

# Tighter UK foreign investment rules on the horizon

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## Introduction

On 17 October 2017, the UK Department for Business, Energy & Industry Strategy published a [Green Paper](#) setting out the UK Government's proposals to reform and strengthen its powers to scrutinize investments in critical businesses and infrastructure which could provide opportunities for foreign investors to "undertake espionage, sabotage or exert inappropriate leverage".

The foreword to the Green Paper notes that, on the one hand, the relevant legal framework must provide the Government with sufficient power to safeguard the UK's national security. On the other hand, the framework should not limit market access for any foreign investor. In keeping with this, the Green Paper proposals aim to follow the examples of other developed countries, and to ensure that any national security issues can be considered in a clear, consistent and proportionate way.

The Green Paper also refers to the [European Commission's draft proposals for a regulation establishing a framework for screening of foreign direct investments into the European Union](#) dated 14 September 2017. These proposals set out a framework for intensified co-operation and information sharing between EU Member States reviewing foreign direct investment and a mechanism for the European Commission to opine on investments of a "Union Interest". The Green Paper notes that the Government is considering its approach to these EU proposals which are likely to come into effect at a similar time to the proposed national reforms and as the UK leaves the EU. This raises the prospect that UK companies will be subject to the proposed investment screening following exit. The Green Paper emphasizes that the proposed EU framework should not be used to control market access for protectionist reasons, and that free trade and investment must be a priority for both a successful UK and European economy.

## Background

Currently, the UK Enterprise Act 2002 allows the Government to intervene in mergers if it reasonably expects there to be "exceptional public interest" concerns" relating to national security, financial stability or media plurality. However, the Government only has this power if the following jurisdictional thresholds are satisfied:

- the target enterprise has annual UK turnover exceeding £70 million; and/or
- the merger creates or enhances UK share of supply of 25% or more.

Where the above thresholds are not met, the Government still has the power to intervene in mergers but only in limited circumstances relating to certain defence contractors, media companies or specific national infrastructure sectors.

The Government considers that its powers to face national security challenges are currently limited and that they appear less well-established than equivalent review procedures in certain developed countries such as the US, France, Australia and Canada (each of which are considered in detail in the Green Paper as examples of how to re-shape the UK's review mechanisms). The purpose of the Green Paper is therefore to consult on a number of proposed reforms (short-term and long-term) to strengthen the Government's powers.

## Short-term reform - amending the turnover threshold and share of supply tests

The Green Paper proposes new jurisdictional tests in the Enterprise Act 2002 for businesses in:

- **the military and dual-use sector** - the Green Paper proposes that this would cover the design and production of military items (such as arms, military and paramilitary equipment) and dual use items (i.e. items which could have both military and civilian uses). Specifically, it proposes that enterprises that design or manufacture items or hold related software and technology specified on the [UK Strategic Export Control Lists](#) would fall within this area; and
- **parts of the advanced technology sector**- the Green Paper proposes that the following would be in scope:
  - **Multi-purpose computing hardware** – enterprises that own or create intellectual property rights in the functional capability of multi-purpose computing hardware, or design, maintain or support the secure provisioning or management of roots of trust of multi-purpose computing hardware; and
  - **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 (including the creation of relevant intellectual property or components).

The Green Paper proposes that transactions relating to these two sectors will be reviewable if:

- the target business has UK turnover of over £1 million in the preceding fiscal year (rather than £70 million); and/or
- the target has an existing share of supply of 25% or more of the relevant goods or services (even if the acquirer has no share). The current share of supply test will continue to apply, where both parties are involved in the relevant goods or services.

If these thresholds are met, the relevant merger would be subject to scrutiny by the UK Competition and Markets Authority (CMA) for competition concerns as well as by the Government for national security, media plurality and financial stability concerns. These assessments would be conducted separately and it is not proposed currently that any amendments be made to the principles underlying the CMA's competition assessment.

However, even if these thresholds are exceeded in respect of a merger relating to these sectors, the notification regime would continue to be voluntary (rather than mandatory) which is the current position under the Enterprise Act 2002. In accordance with current practice, the Government would be able to “call-in” cases not voluntarily notified if they are above the relevant thresholds and they are considered to raise potential concerns.

Responses to the above proposals should reach the Government by 14 November 2017

## Options for long-term reform

The Green Paper also seeks views from businesses, investors and their advisers about possible long-term reforms, to protect national security whilst retaining an open approach to trade and investment. Specifically, the Green Paper sets out two proposed options (which are not mutually exclusive): (i) an expanded call-in power as part of a voluntary notification regime; and (ii) a mandatory notification regime. The Green Paper also notes that the Government would require powers to request information from companies that come within the eventual regime's scope.

***Expanded call-in power as part of a voluntary notification regime***

Under this option, the UK Secretary of State would be able to intervene where he or she reasonably believes that national security risks were raised by:

- the acquisition of significant influence or control over any UK business entity by any investor (e.g. 25% of a company's shares or votes); or
- any other transaction that gives significant influence or control over that company or over its assets or UK businesses (in practice, this is likely to follow the material influence test established under the Enterprise Act 2002).

The Government is also considering extending the above to new projects (i.e. developments and other business activities that are not yet functioning enterprises but can reasonably be expected to become businesses whose activities may have national security interests) and the sales of assets without the elements of a stand-alone business.

In other words, under this option, there would no longer be a requirement for there to be a relevant merger situation (i.e. two enterprises and ceasing to be distinct and the jurisdiction thresholds in the Enterprise Act being met). The Green Paper envisages that the determination of whether a transaction raises national security issues would be conducted separately from and would not impact on the existing competition review process.

As with the current Enterprise Act regime, investors would be able to notify the Government voluntarily if they thought that a merger could raise national security concerns, and the Government would have a period of time to intervene in a transaction after it had occurred (a call-in power). The Green Paper suggests a three month period for this window.

If the Secretary of State is of the view that a transaction raises national security concerns, the Green Paper proposes that he or she would have the ability to impose conditions on the deal or to block it altogether (which are the powers available to the Secretary of State under the existing public interest regime). There would be an effective mechanism for affected parties to seek judicial review of the Secretary of State's decision.

***Mandatory notification regime***

Under this option, the Government would introduce a mandatory notification regime which would cover companies active in the provision of "essential functions" within key sectors, i.e. activities where national security risks from investments are most pronounced. The Government is also considering whether certain individual businesses or assets should be included in the scope of this regime even if the wider sector that they operate in is not in scope. Another point for consultation in the Green Paper is whether the Government should have the power to bring plots of UK land into scope where foreign ownership of that land would give rise to a potential national security risk as that land is close to a national security-sensitive site.

The Government has suggested the following sectors for discussion, i.e. civil nuclear, defense, energy, telecommunications, transport, manufacture of military and dual use items and advanced technology, and government and emergency services. The Green Paper also sets out a proposed list of "essential functions" for each of these sectors. For example, in relation to civil nuclear, an essential function would be the operation of civil nuclear reactors for the primary purpose of electricity generation. In relation to energy, an essential function would be upstream gas and petroleum infrastructure which has a throughput of more than 20 million barrels of oil equivalent per annum.

This proposed regime would be supported by clear sanctions attached to non-compliance e.g. criminal offences, financial penalties and/or director disqualification.

Responses to the above proposals should reach the Government by 9 January 2018.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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