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UK Government Extends Powers to Intervene in Mergers on Public Interest Grounds

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In the UK, there is currently no separate foreign direct investment (FDI) screening regime. Instead, the UK government can only intervene in limited circumstances where a transaction raises at least one of the following public interest issues: national security, financial stability, media plurality and, as of June 23, public health emergencies.[1] At the time of writing, the government has intervened in 20 transactions in this way,[2] notably without blocking any deals.

A new standalone FDI regime is expected shortly in the UK by way of the forthcoming National Security and Investment Bill. Pending the introduction of this new regime and to mitigate the perceived risks to national security in the short-term, as of July 21, the government has extended its powers to intervene in three additional technology sectors – artificial intelligence (AI), cryptographic authentication technology and advanced materials – by applying the lower jurisdictional thresholds introduced in June 2018 (see previous alert, UK Government Introduces Lower National Security Merger Review Thresholds). This means that the government can now intervene in acquisitions of UK businesses in these sectors where the target company has: (i) an annual UK revenue exceeding £1 million (approximately US $1.3 million); or (ii) a UK share of supply of 25% or more (with no need to show an increment to the share of supply).

Investors seeking to acquire UK businesses that are active in these sectors should therefore anticipate increased scrutiny and consider the risk of intervention and implications on their deals early on in the process.

Background

Since the introduction of the Enterprise Act 2002, the government has found that the thresholds as set in 2002 were no longer working effectively as a threshold for intervention on national security grounds in certain areas of the economy. Consequently, in June 2018, the government introduced lower thresholds in relation to military and dual-use technologies, quantum technology and computing hardware, sectors of the UK economy, which were perceived to raise national security concerns (see previous alert, UK Government Introduces Lower National Security Merger Review Thresholds). Based on these reforms, a transaction was reviewable if the target company in those sectors had: (i) an annual UK revenue exceeding £1 million (approximately US $1.3 million); or (ii) a UK share of supply of 25% or more (with no need for an increment to the share of supply). This marked a significant change from the usual UK merger thresholds, under which a transaction is reviewable only if the target has annual UK revenues of more than £70 million (approximately US $89 million) or if it leads to an increment in the parties' *combined* share of supply of 25% or more.

AI, cryptographic authentication technology and advanced materials

Two years on, in July 2020, the lower jurisdictional thresholds have been extended to cover the following three additional technology sectors perceived as important for national security: AI, cryptographic authentication technology and advanced materials.[3]

Under the new reforms[4], the following types of businesses will fall within scope:

- **AI** means "technology enabling the programming or training of a device or software to use or process external data (independent of any further input or programming) to carry out or undertake (with a view to achieving complex, specific tasks) (a) automated data analysis or automated decision making; or (b) analogous processing and use of data or

information."

In the accompanying guidance[5], the government explains that it does intend to cover all businesses that produce, develop and design AI technologies, including components and service providers and all relevant intellectual property, where these products are reasonably expected to be used in systems critical for national security. However, it is not intended to cover goods or services using AI and which are generally available to the public and for use by the consumer, such as traffic routing, SPAM removal, social networking applications, facial recognition for security and shopping recommendations. As such, it is anticipated that only a small minority of mergers will raise national security concerns.

- **Cryptographic authentication** means the "method of verifying (a) the identity of a person, user, process or device; or (b) 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" to protect the authenticity, confidentiality and integrity of such matters.

  Whilst the government recognises that cryptographic technology is integral to a well-functioning economy and acknowledges the importance of these technologies to the UK, it is also concerned that an acquisition in this field may undermine national security by giving a hostile operator access to critical systems, resulting in significant damage through sabotage or espionage. The government has therefore passed legislation to scrutinise transactions involving businesses that develop products whose primary function is authentication using cryptographic means, where these products are reasonably expected to be used in systems critical for national security.

  Examples of technologies within scope of the new legislation include systems authenticating: (i) the identity of a physical person for entrance into a civil nuclear site; (ii) the identity of a user to access the computer network of a power station; (iii) a biometric property of an individual to access a restricted area of an industrial site; (iv) a credit/debit chip-and-pin card at an ATM or retail point of sale; (v) facial recognition technology used in conjunction with CCTV footage; and (vi) the digital information contained in an e-passport.

  Conversely, the government does not intend to intervene where authentication products and systems are generally available to the public and for use by the consumers. For example, companies which develop products whose primary function is encryption and not authentication – for instance, a username and passwords system to access online services or fingerprint and other biometric verification devices built into smart phones.
- **Advanced materials** means "(a) any materials that are capable of modifying (including in real time) the appearance, detectability, traceability or identification of any object to a human or to sensors within the range 1.5e13 Hz up to and including ultraviolet; (b) any alloys that are formed by chemical or electrochemical reduction of feedstocks in the solid state; (c) any manufacturing processes that are involved in the solid state formation of alloys in or into crude or semi-fabricated forms, or powders for additive manufacturing, where "additive manufacturing" means a process of joining materials to make parts from three-dimensional model data; or (d) any metamaterials that do not include (i) fibre-reinforced plastics in structural components, products or coatings with completely random dispersion of pigment or other filler; or (ii) any packaged device components that are designed for civil application."

  Discoveries and scientific development in the context of advanced materials science are considered key enablers across all areas of societal and economic development. For this reason, the government pledges to maintain advantage in its defence and security capability, tackling possible risks if UK companies active in this area are controlled by hostile actors.

Implications for deals

The UK government is clearly addressing the perceived short-term risks to national security until a new standalone FDI regime is in place through the forthcoming National Security and Investment Bill. Whilst the impact of these latest reforms is likely to be limited, deal teams seeking to acquire UK target companies that are active in AI, cryptographic authentication technology or advanced materials sectors should carefully consider upfront the risk of intervention and the potential implications for their transactions.

Notes

1. A new ground effective on 23 June 2020 in response to the COVID-19 pandemic, introduced by statutory instrument The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2020, SI 2020/627.
2. At the time of writing, the government has intervened on public interest grounds under the Enterprise Act 2002 on 20 occasions: 12 on national security grounds, seven on media plurality and once on financial stability.

3. See Enterprise Act 2002 (Share of Supply) (Amendment) Order 2020, SI 2020/748, and the Enterprise Act 2002 (Turnover Test) (Amendment) Order 2020, SI 2020/763.
4. See Enterprise Act 2002 (Share of Supply) (Amendment) Order 2020, SI 2020/748.
5. See Enterprise Act 2002: changes to the turnover and share of supply tests for mergers, Guidance 2020

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