Merger Control and National Security: Recent Developments in the United Kingdom

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National security has been in the spotlight in the United Kingdom due to recently implemented reforms and further proposed changes widening the government's powers to scrutinise mergers on grounds of national security. A number of recent merger investigations have also indicated that the UK Government is willing to scrutinise transactions involving financial investors as well as so-called hostile parties or states.

What powers does the government have to scrutinise transactions on national security grounds?

Since 11 June 2018, the government has had expanded powers to allow scrutiny of acquisitions of advanced technology and military/dual use technology businesses on national security grounds, and additional further reforms have also been proposed.

The definition of 'advanced technology' businesses covered by the short-term reforms is complex and highly technical, but is primarily focused on computer-related technology, notably quantum computing, intellectual property in computer processing units (CPUs) and 'roots of trust' in CPUs.

The government's current powers

The government is currently able to scrutinise mergers on national security grounds in the following circumstances:

- as with any merger, where the target business has annual UK turnover of over *£70 million* or the merger would result in the *creation (or the increase) of a share of supply of 25 per cent* in the UK; or
- the merger does not meet the thresholds in the first bullet but involves a *current or former defence contractor* who has (or had) access to confidential defence-related information and at least one of the merging parties carries on business in the United Kingdom.

In both these cases, the Secretary of State for Business, Energy and Industrial Strategy can 'call in' the merger by issuing an intervention notice, enabling him or her to take the final decision on whether it should be allowed to proceed. The June 2018 reforms expanded this call-in power as set out below.

The expanded call-in power

As of 11 June 2018, mergers involving certain *military/dual use and advanced technology businesses* can also be scrutinised where the target business has just:

- a turnover of over *£1 million* (as opposed to the normal £70 million threshold); or
- a *share of supply of 25 per cent* or more (as opposed to the normal test where a 25 per cent share of supply must be created or increased by the merger, that is, there must be some overlap with the acquiring party).

Reforms proposed further to the government's powers

Despite the recent changes to the regime (see above), the government is proposing more sweeping reforms, in terms of which the relevant minister will be able to 'call in' a merger for scrutiny under the new national security regime if he or she has:

- reasonable grounds for suspecting that a 'trigger event' has occurred, is in progress or is in contemplation; and
- a reasonable suspicion that the trigger event may give rise to a risk to national security.

'Trigger events' include the acquisition of an interest of over 25 per cent in a business or 'significant influence or control' over it. The new regime would also apply to the acquisition of assets even where these would not normally be regarded as constituting a business in their own right.

While the government is not proposing to set out an exhaustive list of activities which may give rise to national security concerns, there will be an indicative list identifying 'core areas' which may be of concern. Unsurprisingly, this is likely to include defence-related and dual use technology businesses, together with suppliers to the police, security and emergency services. However, it will also allow the government to scrutinise transactions involving a much wider range of businesses/assets than have been scrutinised in the past.

These could include: energy, transport and communications infrastructure and potentially also infrastructure relating to chemicals, finance, food, health, space and water; advanced technology businesses, including a broader range of computer technology than at present, together with other areas which are currently out of scope, such as nanotechnology and discovery and development of new materials; critical suppliers (such as key IT suppliers) to businesses which are engaged in national security-sensitive activity; and land adjacent to national security-sensitive sites.

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The Queen's speech

The proposed further reforms detailed above also attracted attention in the Queen's speech on 19 December 2019, in which they were described as being necessary to strengthen the government's existing powers to protect national security in the context of business transactions, and to provide investors with the certainty and transparency they require to do business in the United Kingdom.

Suggested benefits of reform

According to the UK Government, the main benefits of the proposed legislation were said to include:

- protecting the United Kingdom's national security while remaining a global champion of free trade and investment;
- upgrading the government's existing powers to scrutinise relevant investments and acquisitions;
- ensuring hostile parties are not able to circumvent the rules on technicalities (for example, through an asset acquisition, rather than acquisition of the business); and
- enhancing transparency and ensuring the United Kingdom remains open for innovative and dynamic investment.

It was also noted that the new system, which would update the government's powers to bring them in line with powers adopted by other major countries, including Australia, Japan, Germany and the United States of America, would allow for '*quick, efficient screening*' by the government, powers to mitigate risks through imposing conditions or, as a last resort, blocking transactions and a safeguarding appeal mechanism.

The proposed reforms now lie in the government's hands, with the next step likely to be the tabling of draft legislation, which can be expected to be at some point in 2020 at the earliest.

Recent acquisitions scrutinised on national security grounds

In the meantime, pending the proposed further reforms outlined above, the CMA and the UK Government have demonstrated a willingness to rely on the new lower thresholds to scrutinise transactions on national security grounds involving various kinds of acquirer, including financial investors.

An example of this is the recent acquisition of UK defence company Cobham plc.

Scrutiny of the *Al Convoy Bidco/Cobham plc* merger

This deal relates to the proposed £4 billion acquisition of Cobham, a UK defence company and global technology and services innovator, by certain financial investors, through a company called Al Convoy Bidco.

A European intervention notice (rather than a UK public intervention notice) was issued by the Secretary of State on 17 September 2019, on the basis that the proposed transaction has a 'Community dimension', that is, it meets the EU merger control thresholds. Such a notice enables the UK authorities to scrutinise the national security aspects of the deal.

The European Commission also considered the transaction and cleared it in October 2019, but only examined the competition issues and not the national security aspects (Member States are permitted to make their own assessment of national security concerns, subject to certain constraints imposed by the EU merger control regime).

The CMA's report on the transaction to the Secretary of State was published on 19 November 2019.

The CMA found that it had jurisdiction over the investors' indirect acquisition of shares in Cobham, including over the indirect acquisition of a minority investment of 16.8 per cent in Cobham, on the basis that the minority investor would acquire material influence over Cobham as a result of a combination of:

- its ability to appoint one member to each advisory board;
- its relevant industry knowledge;
- its access to Cobham's commercial information;
- the scope of its veto rights, including in particular in relation to *material changes to the nature of Cobham's business,* which was described by the CMA as a right extending beyond a pure minority shareholder protection.

This was despite the fact that the 16.8 per cent shareholding in question did not confer any voting rights on the minority shareholder.

In establishing jurisdiction, the CMA also, unsurprisingly, found that Cobham's activities fell within the framework of 'military/dual use and advanced technology businesses', and that the lower turnover threshold, applicable to military/dual use and advanced technology businesses was met (as Cobham's UK turnover in 2018 exceeded £1 million and in fact also exceeded the higher turnover threshold of £70 million).

National security concerns in the Cobham transaction

Both the MoD and the Home Office identified national security concerns arising from the proposed transaction, and eight third parties submitted representations regarding various national security concerns. The concerns raised by the MoD included the following: (i) the transaction created the potential for parties to access information either being held on or passing through Cobham's systems, and (ii) there was a risk to continuity of supply of services key to existing MoD programmes. The Home Office concurred with the MoD, and raised concerns regarding the effect that unauthorised access to technology and information or insufficient security controls on access to Cobham's radio devices could have on the UK emergency services in particular, as well as on other UK authorities.

Given the national security concerns identified in the CMA's report, it became a matter of agreeing and implementing remedies to address those concerns and avoid a Phase 2 inquiry.

Consistent with previous national security merger investigations, and the concerns articulated, the undertakings proposed by the parties and accepted by the Secretary of State are behavioural in nature and focus on maintenance of strategic capabilities (that is, ensuring continuity of supply) and protection of sensitive information and material (including limiting certain investors' access to information).

The undertakings were published by the Secretary of State for consultation on 19 November 2019, and the consultation period ended on 17 December 2019. The Secretary of State received a material number of representations which did not support the undertakings (indeed these outweighed the supportive representations); nonetheless having considered those representations, the Secretary of State decided to accept the undertakings in unmodified form on 20 December 2019.

Practical implications

Since the expansion of the government's call-in power in June 2018, there have been a number of national security reviews in the United Kingdom in addition to the *Cobham* transaction, including *Gardner Aerospace Holdings/Northern Aerospace* (2018), *Connect Bidco/Inmarsat* (2019), and the recently commenced *Gardner Aerospace Holdings Limited/ Impcross Limited* (2019) and *Aerostar/Mettis* (2019).

Taken together with the recent and proposed reforms to the United Kingdom's defence mergers regime, it appears that the UK Government is willing to investigate a wider range of deals than it has done in the past, including acquisitions (even minority stake acquisitions) made purely for investment purposes by investment funds and private equity firms.

It would therefore be prudent for all types of buyers considering the acquisition of targets with activities which may be of interest to the government from a national security perspective to conduct a thorough assessment of the risk of potential intervention by the Secretary of State, and to factor in the possible consequences of such an intervention.