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Merger control and the public interest: European spotlight on foreign direct investment and national security

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Introduction

Against a backdrop of increasingly protectionist political rhetoric, there has been renewed interest in recent years in the ability of governments to intervene in the M&A process to protect national interests. Depending on the applicable legal framework, this has concerned both the ability of merger control regimes to take into account wider public interests, and the establishment and use of separate foreign direct investment ("FDI") screening mechanisms. This interest flared in 2014, in light of General Electric's bid for Alstom (which lead to a significant overhaul of France's FDI review regime) and Pfizer's attempt to acquire AstraZeneca (which led to calls in the UK for a stronger public interest test in the merger control process to protect wider national interests).[2] It has been reignited in the last year or so, prompted in part by the Brexit vote in the UK and the election of President Trump in the US, and by the large increase in Chinese outbound investment, in particular by State-owned or subsidised entities.

This is a global trend. For example, in the US the regularity and intensity of national security reviews by the Committee on Foreign Investment in the United States ("CFIUS") have increased over the previous few years (leading to a number of high profile prohibitions, such as (ultimately Chinese owned) Grand Chip Investment GmbH's offer for semiconductor-equipment supplier Aixtron SE, and the recent blocking of China-backed Canyon Bridge for Lattice Semiconductors), and legislation is currently under debate which would extend the scope of CFIUS.

In Australia, there have been a number of recent high profile prohibitions under the Foreign Acquisitions and Takeovers Act 1975 (such as the proposed Chinese investments in cattle business S. Kidman and Co. Limited and electricity distribution company Ausgrid). In South Africa – where the Competition Commission and Competition Tribunal must assess the impact of a transaction on the public interest as well as its competitive impact – in the most recent financial years more remedies have been imposed to address public interest concerns (primarily related to employment and black empowerment initiatives) than competition concerns.[3]

This is a trend which has now firmly landed in the EU. This is despite EU countries traditionally having collectively the fewest restrictions on FDI worldwide.[4] For example, in Germany, following a series of investments by Chinese companies in technology targets (such as Midea's acquisition of robotics company Kuka), the Foreign Trade and Payments Act (Außenwirtschaftsgesetz) regime was revised in July 2017 to expand the cross-sectoral public order/public security review regime and introduce a mandatory notification obligation.

At EU level, in September 2017 Jean-Claude Juncker, as part of his State of the Union address, introduced European Commission ("Commission") proposals for an EU framework for FDI screening, stating: "*we are not naïve free traders. Europe must always defend its strategic interests… If a foreign, state-owned, company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen in transparency, with scrutiny and debate*". This is despite the Commission's previous rejection of the need for an FDI vetting

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2 See for example Alex Chisholm & Nelson Jung *The Public Interest and Competition-Based Scrutiny of Mergers: Lessons from the Evolution of Merger Control in the United Kingdom* and David Reader *Pfizer/AstraZeneca and the Public Interest: Do U.K. Foreign Takeover Proposals Prescribe an Effective Remedy?*, both published in the CPI Antitrust Chronicle Oct 2014 (1).

3 See further Jean Meijer, Sandhya Naidoo, André Pretorius & Molly Herron *Public interest in merger control: A look at the South African experience*, Competition Law Insight, June 2017.

4 See S.Thomsen and F. Mistura *Is investment protectionism on the rise? Evidence from the OECD FDI Regulatory Restrictiveness Index*, OECD Global Forum on International Investment, 6 March 2017, OECD.

mechanism[5] following calls by various MEPs for a European Committee on Foreign Investment.[6]

A month later, the UK Government published a Green Paper proposing to extend the UK's merger control public interest regime to enable enhanced national security review of foreign investments.

This article considers in detail the EU and UK proposals, and their interaction with the EU and UK merger control regimes.

EU proposals for FDI screening

Background

The 13 September 2017 proposals[7] were introduced against the backdrop of pressure by France and Germany to take action in this area (but also opposition from a number of other Member States, including reportedly Greece and Portugal).

The EU currently has no legal framework for the assessment of FDI into the EU. The substantive test under the EU Merger Regulation ("EUMR") is a competition test which does not allow for industrial policy or wider public interests (including security concerns) to be taken into account.[8] Article 21(4) EUMR does allow a Member State to take appropriate measures to protect its legitimate interests in respect of a transaction that falls within the EUMR's jurisdictional scope.[9] This expressly includes the protection of public security[10], plurality of the media[11] and prudential rules.[12] Any other claimed legitimate interest must first be communicated to the Commission and recognised by the Commission as compatible with the general principles of EU law before the Member State can take any measures in reliance on Article 21(4) EUMR. The Commission has to date taken a strict approach to such requests.[13] It has intervened in a number of cases where Member States have imposed restrictions on a transaction cleared by the Commission, both under Article 21 EUMR and under the TFEU free movement rules.[14]

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5 See the comments of Commissioner Jyrki Katainen at the time of the launch by the Commission of its *Reflection paper on harnessing globalisation* (reported by MLex, *EU notes foreign-takeover concerns, but warns against new vetting powers*, 10 May 2017). The paper, whilst recognising that openness to FDI is a key source of growth, did however flag that there have been some concerns raised about foreign investors, in particular State-owned enterprises, acquiring European companies with key technologies for strategic reasons, in circumstances where reciprocal access to EU investors is not available.

6 See MLex, *Comment: Foreign mergers, acquisitions need more EU vetting, politicians say*, 21 March 2017. Subsequently, the European Parliament called on the Commission and Member States to: "*screen third country foreign direct investments in the EU in strategic industries, infrastructure and key future technologies, or other assets that are important in the interests of security and protection of access to them*" (European Parliament Resolution of 5 July 2017 on building an ambitious EU industrial strategy as a strategic priority for growth, employment and innovation in the EU).

7 See IP/17/3183 *State of the Union 2017 - Trade Package: European Commission proposes framework for screening of foreign direct investments*.

8 Albeit that Recital 23 to the EUMR does state that the Commission must place its competition appraisal "*within the general framework of the achievement of the* [other] *fundamental objectives*" of the Treaties.

9 It appears that while Article 21(4) EUMR allows Member States to prohibit or impose restrictions on a transaction cleared by the Commission under the EUMR, it would not permit a Member State to allow a merger to take place which the Commission had prohibited.

10 This concept clearly includes military security (in relation to which Article 346 of the Treaty on the Functioning of the European Union ("TFEU") may also apply), but has also been found to include security of supply in relation to products/services of fundamental importance for a Member State (such as energy). This has been strictly interpreted, such that public security may only be invoked where there is a "*genuine and sufficiently serious threat*" to a "*fundamental interest of society*" (see for example COMP/M.4685 *Enel/Acciona/Endesa*).

11 See for example COMP/M.8354 *Fox/Sky*, in which EUMR clearance was granted by the Commission, with parallel media plurality-related notifications being made in Austria, Germany, Ireland and Italy, and a European Intervention Notice (see below) being issued by the Secretary of the State in the UK triggering a public interest review.

12 See for example IV/M.1616 *BCH/A. Champalimaud*.

13 It has also taken a strict approach to attempts to rely on the interests recognised in Article 21(4) EUMR where it is not clear whether these apply, or whether the measures which a Member State wishes to adopt are necessary or proportionate. The Commission has made it clear that where there are "*reasonable doubts*" whether this is the case a notification should be made to the Commission: see COMP/M.4197 *E.ON/Endesa*.

14 For example in relation to COMP/M.4249 *Abertis/Autostrade* and COMP/M.4110 *E.ON/Endesa* / COMP/M.4685 *Enel/Acciona/Endesa*.

According to the Commission, 12 Member States[15] have some form of public interest or FDI screening mechanism in place, but with very different design details and scope (for example in terms of sectors covered, the level of interest triggering intervention rights, which investors the regime applies to, the applicable substantive test, and whether the system requires mandatory pre-notification).

Proposed Regulation

The core of the Commission's proposal is the proposed *Regulation establishing a framework for screening of foreign direct investments into the European Union*.[16] The objective of the draft Regulation is to establish a framework for Member States (and in certain circumstances the Commission) to screen FDI, with the stated aim of ensuring legal certainty while maintaining sufficient flexibility to take into account the diversity between Member States.[17] This will not require Member States to adopt or maintain a screening mechanism, but provides a framework for those that do to ensure that it meets a number of basic requirements.[18] The draft Regulation also aims to establish a cooperation and information exchange mechanism between Member States and the Commission in relation to FDI.

Investments covered

The draft Regulation does not propose as one of the basic requirements that a control threshold be included for triggering the screening mechanism (which is a feature of some, but not all, Member State and third country FDI regimes). It does not explicitly state that qualifying investments should be limited to acquisitions of undertakings (as under the EUMR), rather than, for example, bare assets, although this may be implicit. Article 2(1) of the draft Regulation defines FDI as investments "*of any kind*" by a "*foreign investor*"[19] aiming to establish or maintain "*lasting and direct links*" between the foreign investor and the target entrepreneur or undertaking, including investments which enable the "*effective participation in the management or control of an undertaking*".[20]The draft Regulation provides that Member States may adopt or maintain anti-circumvention mechanisms.[21]

The draft Regulation does not propose monetary thresholds for the application of FDI screening mechanisms.

Member State screening mechanisms

Article 3(1) of the draft Regulation provides that Member States may maintain, amend or adopt FDI screening mechanisms (widely defined[22]) on the grounds of security or public order,[23] in accordance with the terms of the Regulation. Article 6 of the draft Regulation provides that Member States' screening mechanisms:

- Must be transparent, setting out the circumstances triggering the screening, the grounds for the screening, and the applicable procedural rules.

15 Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain and the UK.
16 COM(2017) 487 final, 2017/0224 (COD). See also the accompanying Staff Working Document (SWD(2017) 297 final).
17 See the Explanatory Memorandum and Recitals to the draft Regulation.
18 With the press release emphasising that "*Member States keep the last word in any investment screening*".
19 A natural person or undertaking of a third country (Article 2(2) draft Regulation).
20 The Explanatory Memorandum states that this does not cover portfolio investments, but this limitation does not appear in the text of the draft Regulation.
21 Article 5 draft Regulation. This covers artificial arrangements where the investor is ultimately controlled by a foreign investor (Recital 10).
22 See draft Regulation Article 2(3)-(4).
23 The proposed Regulation does not specifically state that FDI screening mechanisms should not be established on other grounds (for example wider public interest concerns), although this may be the implication (and in any event such mechanisms would need to comply with EU internal market rules, and also Article 21(4) EUMR where they fall within the jurisdictional scope of the EUMR).

- Should contain timeframes for issuing screening decisions (allowing comments of Member States and the Commission to be taken into account – see below).
- Must protect confidential information.
- Should not discriminate between third countries.
- Should provide transaction parties with the ability to seek judicial redress against screening decisions.

Commission screening process

Article 3(2)-(3) of the draft Regulation provides that the Commission may screen FDI that is likely to affect projects or programmes of Union interest on the grounds of security or public order. This includes in particular those projects and programmes which involve a substantial amount or significant share of EU funding, or which are covered by EU legislation regarding crucial infrastructure, critical technologies, or critical inputs. Annex 1 provides an indicative list:

- European GNSS programmes (Galileo and EGNOS, related to space technology).
- Copernicus (related to earth observation).
- Horizon 2020 (related to research and innovation, in particular in relation to key enabling technologies such as artificial intelligence, robotics, semiconductors and cyber security).
- Trans-European Networks for Transport (TEN-T).
- Trans-European Networks for Energy (TEN-E).
- Trans-European Networks for Telecommunications.

Article 9 of the draft Regulation provides that in these cases the Commission may issue an opinion addressed to the Member State where the investment is planned or has been completed, and may request information from the Member State in connection with this.[24] The opinion must be addressed to the Member State concerned within a reasonable period of time, no later than 25 working days following the receipt of any requested information. The Member State must take "*utmost account*" of the Commission's opinion and provide an explanation to the Commission in case its opinion is not followed.[25]

Relevant sectors/factors that may be taken into account

Article 4 of the draft Regulation provides that when screening on the grounds of security or public order (which are not defined), Member States and the Commission may consider the potential effects on:

- Critical infrastructure, including energy, transport, communications, data storage, space, financial infrastructure, and sensitive facilities.
- Critical technologies, including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity, space or nuclear technology.

[24] This must be provided without undue delay. The information shall include: the ownership structure of the foreign investment and the target; the value of the investment; the business activities of the foreign investor and the target and in which Member States these take place; and the funding of the investment, where known.

[25] The Explanatory Memorandum provides that the opinion should be integrated into the Member State's FDI screening process where applicable, or in the absence of such a mechanism in the Member State's "*broader policy making*".

- The security of supply of critical inputs (undefined).
- Access to sensitive information (undefined) or the ability to control sensitive information.

Although the Explanatory Memorandum states that this list is intended to provide legal certainty, the list is non-exhaustive. A number of key concepts are undefined, presumably to allow for flexibility as markets and technologies develop and may become crucial to security/public order over time.[26]

Article 4 specifically provides that when assessing the likely impact on security or public order Member States and the Commission may take into account whether a foreign investor is controlled directly or indirectly by the government of a third country, including through significant funding.

Cooperation and information sharing

Article 8 of the draft Regulation provides that Member States must inform the Commission and the other Member States of any FDI which is undergoing screening within 5 working days from the start of the screening process. Other Member States may provide comments (also to be forwarded to the Commission) in response where they consider the FDI is likely to affect their security or public order, and the Commission may also issue an opinion. As under Article 9, in order to do so other Member States/the Commission may request information from the screening Member State. Any comments/opinions must be provided within a reasonable period of time, no later than 25 working days following receipt of any requested information.[27] The screening Member State must give "*due consideration*" to the comments/opinion provided.

In addition to transaction-specific cooperation and information sharing, under Article 7 of the draft Regulation Member States shall notify to the Commission details of their existing screening mechanisms, and any amendments thereto, together with annual reporting on FDI flows into the territory and on screening decisions (where applicable).

Cooperation and information sharing shall take place between FDI "*contact points*" appointed by Member States (Article 12 of the draft Regulation).

Relationship with merger control

The FDI screening framework within the draft Regulation is clearly separate to the merger control review process under the EUMR, although of course it may apply concurrently to and impact a transaction in parallel to the merger control review. Prior to the publication of the draft Regulation, Commissioner Vestager had made clear her view that any new FDI screening mechanism should be distinct from the EUMR process in order to keep merger control "*clean*".[28] Following publication of the proposals she stated that: "*This new framework doesn't affect the competition rules on mergers. Those rules are about one thing only – making sure that mergers don't harm competition. They apply in the same way to every company, wherever it comes from. And the new framework we've proposed won't change that one bit*".[29] However, there is no requirement within the draft Regulation for Member States' screening mechanisms to be separate to national merger control processes (and in the UK, the current position is that the two processes are integrated, albeit with different decision makers[30]).

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[26] See for example the increased application in the US of the CFIUS regime to technology companies, and semiconductor manufacturers in particular, in the last few years.

[27] Where the Commission's opinion follows from comments made by a Member State, it shall have an additional 25 working days to issue it opinion (Article 8(5)).

[28] See MLex, *Merger reviews should be kept 'clean' from foreign-investment screening, Vestager says*, 13 July 2017.

[29] Speech, EPC Policy Briefing, Brussels, 26 September 2017.

[30] See further below.

In terms of the wider relationship and interaction between the FDI and EUMR processes, when informing the Commission/other Member States about FDI it is screening under Article 8 of the draft Regulation, a Member State should seek to indicate whether it considers the investment is likely to fall within the scope of the EUMR. The Commission has also stated that it will ensure consistency in application between Article 21(4) EUMR and the proposed Regulation, stating that these should be interpreted in a coherent manner.[31]

What clearly may differ (in addition to some transactions being subject to FDI screening regimes but not to the EUMR (for example given its control and turnover thresholds) and vice versa) is timing, despite the 25 working day deadlines within the proposed Regulation for Member State and Commission cooperation being similar on their face to the EUMR's Phase I review period. The timing for Member State FDI review may be longer than the EUMR (or national merger control) review process, leading to additional time in the deal timetable (although it may also be shorter, where any security/public order concerns can be readily dismissed or resolved, but the competition issues are more complex).[32]

Next steps

The proposed Regulation is subject to the ordinary legislative procedure and requires approval of the European Parliament and the Council. It has been reported that the legislative process may be delayed as a result of the objections of some Member States to the Commission's decision to "*exceptionally*" not conduct an impact assessment in relation to the proposals.[33] It is therefore not clear when – and indeed if – the proposal will be adopted, and in what form.

Other policy responses

At the same time as the draft Regulation the Commission published a Communication *Welcoming Foreign Direct Investment while Protecting Essential Interests*,[34] which inter alia discusses the EU's trade and investment policy and efforts to ensure a level playing field. In addition to the proposed Regulation, the Communication outlines complementary measures. Firstly, the Commission will immediately commence (and complete by the end of 2018) a detailed analysis (in conjunction with Member States) of FDI flows into the EU focusing on strategic sectors and assets which may raise security/public order concerns. Secondly, it will set up a coordination group with Member States to help identify joint strategic concerns and solutions in the area of FDI, including identifying sectors and assets that have strategic implications, and discussion of issues of common concern such as subsidies and other practices by third countries facilitating strategic acquisitions.

UK proposals for national security review

Background

On 17 October 2017 the UK Government's Department for Business, Energy & Industrial Strategy ("BEIS") published its long-awaited Green Paper *National Security and Infrastructure Investment*

31 See the Explanatory Memorandum to the Regulation.

32 It is of course already the case that the EUMR timetable may differ from the timetables for third country merger control procedures, and for existing FDI screening mechanisms.

33 See MLex, *EU foreign-investment screening plan might face delay over impact concerns*, 25 October 2017.

34 COM(2017) 494 final.

Review: The Government's review of the national security implications of foreign ownership or control[35] for consultation. The plan to introduce a new legal framework for future foreign investment in Britain's critical infrastructure was first announced when the Government approved the Hinkley Point C new nuclear project over a year ago,[36] and was reiterated within the Conservative Party General Election Manifesto 2017.[37]

It was preceded by comments made by Theresa May, just prior to becoming Prime Minister, as to the need for a "*proper industrial strategy*" enabling Government to step in to defend key sectors (referring to the attempted bid by Pfizer for AstraZeneca and the earlier takeover of Cadbury by Kraft),[38] which therefore appeared to envisage a wider form of FDI control than that based on national security review (in particular in light of impending Brexit and potential removal of the Article 21 EUMR and free movement limitations on such a policy).

The UK does not currently have any specific FDI screening regime.[39] It does, however, have a limited public interest element to its merger control regime, which applies irrespective of the nationality of the investor. The Enterprise Act 2002 ("EA02") largely removed politics from the UK merger control regime: the vast majority of merger control decisions are taken independently by the CMA applying a pure competition test. The Green Paper notes that this offers clarity for businesses and builds investor confidence.[40]

However, this is subject to a number of strictly defined exceptions where the Secretary of State retains the power to intervene in relevant transactions[41] on specified public interest grounds, which can be expanded by statutory instrument.[42] The specified public interest considerations ("PICs") are currently national security, media plurality/accurate presentation of news, and maintenance of the stability of the UK financial system.[43]

In order to intervene the Secretary of State must issue an intervention notice:

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35 Available here.

36 See *Government confirms Hinkley Point C project following new agreement in principle with EDF*, 15 September 2017, available here. This approval - including as to the involvement of China General Nuclear Power Group ("CGN") - was not granted pursuant to any statutory review scheme, but arose from the Government's role in supporting the project inter alia through a 'contract for difference' (see SA.34947 *Support to Hinkley Point C Nuclear Power Station* in relation to the State aid aspects of the project). From a merger control perspective, the Commission cleared the EDF and CGN joint venture under the EUMR in M.7850 *EDF/CGN/NNB Group of Companies* (on which see further Kyriakos Fountoukakos & Camille Puech-Baron *China/EU: The gradual evolution of the EU Commission's merger control decisional practice towards SOEs amidst an increasingly protectionist world*, Concurrences N° 4-2017).

37 Available here.

38 "*Because as we saw when Cadbury's – that great Birmingham company – was bought by Kraft, or when AstraZeneca was almost sold to Pfizer, transient shareholders – who are mostly companies investing other people's money – are not the only people with an interest when firms are sold or close. Workers have a stake, local communities have a stake, and often the whole country has a stake. It is hard to think of an industry of greater strategic importance to Britain than its pharmaceutical industry, and AstraZeneca is one of the jewels in its crown. Yet two years ago the Government almost allowed AstraZeneca to be sold to Pfizer, the US company with a track record of asset stripping and whose self-confessed attraction to the deal was to avoid tax. 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*." Speech of 11 July 2016, available here.

39 There are broad powers within the Industry Act 1975 entitling the Government to intervene in the event of a transfer of control of manufacturing firms to foreign owners "*where that change of control would be contrary to the interests of the United Kingdom*", but these powers have never been used and remain untested.

40 See Chapter 2.

41 Transactions which result in two or more 'enterprises' (essentially businesses) ceasing to be distinct (through a merger of enterprises, or through one enterprise acquiring *de jure* control, *de facto* control, or material influence, over another).

42 Section 58(3) EA02.

43 This PIC was added in addition to those specified in the EA02 in order to clear *the Lloyds/HBOS* merger, in relation to which the then Office of Fair Trading had identified competition concerns, at the height of the financial crisis. See further Craig Pouncey & Ingrid Bukovics *Merger control, credit-crunch style: UK Government intervention in the Lloyds/HBOS merger*, ECLR 2009, 30(2). This PIC does not apply to European intervention notices.

- A public interest intervention notice ("PIN") in relation to transactions falling within the jurisdictional scope of the EA02 (where the target's UK turnover exceeds £70m and/or the transaction will create or enhance a share of supply in the UK of 25% or more).[44]
- A European intervention notice ("EIN") in relation to transactions falling within the jurisdictional scope of the EUMR.[45]
- A special public interest intervention notice ("SPIN") in relation to transactions which do not meet either the EA02 or the EUMR jurisdictional thresholds, applicable only in the case of mergers involving defence contractors and a specific category of media mergers.[46]

In these cases it is the Secretary of State who is the final decision maker, not the CMA (although the CMA's conclusions on the competition assessment of the transaction, where applicable, are binding on the Secretary of State). There are binding timelines for some – but not all – steps in a PIN/SPIN/EIN process.

Interventions under the existing regime have been relatively limited (with 12 formal interventions having been made to date), although there are a number of recent examples. For example, the PIN issued in *Hytera/Sepura* on national security grounds (resolved by undertakings intended to provide assurance that sensitive information and technology is protected and to ensure the maintenance of UK capabilities in servicing and maintaining radio devices used by emergency services in the UK[47]), and the EIN issued on media plurality/broadcasting standards grounds in the ongoing *21st Century Fox/Sky* review.[48]

Green Paper

The Green Paper stresses the benefits of FDI[49] and that the UK is open to investment, but states that it is necessary to update the UK's arrangements for safeguarding national security in relation to essential functions/services, in line with other "*developed and open economies*" with national security screening procedures (citing regimes in the US, Canada, Australia and France[50]).

The Green Paper flags the risk that ownership or control of critical businesses or infrastructure could provide opportunities to "*undertake espionage, sabotage or exert inappropriate leverage*", and states that foreign nationality is considered a risk factor when making assessments of the threat to national security. Its focus is on the ownership or control of national infrastructure (and more particularly "*critical*" elements of national infrastructure), as this is where the loss or compromise of a service would have a major detrimental impact on essential services. It flags that the growing importance of technology means that threats are not confined to large companies with high turnover.[51]

Overall, BEIS states that the UK's current approach to national security protection appears less developed than in other jurisdictions to deal with the risks to national security faced in today's world,[52] and proposes short- and long-term steps to remedy this.

Proposed short term changes - military/dual use and advance technology sectors[53]

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44 Section 42 EA02.
45 Section 67 EA02.
46 Section 59 EA02.
47 See *Proposed acquisition of Sepura plc by Hytera Communications Corporation Ltd: decision notice*, 12 May 2017, available here.
48 ME/6668/17 *21st Century Fox/Sky* merger inquiry: see here.
49 See Chapter 1.
50 See Chapter 5 and Annex B.
51 See Chapter 3.
52 See Chapter 6.
53 See Chapter 7. The consultation on these proposals closed on 14 November 2017.

BEIS proposes to take "*immediate action*" to amend the EA02 jurisdictional tests for specified sectors (which it could do via secondary legislation designed to allow the thresholds to be amended to reflect changing economic circumstances). It states that these thresholds are not appropriate for Government intervention in mergers on national security grounds, given that niche businesses with relatively low turnover can be involved in activities which raise national security risks (although the Green Paper does not identify any transactions which it considers raised potential national security concerns, but the Government was not able to review due to the jurisdictional scope of the EA02).

BEIS proposes to amend the EA02 tests to close this perceived "*loophole*", allowing the Secretary of State to exercise its EA02 'call-in' powers in relation to a greater number of mergers. For specified sectors it proposes to:

- Reduce the UK target turnover threshold to £1 million; and
- Amend the share of supply test such that it would not require any increment or aggregation (and therefore could be met if the target alone has a share of supply of 25% or more in the UK, for example).

BEIS proposes that these changes apply to:

- The military and dual-use sectors (by reference to products or technology on the Strategic Export Control Lists); and
- Parts of the "*advanced technology*" sector (namely businesses involved in "*multi-purpose computing hardware*"[54] and "*quantum-based technology*"[55]).

The proposed reforms do not distinguish between foreign and other acquirers (although in practice national security concerns may only arise in relation to the former), or make any changes to the level of ownership or control which triggers the EA02 regime (which covers the acquisition of control or 'material influence' over an enterprise).

Although driven by national security concerns, as the proposed amendments are to the EA02 thresholds generally the lower thresholds would also apply to the CMA's powers of review on competition grounds. This means that more transactions (in the specified sectors) would fall within the scope of the CMA's jurisdiction, such that businesses will need to decide whether to notify (although the EA02 merger regime is voluntary, merging parties may choose to notify for legal certainty purposes). However, the CMA has stated that it does not envisage the self-assessment process of whether to notify from a competition perspective (or indeed the CMA's decision whether to 'call-in' an un-notified merger) would change in practice, as it would expect any transaction with the potential to give rise to competition concerns would already meet the share of supply jurisdictional test.[56]

Proposed longer term reform - options for wider national security review[57]

54 The proposed definition of which covers: "*enterprises that: (i) own or create intellectual property rights in the functional capability of multi-purpose computing hardware; or (ii) design, maintain or support the secure provisioning or management of roots of trust of multi-purpose computing hardware*". The first limb of the definition is potentially (possibly, not intentionally) very wide. The CMA has emphasised the need for the scope of the new regime to be defined as clearly as possible, to ensure that businesses and the CMA are not unduly impacted by uncertainty (see *Response from the Competition and Markets Authority to the Government's National Security and Infrastructure Investment Review Green Paper* ("CMA Response"), available here.

55 The proposed definition of which covers: "*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*".

56 See CMA Response.

57 See Chapter 8. The consultation on these proposals closes on 9 January 2018.

Within the Green Paper, BEIS canvasses a number of different options for a more significant overhaul of the regime, which it states could be adopted alone or combined as a package. It seeks views on how best to achieve "*targeted and proportionate*" reforms, given the merits and demerits of voluntary versus mandatory systems in terms of burdens on business, transparency and legal certainty, and the potential for gaps in the Government's awareness of potentially relevant transactions.

Option 1: voluntary notification regime and 'call-in' power

Under this option the EA02 regime would be retained in terms of structure, allowing the Secretary of State to intervene in qualifying transactions (within a specified time window), whether notified to the CMA or not, on national security grounds. However, the range of transactions susceptible to national security interventions (as opposed to competition review) would be expanded beyond those currently covered. The Green Paper is not precise on this point, but it appears that the intention is to extend the concept of qualifying transactions for national security review to:

- Acquisitions which would not qualify as a 'merger' under the current EA02 regime, for example acquisitions which do not involve the acquisition of control or material influence over a business, but do involve the acquisition of control or "*significant influence*"[58] over a business or assets in the UK (for example an investor obtaining unrestricted access to sensitive sites or data), potentially including bare assets and greenfield projects; and
- Transactions which do not meet the EA02 turnover or share of supply jurisdictional tests (it is not clear whether any alternative jurisdictional test is envisaged - as under the short-term reforms - or whether this will be completely unlimited).

The proposed reforms under this option do not distinguish between foreign and other acquirers (although in practice national security concerns may only arise in relation to the former), and are not limited to specific sectors.

Option 2: mandatory notification regime for "essential functions" in "key sectors"

Under this option a mandatory notification regime would be introduced under which prior approval would need to be obtained from the Government before a qualifying transaction could be completed. Sanctions could be imposed for failure to comply. It appears that such a regime would apply only to the acquisition of foreign ownership or control. As a result of such a review the Government would have the power to impose conditions on a deal or ultimately block it (and to unwind transactions implemented without approval).

- Relevant sectors

Such a review would apply only to foreign investment in targets which undertake specified "*essential functions*" (a proposed list of which is annexed to the Green Paper[59]) within specified "*key sectors*". Key sectors would include civil nuclear, defence, energy, telecommunications and transport (together with military and dual-use items and advanced technology, and potentially the government and emergency services sectors). BEIS is also considering whether particular individual businesses/assets which do not fall within those functions/sectors, and certain acquisitions of land, which nevertheless raise potential national security concerns, should also be specifically covered.

[58] It is not clear whether this would be defined by reference to a bright line 25% stake or on a more qualitative basis as under the current 'material influence' test.

[59] For example in relation to communications "*the provision of infrastructure in the UK relating to voice or data networks if the impairment of such infrastructure could cause the loss of a voice or data network to more than one million end users*", and in relation to energy "*upstream gas and petroleum infrastructure which has a throughput of more than 20million barrels of oil equivalent per annum*" and "*energy suppliers that provide energy to significant customer bases*".

The list would be extendable by secondary legislation.

- Design details

The Green Paper provides relatively little other detail on how such a new regime would operate, for example in terms of notification procedures, timing, or which departments or agencies would be involved, other than to state (which is consistent with the proposed EU Regulation) that the Government would aim to set out a "*clear, short timeframe*" within which investors would receive a decision and that an effective mechanism for judicial review of the Secretary of State's decision would be available. BEIS indicates that the Government would publish the outcomes of its reviews, in the interest of transparency and clarity, except where to do so would harm national security or other public interests.

- Relationship with merger control

BEIS states that it wishes to retain the independence of the CMA and maintain a separation between competition and national security assessments (although the extent to which the expanded security review would sit within current EA02 processes is not entirely clear).

The CMA has emphasised that it considers there should be a clear separation between a national security regime and the merger control regime (with different thresholds, processes and substantive tests tailored to each regime), in order to maintain business confidence in a consistent and predictable competition focused merger control regime.[60] It has also highlighted the need for the jurisdictional scope of the revised regime to be delineated carefully to ensure certainty, and for there be a transparent, timely process for engaging with the Government, so as to avoid unnecessary merger control notifications being submitted to the CMA as the parties attempt to control the timing of any potential public interest intervention (to the extent the two regimes remain enmeshed).[61]

Wider measures and updates to the Takeover Code

In relation to the potentially wider grounds for review of FDI taking into account industrial policy concerns foreshadowed by Theresa May, no further comment from the Government has been made. In light of the emphasis in the Green Paper on national security rather than protectionism, and given the need to encourage trade and FDI in particular following the UK's exit from the UK, it may be that this possibility does not re-emerge, at least in the medium term.

In relation to the bidder's plans for the target company (the reversal of which led to much consternation in the case of Kraft/Cadbury), the Takeover Panel launched a consultation in September 2017[62] on proposed changes to the Takeover Code applicable to takeovers of public companies. This includes proposals in respect of statements of intention (including accelerating the timing for publication of these and requiring further detail on specified topics such as R&D functions, employees and management and the location of the target's headquarters), the ability of the target to pause the takeover process, and reporting on post-offer undertakings and intention statements.

Impact of EU and UK proposals

It remains to be seen how the EU and UK proposals will progress through the respective legislative procedures, in particular at EU level given the divergence of opinion between Member States (and at

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60 See paragraphs 25-28 of the CMA Response.

61 See paragraphs 20-23 of the CMA Response.

62 PCP2017/2 19 September 2017 *Statements of intention and related matters*, available here. The consultation closed on 31 October 2017.

UK level in light of limited Parliamentary time given the impact of Brexit).

Both sets of proposals seek to tread a fine balance between enabling sufficient control over FDI, and avoiding deterring welcome investment. Both emphasise that national security/public order is the focus, not economic protectionism[63], but only the application of the tests in practice will determine whether other interests will be admitted by the 'back door', and therefore whether foreign investors will have confidence in these stated intentions. Both also seek to keep any FDI review separate to the pure competition analysis under the respective merger control regimes.

Putting aside the substantive test, if this balancing act is to be achieved, the design details of any new UK regime, and any Member State FDI screening regimes adopted or amended as a result of the proposed Regulation (and indeed the interaction with the Commission and other Member States at EU level), will be crucial. These should in our view tightly define the regimes' jurisdictional scope, such that it is clear when a transaction falls or does not fall within the regime.[64] In addition, review processes would ideally be designed such as to minimise burdens on business in terms of the information to be provided, timetables, and the ability to informally consult with decision-makers. Otherwise the length, cost and unpredictability of cross-border M&A processes, which already need to take account of the varying requirements of EUMR/Member State merger control regimes and third country merger control and FDI screening regimes, will increase further.

The outcome of both legislative processes will therefore be closely anticipated.

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63 See for example paragraph 70 of the UK Green Paper: "*We are clear that screening to prevent threats such as espionage, sabotage and leverage merit special treatment but this should not be conflated with screening to control market access for protectionist reasons. The UK is committed to free trade and investment, which must remain a priority for both a successful UK and European economy.*" And paragraph 79: "[the changes] *would empower the Government to act only where legitimate national security risks are raised…no part of the economy…would be automatically off limits to foreign investment*".

64 In relation to which the non-exhaustive list of sectors covered in the proposed Regulation may give rise to concerns.