

COVID-19 NEWS OF INTEREST

# UK Government Sharpens its Screening Tools for Foreign Investments

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*The UK introduces new public health emergency intervention power to protect businesses from COVID-19 impact as well as new national security review grounds, ahead of a more comprehensive reform of national security and investment reviews*

On 22 June 2020, the UK Government introduced two pieces of secondary legislation to amend the Enterprise Act 2002 to significantly expand its jurisdiction to review M&A activity involving UK businesses in specified strategic sectors.

1. **The new public health emergency intervention power under general merger control thresholds:** The first piece of legislation (The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2020)<sup>1</sup> came into force on 23 June 2020 and will allow the UK Government to intervene in acquisitions of UK businesses "with a role in" combatting or mitigating the impacts of public health emergencies, such as the current COVID-19 pandemic.
2. **The additional national security grounds under lower merger control thresholds:** The second piece of legislation amends the Secretary of State's powers to scrutinise transactions involving artificial intelligence (AI), cryptographic authentication technology and advanced materials. These additional categories are introduced under the *lower* merger control thresholds, which came into force in June 2018 and currently apply to certain transactions in the military and dual-use, quantum technology and computing hardware sectors that may raise

<sup>1</sup> See [here](#).

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national security risks. The draft Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2020<sup>2</sup> introducing these changes will now be debated in and will require approval by both Houses of Parliament which is expected to be forthcoming in short order.

These new powers bridge a gap in the UK Government's ability to screen *foreign* investment, pending the introduction of more fundamental and comprehensive reforms.<sup>3</sup> It is expected that the implementing legislation for a comprehensive new UK foreign investment screening regime, the National Security and Investment Bill, will be tabled in Parliament in the near future.

### **The new public health emergency intervention power under general merger control thresholds**

The new power for the UK Government to intervene in mergers on public health emergency grounds aims to mitigate immediate risks arising from acquisitions of UK businesses with critical capabilities, for example, a vaccine research company or personal protective equipment manufacturer, which may be perceived by the UK Government as hostile to the UK's national interests.<sup>4</sup>

However the way the legislation is cast potentially encompasses a much wider range of businesses arguably relevant to the UK's ability to combat both present and future public health emergencies. Examples provided in the UK Government's Explanatory Memorandum include an internet service provider critical to meet an increased demand for internet services in a health-related lockdown situation and a food supply chain company providing services to minimise disruption to food supply.<sup>5</sup> By extension, certain companies in the food delivery, logistics and transportation sectors which play a role in ensuring the UK population's continued access to essential products services, may fall within the scope of the new power.

The Explanatory Memorandum makes further reference to "*usually stable businesses*" which may be particularly susceptible to takeover due to short-term impacts on their share price or profitability.<sup>6</sup> This can potentially be very broadly interpreted and introduces a complex interplay between the public interest intervention regime, state aid rules and failing firm arguments recently advanced in the context of merger investigations carried out by the UK's Competition and Markets Authority (CMA).

Although introduced to address immediate concerns arising from the COVID-19 pandemic, another indication that the new power may be deployed more broadly in the long term is the statement in the Explanatory Memorandum which makes

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<sup>2</sup> See [here](#).

<sup>3</sup> These reforms were first proposed in the form of a Green Paper in October 2017 ([here](#)), followed by a White Paper in July 2018 ([here](#)).

<sup>4</sup> Explanatory Memorandum ([here](#)), at 7.3.

<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

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clear that the new power can be exercised to *preserve* critical capabilities in relation to *future* public health emergencies, underscoring the need for the Government to “*act outside of and in advance of*” such emergencies.<sup>7</sup>

Finally, while the UK Government’s press release<sup>8</sup> makes reference to perceived “*hostile takeovers*” and “*malicious acquirers*”, the wording of the legislation itself is neutral and could apply to *any* foreign investor, including potentially EU investors, particularly in light of significant uncertainties in relation to the future of the UK’s relationship with the EU, as well as investors from close trading partners such as the United States. As set out in the Explanatory Memorandum, the emphasis is to ensure delivery, self-reliance and self-determination of critical public health capabilities within the UK.<sup>9</sup>

The new public health emergency intervention power will allow the UK Government (through the designated Secretary of State) to intervene where the CMA’s ordinary jurisdictional thresholds for merger reviews are met, i.e.:

- the value of sales of the target business that were generated in the UK must exceed £70 million in the last financial year (the “turnover test”), or
- as a result of the transaction, the parties’ combined share of supply of goods or services is 25% or more in the UK or any substantial part of it (the “share of supply test”).

The “share of supply test” requires an increment to the merger parties’ combined share of supply, meaning both parties must be present in the UK and have at least some overlapping activities. In this regard, it is important to be aware that the CMA has wide discretion in describing the relevant goods or services, which need not amount to an economic market. In addition, the Secretary of State may intervene in a merger case which is subject to the European Commission’s “one-stop shop” merger control procedure by issuing a European intervention notice.<sup>10</sup>

Under existing rules, the Secretary of State can only intervene on the basis of three existing specified public interest considerations, i.e. national security, media plurality and financial stability. Such interventions are rare; since the Enterprise Act 2002 was enacted, the Government has only intervened on 20 occasions: 12 on national security grounds, 7 on media plurality and once on financial stability. No transaction has been blocked on public interest grounds. These powers in relation to EU merger reviews will remain relevant until the expiry of the current Withdrawal Agreement of the UK from the EU at the end of 2020.

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<sup>7</sup> Ibid at 7.4.

<sup>8</sup> See the Department for Business, Energy & Industrial Strategy press release of 21 June 2020: [here](#).

<sup>9</sup> Explanatory Memorandum at 7.3.

<sup>10</sup> The introduction of new public interest considerations in the context of EU mergers is subject to Article 21(4) of the EU Merger Regulation.

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### The additional national security grounds under lower merger control thresholds

In June 2018 the UK Government lowered the “turnover test” review thresholds in the UK merger regime from £70 million (see above) to £1 million and removed the requirement for an increment under the “share of supply test” for transactions involving businesses active in the production or development of military and dual-use items, quantum technology or computing hardware.

By the draft Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2020, the UK Government now seeks to introduce three *additional* categories of businesses subject to review under this lower threshold regime, namely AI, cryptographic technology and advanced materials.

These new categories are intended to capture changes in the form of threats to national security brought about by technological advancements and economic developments. In the Explanatory Memorandum to the draft legislation,<sup>11</sup> the UK Government sets out the reasons for enhanced scrutiny of transactions in the three sectors as follows:

a. AI

AI is defined in the draft legislation as businesses that produce, develop and design digital AI and machine learning technologies (excluding physical robotics), including components and service providers and all relevant intellectual property.

AI utilises vast datasets to perform complex tasks in the digital and physical environment and has the potential to be programmed remotely, misdirected or misused. The definition of AI is deliberately drafted broadly in order to enable the UK Government to protect national security in this rapidly developing sector.<sup>12</sup>

b. Cryptographic technology

Cryptographic technology refers to technology that enables information to be protected whilst in storage or in transit. It includes methods of verifying the identity of a person, user, process or device, or the origin or content of a message, data or information, by means of electronic communication, where the method of verification has been encrypted or subject to other analogous application.

This technology, which has been a focus of research and innovation in the UK, is critical to the maintenance of cybersecurity and the integrity of systems critical to national security.<sup>13</sup>

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<sup>11</sup> See [here](#).

<sup>12</sup> Explanatory memorandum, at 7.16-7.19.

<sup>13</sup> *Ibid* at 7.20-7.22.

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### c. Advanced materials

The UK Government considers materials and manufacturing science fundamental enablers across all areas of development. This category has accordingly been introduced to protect UK businesses engaged in the understanding, manipulation and exploitation of the composition, arrangement and properties of matter, and consequently to maintain the UK's advantage in its defence and security capability.

The definition of advanced material in the draft legislation is technical and includes, for example, any materials capable of modifying the appearance, detectability, traceability or identification of objects or humans (e.g. materials with counter-surveillance applications) and 3D printing capability (e.g. novel technology in relation to ceramics and metals).

Further explanatory guidance on the practical effects of these changes will be published and the Government expects to update these definitions as technology evolves. Transactions that can be reviewed by the Secretary of State under the lower thresholds can also be reviewed by the CMA on competition grounds.

### Significance

The new public interest and national security review powers introduce an additional layer of complexity and uncertainty in acquisitions involving a foreign purchaser and businesses with a significant UK presence.

Investors contemplating transactions in sectors affected by the new and impending rules should consider the potential impact of these rules on the timing, cost and viability of those transactions from a public interest perspective, even if no competition law issues arise.

Although notification remains on a voluntary basis, early engagement with the CMA and relevant government departments may be beneficial, as public intervention procedures can take place *post-completion* if the transaction was not pro-actively notified to the CMA under the CMA's merger control regime.

It is also clear that the introduction of a standalone, comprehensive foreign investment screening regime has not fallen off the legislative agenda, and the National Security and Investment Bill will likely be tabled in the near future.

More broadly, regulation of foreign investment across the EU has also intensified significantly in recent years. In addition to the introduction of new national foreign investment control regimes, the EU Framework for Screening of Foreign Direct Investment, due to come into force in October 2020, creates a mechanism for EU Member States to exchange information and raise concerns related to specific investments. Transactions that affect critical technologies, infrastructure, inputs or sensitive information in the EU are likely to attract close scrutiny.

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The COVID-19 pandemic has accelerated this trend. In March, the European Commission issued specific Guidance urging EU Member States to adopt necessary measures to preserve critical assets and technology which are part of the backbone of the EU's economy, highlighting risks that go beyond the healthcare sector, extending to strategic assets crucial to Europe's security.<sup>14</sup> Many Member States, notably Spain, France, Italy and Germany, have already introduced stringent foreign investment screening rules. Others are expected to follow.

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<sup>14</sup> See [here](#).