25%. It sought views on the definitions of the proposed areas of the economy (military and dual-use technologies and parts of the advanced technology sector) to which the new tests would apply. Finally, it also sought views about what public guidance might be most useful, and about the benefits and costs associated with the proposals.

### The consultation responses received

The Government received 27 formal responses from legal and advisory firms, trade associations and industry groups, individual businesses and government and research bodies. Feedback on the proposals was also obtained through meetings with an additional seven organisations during the course of the consultation.

Stakeholders demonstrated some support for the principle of and rationale for the intended action.

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<sup>1</sup> <https://www.gov.uk/government/consultations/national-security-and-infrastructure-investment-review>

Most also provided some specific views about the detail of the proposals. In particular, the proposed scope of the amendment (i.e. the sectors to which amended thresholds would apply) was variously found to be less clear or focused than respondents wished or advised. Legal firms also raised wider concerns, querying whether the Government should make changes to the mergers thresholds within the Enterprise Act 2002 using secondary legislation powers. Some considered that it might be more appropriate to make changes to the special public interest sections of the Act instead. They also raised concerns about the implications of, and costs associated with, additional mergers being subject to scrutiny on competition grounds.

The Government believes that the national security context means that the reform should be made. It does this in knowledge of the fact that it has implications for the threshold for intervention on competition grounds, but considers that it ought to have no material difference in practice to the Government's approach to competition concerns.

The Government believes that its proposals are within the powers granted under sections 28 and 123 of the Enterprise Act 2002, as well as the spirit of the Act. There is nothing in s.28 or s.123 that suggests that the Government's powers to amend the threshold can be exercised only for competition reasons, rather than for identifying merger situations that may give rise to all or any of the various public interest concerns that is capable of leading to a merger being scrutinised.

As a result of the constructive consultation responses and feedback from wider engagement with stakeholders, the Government has made a number of amendments to its proposals. In particular, the Government has refined the proposed sector definitions to give greater clarity and to ensure they are more closely targeted on the national security issues of concern.

## Next steps

An Order has been laid in draft in Parliament, amending the share of supply test within the Enterprise Act 2002. The Order makes amendments to section 23 (relevant merger situations) including by introducing new subsections (2A), (2B), (4A) and (4B) and inserts a new section 23A ("the new provisions"). The intention is to lay a further Order to amend the turnover threshold. Subject to Parliament's consideration and approval, both Orders will come into force at the same time.

The Government will continue to assess risks in other sectors, including emerging technologies. If there is evidence to suggest that Government should take action in additional areas of the economy, then it will bring forward further legislation.

The Government also intends to bring forward longer-term reforms, as set out in the Green Paper. The consultation on the longer-term reforms closed on 9 January 2018. The Government is now considering the responses received and will lay out its plans for long-term reform in due course.

# The Consultation

## What was the background to the consultation?

1. The United Kingdom has a well-deserved reputation as an open economy. We enjoy one of the highest rates of inward foreign direct investment in the world. However, in recent years there have been a small number of transactions which have raised questions about whether our regime is sufficient to protect our national security effectively.
2. Until now, the UK has used the Enterprise Act 2002 to examine mergers for the purposes of national security and other areas of public concern. The Government has found that the Enterprise Act 2002 as currently drafted is no longer sufficient to ensure that national security risks receive the appropriate level of scrutiny and the Government does not have the necessary powers to ensure the national security of the UK.
3. In order to remedy gaps in the Enterprise Act 2002, in the short term the Government proposed to amend the turnover thresholds and share of supply tests in relation to specific areas of the economy. This was to allow the Government to examine and potentially intervene in mergers that currently fall outside the thresholds in two areas: (i) dual-use and military use technologies and (ii) parts of the advanced technology sector. For these areas only, the Government proposed to lower the target's UK turnover threshold from £70 million to £1 million and to remove the current requirement for the merger to increase the share of supply to or over 25%.
4. The Government consulted on these secondary legislation proposals as part of the Green Paper 'National Security and Infrastructure Investment Review' published on 17 October 2017.
5. The consultation welcomed respondents' views on the precise forms of words to define the relevant areas and the new thresholds, and invited comments on the best way forward.

## What did we consult on?

6. The consultation included six questions:
  - **Do you think the proposed definitions for the dual-use and military and advanced technology sectors provide sufficient clarity and certainty to businesses and investors?**
  - **Do you think the scope of the new thresholds should reflect updates to the relevant Strategic Export Control lists? Do you think that enterprises**

**that design or manufacture items subject to temporary export controls should also be in scope?**

- **Are the proposed definitions sufficiently focused on sectors where national security concerns may arise? What amended definitions would help achieve this?**
- **Do you agree that the new jurisdictional tests in the Enterprise Act 2002 for businesses in the above defined sectors should be:**
  - **a turnover of over £1 million, rather than £70 million as now; and/or**
  - **a merger or takeover involving a target with 25% or more share of supply (i.e. with no need for an increase), or which meets the current test of creating or enhancing a share of supply of 25% or more?**
- **Would Government guidance in relation to its views about the amendments including their solely national security focus be useful? What would this cover?**
- **What do you think are the most important costs and benefits from the proposed threshold changes to the Enterprise Act 2002 for the defined sectors?**

### Whom did we consult?

7. The consultation was published on [GOV.UK](https://www.gov.uk) and on the BEIS Citizen Space consultation hub. We drew the consultation to the attention of organisations and groups which we expected would have an interest in the proposals. Among others, the key groups we were keen to hear from were technology experts, defence experts, trade associations, law firms and investors. Feedback was also obtained at other events and meetings.

### Who responded?

8. We received 27 written responses and we spoke to an additional seven organisations through official meetings. The respondents were members of legal and advisory firms, representatives from trade associations and industry groups, individual businesses, and government and research bodies. The full list of respondents can be found in Annex 1.

# Summary of consultation responses and the Government's response to these

## Introduction

9. An overview of the written submissions in response to the above questions is provided below, together with the Government response. Feedback obtained from meetings held during the consultation has also been taken into account in the consultation response.
10. This Government response refers to how the new provisions have taken account of the feedback provided during the consultation.

## Overall feedback about the Government's approach to reform

11. Overall, there was some support for the Government's rationale for the proposals. In particular, respondents recognised the technological, economic and national security challenges the Government had described in the Green Paper. Respondents provided challenging and constructive feedback on the details of the proposed reforms.

## *Legal powers*

12. A number of legal firms raised more specific questions about the Government's proposed approach of using secondary legislation to amend the turnover and share of supply tests in relation to certain sectors for national security-related reasons.
13. Specifically, respondents from the legal and advisory firms variously described the proposed approach as "inappropriate" or "disproportionate". They suggested that the jurisdictional thresholds in the Enterprise Act 2002 are focused on competition concerns (and therefore amendments to these thresholds should not be made for only public interest-related reasons) and/or that the existence of the Special Public Interest Regime (designed to deal with mergers between certain enterprises below the thresholds) meant that the proposed reforms were an inappropriate use of delegated powers.
14. The Government has considered these submissions carefully. However, it has reached a different conclusion. The Government believes that the reforms (and the new provisions laid in draft in Parliament) are an entirely appropriate response and within the powers granted by the Act.
15. The Act, in its structure and powers, recognises clear grounds for Government to have a legitimate interest in mergers. The regime is not restricted to competition

concerns - it is intended to protect all of the public interests that can potentially lead to a merger being prohibited.

16. The Act does establish the same turnover and share of supply tests for both bases of intervention. The Government considers it in keeping with the Act for these to be amended solely on public interest grounds, notwithstanding that this also changes the threshold for any potential competition assessment or intervention.
17. Similarly, the existence of the Special Public Interest Regime does not undermine or alter the delegated powers granted under sections 28 and 123. In creating this regime, Parliament designed a system that entirely removed the turnover and share of supply 'safe harbours' provided in relation to all other mergers. It did this for very limited circumstances – in the case of national security, this was the limited category of certain defence contractors who have been notified that they hold confidential information. Although the Act does provide for a Special Public Interest regime, Parliament has expressly conferred on the Secretary of State's powers to intervene in national security cases outside this framework. Additionally, Parliament has expressly granted the Secretary of State power to amend the thresholds in the general merger regime. To expand the existing special public interest regime to include all the sectors on which Government consulted would, Government considers, be a less proportionate act than its proposed new provisions.

#### *The reform's impact on competition-related processes*

18. Finally, legal and advisory respondents also raised concerns about the reform's implications for the competition assessment of mergers. Specifically, they raised a concern that there will be a large increase in the numbers of referrals for competition assessments by the Competition and Markets Authority (CMA).
19. However, the Government believes that the reform should not have any material impact on the number of mergers scrutinised only for competition reasons. The CMA's response to the Green Paper<sup>2</sup> described its view in similar terms:
- "The CMA does not expect that the proposals outlined in the Green Paper will bring about any material change in its approach to the assessment of mergers on competition grounds"
20. The Government's guidance was produced following close engagement with the CMA, in order to emphasise that the proposed reforms are not concerned with new mergers from a competition perspective. Neither the Government nor the CMA itself expects that there will be a consequential material change in the latter's approach to

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<sup>2</sup> Competition and Markets Authority (2017), 'National security and infrastructure investment review: CMA response', <https://www.gov.uk/government/publications/national-security-and-infrastructure-investment-review-cma-response>

competition concerns. The nature of the mergers brought into scope by the new provisions (i.e. those involving firms with turnover under £70 million and/or not involving an increase in the share of supply) is such that competition concerns are very unlikely to be raised.

21. As such, the Government would not anticipate the need for businesses to voluntarily notify the CMA about mergers affected by the new provisions on competition grounds. Government will include in published guidance details of who businesses should contact if they believe their merger could give rise to national security concerns. Should, contrary to its and the Government's expectation, the CMA have competition concerns about an affected merger, it will contact the parties in the usual manner.

## Sector definitions

22. The Green Paper sought views on the proposed definitions through two separate questions. Question 1 asked “do you think the proposed definitions for the dual-use and military and advanced technology sectors provide sufficient clarity and certainty for businesses and investors?” This question was designed to ascertain if businesses would understand whether they would be in scope of amended merger thresholds. Question 3 asked “are the proposed definitions sufficiently focused on sectors where national security concerns may arise? What amended definitions would help achieve this?” This question sought feedback on whether the Government is targeting the right areas of the economy for national security.

23. Some respondents provided answers to these questions interchangeably. A summary of the views and the Government’s response to both questions is provided below.

### Consultation proposal

24. The consultation document set out how changes in technology, economic structures and national security threats meant that the Government required powers to scrutinise mergers of certain businesses in particular areas of the economy.

25. The national security interests in the dual-use<sup>3</sup> and military technologies are obvious – these items can, in the wrong hands, pose clear and immediate risks to the UK, our people and society. There are also indirect national security interests – thanks to UK businesses’ innovation, our military and defence forces have a clear operational advantage over others. The acquisition of UK businesses with this expertise and intellectual property can, therefore, raise legitimate and significant national security concerns for the country as a whole.

26. The consultation set out that the Government proposed to use some of the Strategic Export Control Lists (SECLs) as the basis for determining which businesses in the military and dual-use sector will be subject to amended thresholds for intervention in mergers. The Government proposed that enterprises that design or manufacture items or hold related software and technology specified on the UK Military List, UK Dual-Use List, Radioactive Source List and EU Dual-Lists would be in scope of the amended thresholds.

27. In addition, the Green Paper highlighted that advances in technology now mean that there are ubiquitous goods with the potential to be directed remotely should a hostile actor obtain access or control. Mergers related to companies that undertake these activities, therefore, have the potential to give hostile actors knowledge or expertise that could be used to undermine our national security.

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<sup>3</sup> Dual-use goods, software or technology are items which could have both military and civilian uses.

28. The innovation behind these changes has often been driven by small businesses, whose energy and creative thinking has brought new perspectives to sometimes old problems. Therefore, there is a real risk that mergers involving these types of businesses which fall below the current thresholds could raise national security concerns.

29. The Government proposed that amended thresholds are applied to businesses operating in certain areas of the economy (definitions below). The Government welcomed respondents' views about the scope of the proposed definitions and whether they are sufficiently focused on sectors where national security concerns may arise. The Government sought suggestions on any amended definitions which would help achieve this.

30. The Government proposed a set of definitions for the dual-use and military and advanced technology sectors as follows:

Area of advanced technology	Definitions included in the consultation
Military and dual-use	Enterprises that design or manufacture items or hold related software and technology specified on the UK Military List, UK Dual-Use List, UK Radioactive Source List and EU Dual-Use Lists.
Multi-purpose computing hardware	Enterprises that: <ul style="list-style-type: none"> <li>(i) own or create intellectual property rights in the functional capability of multi-purpose computing hardware; or</li> <li>(ii) design, maintain or support the secure provisioning or management of the roots of trust of multi-purpose computing hardware.</li> </ul>
Quantum-based technology	Enterprises that research, develop, design or manufacture goods for use in, or supply services based on, quantum computing or quantum communications technologies. This would include the creation of relevant intellectual property or components.

31. The Government welcomed respondents' views about the appropriateness of these definitions which would form the basis for the definitions in the secondary legislation.

## Consultation responses

### *Overall*

32. Stakeholders (primarily members of legal and advisory firms) did not feel that the proposed definitions sufficiently focused on areas where national security concerns

may arise. Some stakeholders felt that the proposed definitions were too wide and may create confusion when determining whether the revised thresholds would apply to them. Other stakeholders felt that the definitions were too speculative a basis for intervention. However, some stakeholders (including trade associations) supported the Government's rationale for the new provisions covering these technologies. Stakeholders provided specific drafting and technical suggestions for improvements to the definitions to ensure that they covered potential national security risks.

#### *Military and dual-use*

33. Respondents provided a mixed response to the proposed definitions for military and dual-use goods. Some felt the definitions provided sufficient clarity and certainty and therefore should remain unchanged.
34. Others considered that the military and dual-use lists are too long for these purposes and suggested that the Government produces a bespoke list for clarity.
35. Stakeholders expressed a concern that there is a large number of UK businesses which manufacture or otherwise deal with or in dual-use goods, software or technology and who may not export these goods and therefore may be unfamiliar with the SECLs.

#### *Multi-purpose computing hardware*

36. Stakeholders expressed the opinion that they would prefer a more focused and precise definition for multi-purpose computing hardware. Certain stakeholders argued that all computing hardware could be defined as 'multi-purpose' and any owner or creator of Intellectual Property (IP) relating to computing hardware could be caught by the proposed reforms.
37. Legal and advisory firms set out that the definition was not simple enough to be understood by non-specialists and this could create uncertainty as to whether or not a business could fall into the regime. They suggested that the Government clarified the proposed definition.

#### *Quantum-based technology*

38. Some stakeholders reported that the definitions for quantum-based technology were too broad in some areas. It was noted that quantum-based technology is developing very rapidly and could apply to a number of sectors.
39. The wording 'for use in' was considered a particularly problematic element of the quantum definition for members of the photonics industry. As worded, respondents considered that the scope of the definition could encompass any business that has supplied goods to the extensive quantum technology research programmes in the

UK. Stakeholders advised the Government to consider narrowing this particular element of the definition in order to provide more clarity.

### **Government response**

40. The Government acknowledges and welcomes the constructive comments provided during the consultation regarding the proposed definitions for the military and dual-use technologies and parts of the advanced technology sector.

#### *Military and dual-use*

41. The Government has concluded that using certain export control lists remains an appropriate and useful basis for its definition of businesses which would be covered by amended turnover and share of supply thresholds.

42. The Government considered whether businesses that produce specific items on these lists that can be excluded from scope of the new provisions but concluded that it is unlikely that this will be the case. Indeed, no respondent highlighted any type or class of item on the lists where they considered that the Government should not have a legitimate interest in the potential acquirer of its manufacturer or designer.

43. For example, by excluding businesses that produce certain dual-use items, this could mean that there is a national security threat posed if ownership of such companies changes and these technologies were adapted for use in military applications. The Government is also concerned that by excluding companies that produce items that can be freely exported within the EU, this could pose an increased national security risk related to the proliferation of sensitive technologies. The Government has decided to proceed with the approach set out in the Green Paper.

44. The Government considers that the items on the list are such that anyone designing or manufacturing them, even if they had not yet sought to export them, would be aware of Government's legitimate interest from a national security perspective. It considers it reasonable, therefore, that they (or their would-be investor) would undertake reasonable levels of due diligence that would establish whether any merger would be in scope of the new provisions.

45. The Government also notes that it had already reviewed the wider Strategic Export Control List and not included the human rights-focused lists in the proposals.

46. Notwithstanding its view that the well-established nature of the SECLs provides certainty, the Government has considered whether it can provide greater clarity to businesses as to whether they are in scope of the SECLs. As a result, the Government will publish detailed guidance about the list and export control

alongside the new provisions. There is also a Goods Checker tool available on gov.uk<sup>4</sup>.

*Multi-purpose computing hardware*

47. The Government has considered the views of stakeholders and amended the definition for multi-purpose computing hardware to provide more clarity.

48. The Government has clarified the definition to ensure it explicitly sets out that only processing units and firmware (related to computing hardware) are included in the scope of the legislation.

Previous definition	Revised definition
<p>Enterprises that:</p> <ul style="list-style-type: none"> <li>(i) own or create intellectual property rights in the functional capability of multi-purpose computing hardware; or</li> <li>(ii) design, maintain or support the secure provisioning or management of roots of trust of multi-purpose computing hardware.</li> </ul>	<p>Enterprises whose activities include:</p> <ul style="list-style-type: none"> <li>(a) owning, creating or supplying intellectual property relating to the functional capability of—                             <ul style="list-style-type: none"> <li>(i) computer processing units;</li> <li>(ii) the instruction set architecture for such units;</li> <li>(iii) computer code that provides low level control for such units;</li> </ul> </li> <li>(b) designing, maintaining or providing support for the secure provisioning or management of—                             <ul style="list-style-type: none"> <li>(i) roots of trust of computer processing units;</li> <li>(ii) computer code that provides low level control for such units.</li> </ul> </li> </ul> <p>The SI also includes the following definition:</p> <ul style="list-style-type: none"> <li>- “roots of trust” :</li> <li>- (a) means hardware, firmware, or software components that are inherently trusted to perform critical security functions, and</li> <li>- (b) includes cryptographic key material bound to a device that can</li> </ul>

<sup>4</sup> <https://www.ecochecker.trade.gov.uk/spirefox5live/fox/spire/>

	identify the device or verify a digital signature to authenticate a remote entity
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49. The Government considers that the changes will mean that the definition is more clearly targeted on the national security risks of concern. For example, a national security concern could arise from the manipulation of processing units so that they transfer data to a hostile actor. Therefore, the design or manufacturing of processing units have been explicitly specified in the new provisions’ definition of multi-purpose computing hardware.

50. These amendments will provide businesses with greater clarity as to whether they are in scope, as requested by consultation respondents. In its accompanying guidance, the Government has also provided further clarity and detail, including examples, in order to assist businesses, investors and their advisers to understand the scope of the new provisions.

*Quantum-based technology*

51. In light of the responses to its consultation, the Government has made some amendments to the definition of enterprises within the quantum technology area that will be included within scope of the amended thresholds.

52. The scope encompasses enterprises that produce goods ‘designed for use in’ specific quantum technologies. The Government has also clarified that companies that supply services ‘employing’ certain quantum technologies should be in scope, thus creating greater clarity for businesses and investors.

Previous definition	Revised definition
Enterprises that research, develop, design or manufacture goods for use in, or supply services based on, quantum computing or quantum communications technologies. This would include the creation of relevant intellectual property or components.	<p>Enterprises who undertake following activities:</p> <p style="padding-left: 40px;">research into, the development or production of anything designed for use in, or the supply of services employing—</p> <ul style="list-style-type: none"> <li>(i) quantum computing or simulation;</li> <li>(ii) quantum imaging, sensing, timing or navigation;</li> <li>(iii) quantum communications; or</li> <li>(iv) quantum resistant cryptography;</li> </ul> <p>The SI will also set out explanations of these technologies (not listed here for brevity). Note; this definition will include the creation of intellectual property for these areas as intended</p>

	(through use of term research/development).
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53. A small number of stakeholders suggested the Government makes explicit that quantum sensing, imaging and timing are included in the definition for quantum-based technology and highlighted the potential risks around emerging quantum-safe encryption related technologies. The Government has considered the potential national security threats of quantum-related technologies and has decided to ensure that explicit reference is made within secondary legislation to cover potential risks across a broader range of areas. This will ensure the Government has the power to intervene in mergers that could raise national security concerns in this area.

54. In its accompanying guidance, the Government has also provided further clarity and detail, including examples, in order to assist businesses, investors and their advisers to understand the scope of the new provisions.

## Updates to the Strategic Export Control Lists

### Consultation proposal

55. The Green Paper highlighted that the export control lists are subject to periodic updates, and that the Government also has powers to exercise *temporary* export control. It sought views from respondents about whether items added to the list following implementation of the new provisions and/or those subject to temporary control should also be within scope of the amended turnover and share of supply thresholds.

### Consultation responses

#### *Reflecting updates to the SECLs*

56. Whilst some stakeholders expressed concern that the scope of the new thresholds would change to reflect updates to the relevant Strategic Export Control Lists, in general it was viewed as a sensible and necessary approach, subject to confirmation that such an approach was possible within the delegated powers under the Enterprise Act 2002.

57. Some stakeholders commented that the reforms would create uncertainty as the Strategic Export Control Lists are regularly updated. Some suggested that amendments to the lists are often made with little notice and it is unclear which part of Government is responsible for updating the lists. This may mean that businesses are unaware that they become in scope. Some law firms were concerned with the added bureaucracy and uncertainty to businesses created by including updates to the relevant SECLs within the scope of the new thresholds.

58. A majority of respondents considered that it is pragmatic for the new thresholds to reflect updates to the relevant SECLs. Some trade associations highlighted the thresholds should be regularly reviewed as technology and its applications are rapidly changing. The proposed method, they responded, would be a dynamic and responsive way of handling new developments in technology and the national security concerns they may present.

59. A small number of stakeholders advised that there needed to be greater clarity about the process for updates to the lists.

#### *Temporary export controls*

60. The majority of stakeholders believed that enterprises that design or manufacture items subject to temporary export controls should not be in scope of the new thresholds. It would not be practical to include items subject to temporary export controls in the scope of the new thresholds given that the nature and terms of the controls imposed by a temporary order are not sufficiently predictable.

61. Stakeholders expressed concern that including temporary items in the scope of the new thresholds creates unnecessary uncertainty and unpredictability.

### **Government response**

62. The Government appreciates that a large proportion of stakeholders expressed a preference for the new thresholds to reflect automatic updates to the relevant SECLs. However, the Government has come to the conclusion that such an approach is not possible within the terms of the legal powers under which the relevant Orders are being made. Therefore, businesses which produce items added to the SECLs after the new provisions come into force will not automatically be brought into scope of the amended mergers thresholds. The Government will periodically lay further secondary legislation to reflect updates to the SECLs. This approach has the advantage that it will give businesses greater transparency and certainty as it signals to Parliament each time that the scope of the amended Enterprise Act mergers thresholds is extended to include new items added to the SECLs.

63. The Government has also concluded that including enterprises that design or manufacture items subject to *temporary* export controls should not be in scope of the new thresholds. The Government has concluded that there is no practicable means of bringing such enterprises into scope and it is likely such an approach would bring uncertainty to businesses.

64. Some respondents queried if Government would have the power to intervene in a transaction to which they had committed prior to the SECLs being updated and being brought into scope. The changes which the proposed Orders amending the share of supply and turnover tests make to the Enterprise Act 2002 will only apply to cases in which enterprises cease to be distinct after the changes come into force. A similar approach will be adopted in relation to any subsequent Orders made to bring into scope changes to the SECLs.

## Thresholds

### Consultation proposal

65. The Government proposed amending both the turnover threshold and share of supply tests for mergers in the narrow areas of the economy as outlined in the definitions. The Government reviewed the UK turnover of businesses in key sectors and, in light of this, proposed to lower this threshold to £1 million, from the current threshold of £70 million.
66. The Government also proposed to remove the current requirement for a qualifying merger or takeover to bring about an increase in the share of supply. Instead an additional test would be added such that the share of supply threshold would also be met if the merger related to a business operating in the specified areas of the economy which had an existing share of supply of 25% or more of the relevant goods or services in the UK.
67. These amendments would represent the first changes to the turnover threshold and share of supply test since the Enterprise Act 2002 came into force. The real and significant national security issues require us to act. The Government, therefore, welcomed respondents' views about how best these changes could be made.

### Consultation responses

#### *Turnover threshold*

68. A number of stakeholders expressed concern with the £1 million turnover threshold, but the feedback from those who believe £1 million is too high was in equal proportion to those who believe it is too low.
69. Certain trade associations felt the turnover threshold was too high. They and others voiced a concern that a £1 million threshold would miss micro-businesses which may hold significant intellectual property that could be a threat to national security. Stakeholders suggested £1 million was an arbitrary figure and there should simply be no turnover threshold to ensure no business with a national security consideration can slip through the net.
70. Other stakeholders advised that the turnover threshold was too low, therefore bringing a disproportionate number of businesses into scope for potential Government and/or CMA intervention. The amended threshold may cover a number of transactions which raise no material national security concerns, which could negatively affect future financial and investment decisions. The proposed thresholds, in particular, may disproportionately affect smaller businesses, which are less able to bear the costs of public intervention in a merger or where new regulatory barriers for third party investment would be unwelcome. This could, they considered, discourage the development of small and medium-sized enterprises.

### *Share of supply threshold*

71. Legal and advisory firms expressed the belief that the share of supply test is redundant and inherently subjective. They queried the proposed amendment to the share of supply test given it would only be needed in order to scrutinise mergers involving a target under £1 million turnover. By removing the requirement for an increase in the share of supply, by definition, there cannot be a lessening of competition. Furthermore, they highlighted that the share of supply threshold is complex and involves complex assessments, which would lead to disproportionately high costs for smaller businesses.
72. Two stakeholders suggested that the share of supply test is a competition-related consideration, and not a concern within the remit of national security.

### *National security implications*

73. A small number of stakeholders expressed the opinion that the proposed thresholds are appropriate in order to prevent the takeover from a hostile state of new, smaller companies working in sensitive areas of the economy without due diligence being applied. The revised thresholds, therefore, constitute a thorough first step in seeking to place safeguards on national security.

### **Government response**

74. Having considered the consultation responses, the Government will retain the two amendments proposed in the consultation – i.e. a £1 million turnover threshold, and an additional share of supply test that would in effect remove the requirement for there to be an increase in the UK share of supply arising out of a merger.
75. The Government will retain the £1 million figure. The Government considers that this will be well-understood by businesses, and is well-established as a regulatory threshold being the upper limit of ‘micro-businesses’. Stakeholders have not provided any quantitative evidence to support their positions in order for the Government to amend the threshold in either direction.
76. The Government acknowledges that a small number of consultation responses queried the proposed amendment to the share of supply test. At this stage, the Government has concluded that the importance of covering deals involving a buyer with no footprint in specific markets is an important approach, and so will retain the additional test.
77. Some law firms raised the concern that businesses with overseas activities in quantum technology, computing hardware or the dual-use and military goods could be brought into scope of the revised turnover threshold if they have unconnected sales in the UK. In light of these comments, the Government considered whether

the new provisions could be made to operate such that turnover relating to sales of only 'relevant' products or services in the UK was taken into account when determining whether the £1 million threshold had been met.

78. The Government has concluded that there could be considerable practical difficulties in determining what part of the turnover of a business related to the particular activities captured by the definitions in the legislation where those activities are part of a wider business.

79. Moreover, it is not clear that, even were such a business to be over the revised thresholds, there would be any significant burden for the business concerned. In a case where a business had no activity in one of the relevant sectors in the UK, it is highly unlikely that the Government could conclude that a merger involving its acquisition would give rise to a risk to national security. The CMA's guidance also confirms that it does not envisage our amendments to the turnover thresholds to bring about any material change in its approach to the assessment of mergers on competition grounds.

80. In light of the above, the Government has concluded not to introduce such an amendment within the new provisions.

81. Some respondents also raised concerns that the new turnover threshold will be based on UK turnover only without expressly requiring that the target business must carry on business in the UK or do so by, or under the control of a UK company. They considered that this could therefore lead to the scrutiny of mergers involving overseas businesses that just export to the UK.

82. Section 86 of the Enterprise Act 2002 already includes limitations on the extra-territorial reach of the powers of the Secretary of State and the CMA and limits the extent to which the conduct of overseas enterprises can be controlled. An enforcement order can only extend to a company's conduct outside the UK if the company is incorporated here in the UK or "carries on business" in the UK. Moreover, the Government would always act reasonably in assessing potential national security risks arising out of a transaction involving an overseas business which only exports to the UK.

83. The Government has therefore concluded that no additional requirements should be imposed with regards to presence in the UK than are already required under the terms of section 86 and the need for the business to either have turnover or a share of supply in the UK.

## Guidance

### Consultation proposal

84. The Government proposed to publish guidance alongside the secondary legislation setting its views out in more detail to provide further reassurance to businesses and investors about the solely national security-focused rationale for these amendments.

85. The Government welcomed respondents' views on whether guidance in relation to its views about the amendments including their solely national security focus would be useful. The Government sought suggestions on what any guidance might cover.

### Consultation responses

#### *Views on guidance*

86. All stakeholders agreed guidance would be useful and necessary to ensure a smooth transition once the reforms are implemented.

#### *Suggestions*

87. There were four main suggestions on what guidance should cover:

- The majority of stakeholders suggested that the Government provide clear guidelines on how companies can assess whether they are in scope of the reforms. This will give businesses greater certainty and clarity when planning and undergoing a transaction or merger.
- A large proportion of stakeholders recommended the Government issue clear guidance on the process of assessment and review and give a realistic expectation of how long it will take to reach a decision. Included in this would be the factors the Government will consider in assessing mergers for national security reasons.
- Stakeholders indicated that guidance should reiterate that the reforms are not intended for 'economic nationalism' or as a protectionist policy, but are underpinned by national security considerations. The Government will not act with bias when investigating a specific investor or transaction for national security concerns.
- Stakeholders from trade associations and academic organisations suggested that the Government promote a positive message throughout the guidance. The UK encourages and fosters investment and we are working in collaboration with the current defence technology strategy. The reforms are not intended to discourage investment or the growth of technology start-ups.

## Government response

88. The Government recognises the need to provide clear guidance in relation to its views about the reforms, including their solely national security focus, in order to provide clarity for businesses, investors and stakeholders.
89. The Government has published guidance alongside the Order amending the share of supply test when it was laid in draft.
90. The guidance explains why the Government is amending the Enterprise Act 2002, describe the new provisions' effects in law and in practice, and offer advice to businesses and others about what they should do (and not do) as a result of the changes.
91. The guidance is not statutory guidance. The guidance does not change, for example, the legal duties of the CMA. Nor does it impose legal duties on businesses or any other organisation.
92. The guidance seeks to provide clear and practical advice from Government about the new provisions to those affected, or potentially affected by it. Businesses are also advised to consider their own particular circumstances and, where necessary, seek advice from others.
93. The Government will keep this guidance under review, updating it to ensure it remains as relevant and as useful as possible.

## Costs and Benefits

### Consultation proposal

94. The Government acknowledged that there are important costs and benefits to be taken into consideration when making an amendment to existing legislation.

95. The Government welcomed respondents' views on the most important costs and benefits from the proposed threshold changes to the Enterprise Act 2002 for the defined sectors.

### Consultation responses

#### *Costs*

96. A large majority of stakeholders, especially those from legal and advisory firms, expressed concern that the costs and added bureaucracy associated with the scrutiny process might deter vital foreign investment and undermine investor confidence. The concern lies in time costs associated with these reforms during the assessment process. Others advised that the reforms would not necessarily deter investment.

97. Stakeholders indicated that small and medium enterprises will suffer disproportionate cost as the value of the transaction might not equal the cost associated with the checks required. There is a major concern that the changes (if they involved a competition assessment, referral or CMA intervention) will incur a disproportionate amount of administrative burden.

#### *Benefits*

98. At this stage, the most important benefit identified by stakeholders was that the reforms would improve the Government's ability to intervene in mergers and transactions which raise national security concerns.

### Government response

99. The Government welcomes stakeholders' identification of the positive benefit that the proposed reforms will bring when protecting national security during future mergers and transactions.

100. The Government acknowledges and is aware of the potential administrative costs the reforms may bring and is taking all necessary steps to identify these and put measures in place to alleviate their affect. For example, the Government has published comprehensive guidance to provide greater clarity to businesses and investors.

101. The Government's assessment of the costs and benefits are outlined in the following section. An Impact Assessment has been published covering the detail of the Government's assessment.

## Impact assessment

102. The Government has undertaken analysis to ascertain the number of businesses that will be in scope of the revised thresholds.

103. As it describes in the Impact Assessment published alongside the Order, the Government conducted internal analysis to estimate the number of additional mergers and acquisitions potentially subject to a national security assessment under the revised regime. It estimates that an additional **5 to 29 mergers and acquisitions per annum would be brought into scope for potential Government intervention** as a result of the new provisions.

104. Of these, the Government estimates that between 3 and 17 merger cases per year would be identified as no risk by its mergers and acquisition monitoring and assessment activities.

105. The remaining 2 to 12 cases per annum would require a more in-depth assessment by the Government to review potential national security risks. We estimate that in half of these cases (1 to 6 cases per annum) the Government's assessment would conclude that they pose **no risk** to national security. For such cases, we assumed no further action was taken. For the other **1 to 6 cases per annum** we estimate that the Government's assessment would conclude that there may be a risk to national security such that the Secretary of State issues a public interest intervention notice to more closely and formally examine the transaction.

106. It is important to note that these estimates are based on analytical assumptions used for the purpose of the Impact Assessment to estimate the likely impact on business. When the regime comes into effect, mergers and acquisitions will be reviewed on a case-by-case basis to determine if the transaction raises any potential national security concerns.

### *Monetised costs*

107. Based on our estimates on the number of businesses, mergers and acquisitions affected by the new provisions, we estimate a **total direct cost of £1.1m per annum in our central case**, with a lower bound of £0.3m per annum and an upper bound of £1.8m per annum. The following table shows the breakdown of costs by businesses, Government, and the CMA.

**Total Direct Costs to Business, Government, and the CMA**

<b>Direct Costs by Affected Group:</b>	<b>Low Estimate</b>	<b>Central Estimate</b>	<b>High Estimate</b>
Business	£200,500	£878,500	£1,497,000
Government (administration of the regime)	£31,500	£64,500	£85,000
CMA	£40,000	£130,000	£190,000
<b>Total</b>	<b>£272,000</b>	<b>£1,073,500</b>	<b>£1,772,000</b>

*Non-monetised costs*

108. The new provisions might have a potential impact on the value of takeover offers through the uncertainty that a deal may fail, or be blocked by regulators, being priced into offers. We have, however, not been provided with firm evidence about the potential impact on value arising from the proposed reforms. The Government believes its proportionate and transparent approach will mean that any such impacts will be minimised.

109. We also considered the relationship between regimes for scrutinising the national security implications of overseas investment and the flow of inward foreign direct investment (FDI). Whilst consultation responses of some legal and advisory firms suggested the scrutiny process may deter FDI and undermine investor confidence, findings from the externally-produced research paper, "Sources of Capital"<sup>5</sup>, found that clear and predictable national security regimes with transparent and objective criteria are not seen as significant barriers to investment. This supported some stakeholders' views that the reforms would not necessarily deter investment.

110. The Government has concluded that any potential impact on FDI into the UK will be very limited, particularly given that the Government has committed to implementing a transparent, proportionate and wholly national-security focused regime targeting those areas of the economy which present heightened risks to national security.

*Non-monetised benefits*

111. The principal benefit of the proposals, which was identified by stakeholders in consultation responses and meetings, was that the reforms would improve the Government's ability to intervene in mergers and acquisitions which raise national security concerns. While it is often difficult to assign an exact monetary value to a national security benefit, an improved ability to prevent, detect and mitigate threats to national security will likely have positive long-term economic, social and

<sup>5</sup> (Forthcoming) Produced by Economic Insight for BEIS

reputational impacts. National security is the highest responsibility of any nation state.

112. The specific benefits of the proposed regime are to provide greater powers, set out in a more transparent and appropriate way, to deal with national security concerns and to take reasonable steps as required mitigating these concerns.

113. We anticipate the regime will improve identification, mitigation and thereby avoidance of potential risks to national security, enhancing the stability of the UK. Given that businesses and investors take into consideration a country's relative stability we believe the regime will support long-term business and investment planning (and subsequent investment, innovation and growth).

## Next steps

114. An Order has been laid in draft in Parliament, amending the share of supply test within the Enterprise Act 2002. It is proposed that a further Order will be laid to amend the turnover threshold. Subject to Parliament's consideration and approval, both Orders will come into force at the same time.

115. The Government will continue to assess risks in other sectors, including emerging technologies. If there is evidence to suggest that Government should take action in additional areas of the economy then it will bring forward further legislation.

116. The Government also intends to bring forward longer-term reforms, as set out in the Green Paper. The consultation on the longer-term reforms closed on 9 January 2018. The Government is now considering the responses received and will lay out its plans for long-term reform in due course.

# Annex 1 – List of respondents

## Legal and advisory firms

- Akin Gump Strauss Hauer & Feld
- Berwin Leighton Paisner LLP
- Clifford Chance
- City of London Law Society Competition Law Committee
- Eversheds Sutherland
- Baker Mackenzie
- Allen & Overy LLP
- Freshfields Bruckhaus Deringer LLP
- Linklaters LLP
- White & Case LLP
- Law Society of Scotland
- Ashurt LLP

## Trade associations and industry groups

- The Investment Association
- British Private Equity and Venture Capital Association
- EEF and NDI
- Elec Tech Council
- Gambica
- Techworks
- Internet of Things Security Foundation
- Photonics Leadership Group

## Individual businesses

- Cobham PLC
- Dynex Semiconductor Ltd
- CST Global Ltd
- Maxeler Technologies
- Rolls Royce
- Trade Compliance & Brexit Consulting
- EDF Energy
- Vodaphone

## Government and research bodies

- Competition and Markets Authority
- Scottish Government
- Innovate UK

- Engineering and Physical Sciences Research Council
- Centre for Competition Policy, University of East Anglia
- Quantum Communications Hub

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