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UK Merger Control and FDI—New Jurisdictional Tests and Recent Developments

Upcoming Amendments to the UK Merger Control Thresholds and the Commencement of the UK FDI Regime

EXECUTIVE SUMMARY

UK merger control: As part of broader reforms to its competition and consumer policy, the UK government has announced its intention to modify the jurisdictional thresholds that determine transactions that the Competition and Markets Authority ("**CMA**") can review. The changes comprise:

- an increase in the existing turnover threshold from £70 million to £100 million to adjust for inflation;
- the addition of a new acquirer threshold aimed at capturing 'killer acquisitions' and potentially harmful non-horizontal mergers; and
- the introduction of a safe harbour for small mergers.

The government also consulted on whether to adopt a mandatory notification regime and replace the (much criticised) share of supply test, but decided against these reforms for the time being.

UK foreign direct investment ("FDI"): The new UK FDI regime came into effect on 4 January 2022, with retrospective effect from 12 November 2020. It is a hybrid regime, requiring mandatory notification if certain conditions are met, but enabling the government to 'call in' other qualifying transactions for review that do not meet the mandatory notification thresholds.

Central to the regime is a list of 17 sectors of the economy identified by the government as particularly sensitive. Only qualifying acquisitions of target entities with activities in these sensitive sectors require mandatory notification and pre-closing approval. However, acquisitions of entities or assets that are closely linked to these activities may warrant a voluntary notification.

The regime is far-reaching, and even transactions that would not, on their face, appear to give rise to any national security risks may be subject to review.

I. THE UK MERGER CONTROL REGIME

In July 2021, the UK government published its consultation on 'Reforming competition and consumer policy', in which it posed a wide-ranging reform programme covering, inter alia, the UK's merger control system.[1] The consultation ran until October 2021, with the government response to the consultation published in April 2022, announcing significant reforms to the UK's merger control thresholds.[2]

Under the current law, in most cases, the CMA may conduct a merger review only if:

a) the business that is being acquired has a UK turnover of more than £70 million (the turnover test); or

b) the merger would result in the creation or enhancement of at least a 25% share of the supply of particular goods or services in the UK, or a substantial part of the UK (the share of supply test).

The consultation covered the following potential reforms to the merger control regime.

MANDATORY OR VOLUNTARY REGIME

Merger filings in the UK are voluntary and non-suspensory, meaning that parties can choose whether to notify mergers to the CMA and they do not automatically need to suspend closing or integration while they wait for the outcome of the CMA's merger review. However, the CMA can 'call in' for investigation mergers about which it has concerns (provided that they meet one of the thresholds outlined above) and impose an initial enforcement order to prevent integration between the merging firms while it investigates the merger.

The voluntary nature of the regime means that fewer transactions are notified to, and reviewed by, the CMA than in jurisdictions with mandatory filing regimes. It benefits parties involved in clearly non-problematic transactions. However, it also gives rise to uncertainty for parties where the impact on competition (or lack thereof) of the transaction is less clear. Where there is overlap between them but seemingly no competition concerns, parties may choose not to notify the transaction to the CMA, and later find it 'called in' for a review.

However, the outcome of the government consultation was that the voluntary regime should be retained. Although the government noted increased support compared to previous consultations for a mandatory regime with clear, turnover-based 'bright line' thresholds for establishing the CMA's jurisdiction, the majority of respondents to the consultation agreed with the government's preference to retain the voluntary regime.

NEW THRESHOLDS

Following the consultation, the government intends to (a) increase the turnover threshold from £70 million to £100 million to adjust for inflation, and (b) introduce a new acquirer threshold.

The new threshold will apply where an acquirer has both:

a) an existing share of supply of goods or services of 33% in the UK or a substantial part of the UK; and

b) a UK turnover of £350 million.

The current share of supply test requires the merging parties to have overlapping shares of supply in the UK, and therefore addresses the most commonly harmful type of merger, the removal of a current, direct competitor from a market. However, it does not adequately address (a) mergers that remove potential competition from a market (*e.g.*, so-called 'killer acquisitions', where a company that is developing a new product or service is bought out before it can develop to become a competitor) and (b) mergers that facilitate the leveraging of market power across products or services that exist in different markets or at different levels of the supply chain. The new acquirer threshold is aimed at enabling the CMA to review these types of mergers.

Many respondents to the consultation recommended, and the government agreed, that if the new acquirer threshold was adopted, a clearer UK nexus test should be established to ensure that only mergers with an appropriate link to the UK would be captured. It remains to be seen what the new UK nexus criterion will require. However, in light of recent decisions in which the CMA creatively found jurisdiction despite very limited target activity in the UK,[3] the addition of a clear nexus criterion is to be welcomed.

SAFE HARBOUR FOR SMALL MERGERS

The government intends to introduce a safe harbour for mergers between small companies, where the UK turnover of each of the merging parties is less than £10 million. The safe harbour would prevent the CMA from reviewing such mergers, even if they meet the share of supply test.[4]

This is a significant improvement on the government's original proposal to set the safe harbour at *worldwide* turnover of £10 million, which would have had limited impact, as few businesses of that size would ordinarily undergo merger review in any case. Furthermore, a safe harbour set by reference to UK turnover rather than worldwide turnover would provide greater certainty for 'foreign to foreign' mergers involving overseas businesses with little or no UK turnover.

SHARE OF SUPPLY TEST

The government acknowledged in the consultation that concerns have been expressed about the inherent flexibility of the share of supply test. In determining whether the share of supply test is met, the CMA may have regard to value, cost, price, quantity, capacity, number of workers employed or any other criterion, and is not limited to considering economic markets. This significantly reduces the predictability of the UK's merger control system.

Some respondents to the consultation supported the replacement of the share of supply test, while others recommended a range of potential amendments. According to the government response, there was no clear view among respondents on the best way to reform the share of supply test. As such, the government considered it premature to reform the test at this time. The government noted that it would monitor the operation of the share of supply test and may consider further reforms at a later date.

REVISED JURISDICTIONAL TEST

In light of the above, the revised jurisdictional test is likely to take a form similar to the following.

The CMA would have jurisdiction to review a merger if:

a) the business that is being acquired has a UK turnover of more than £100 million; or

b) the merger would result in the creation or enhancement of at least a 25% share of the supply of particular goods or services in the UK, or a substantial part of the UK; or

c) the acquirer has an existing share of supply of goods or services of 33% in the UK or a substantial part of the UK and a UK turnover of £350 million;[5]

Unless, the UK turnover of each of the merging entities is less than £10 million.

II. THE UK FDI REGIME

The National Security and Investment Act 2021 ("**NSI Act**"), which came into force on 4 January 2022, established a new foreign investment regime in the UK. The NSI Act gives the Secretary of State for Business, Energy and Industrial Strategy ("**BEIS**") wide powers to investigate transactions that may threaten national security, and to block or impose conditions on transactions. These powers are exercised by the Investment Security Unit ("**ISU**"), which sits within BEIS, and is responsible for administering the NSI Act. BEIS expects to block transactions only rarely, but the regime still has important timing implications for transaction parties due to the need, in the case of mandatory notifications (or where an interim order has been issued), to obtain clearance prior to closing the transaction.

The ISU has 30 working days to conduct an initial review following receipt of a complete notification, after which the transaction will either be cleared or called-in for a full national security assessment. If a full national security assessment is required, the ISU has a further 30 working days to conduct the review, extendable by 45 working days, and with further voluntary extensions possible if agreed with the parties.

Where no mandatory notification is required, the ISU may still 'call in' certain transactions for review, and has the power to unwind completed transactions where there are national security concerns. Therefore, absent a mandatory notification requirement (about which further details are provided below), parties may still choose to voluntarily notify a transaction to the ISU in order to obtain deal certainty.

THE UK FDI REGIME IS AMONG THE MOST FAR-REACHING REGIMES IN THE WORLD

Notably, the UK regime has no financial thresholds for notification, nor does it offer a de minimis exemption. Furthermore, despite being commonly referred to as a 'foreign' investment regime, it captures acquisitions by UK investors as well as acquisitions by foreign investors.

In addition, the regime affects 'foreign to foreign' transactions, where the target has no legal entity or assets in the UK. To be caught, it is sufficient for the target to carry on activities in the UK (*e.g.*, a foreign company doing business in the UK from a regional office or R&D facility in the UK) or to supply goods and services to people in the UK. For the acquisition of land or tangible moveable property situated outside the UK, or any intellectual property, it is sufficient that such assets are used in connection with activities carried on in the UK (*e.g*., machinery located overseas used to produce equipment that is used in the UK) or used in connection with the supply of goods or services to people in the UK (*e.g*., an offshore wind farm that is used to generate electricity which is supplied to the UK).

Finally, BEIS has the ability under the NSI Act to retrospectively call in transactions completed on or after 12 November 2020 for up to five years (or six months after becoming aware of the transaction).

HYBRID MANDATORY AND VOLUNTARY NOTIFICATION REGIME

Broadly, a mandatory notification requirement is triggered if both of the following criteria are met:

1. The acquisition is of a qualifying entity[6] that carries on certain activities in the UK within one of 17 sensitive areas of the economy set out in The National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021 (the "**Notifiable Acquisition Regulations**").

2. Any of the following apply:

    a) The acquirer's shareholding stake or voting rights increase:

        i) from 25% or less to more than 25%

        ii) from 50% or less to more than 50%

        iii) from less than 75% to 75% or more

    b) The acquisition is of voting rights and this will enable the acquirer to secure or prevent the passage of any class of resolution governing the affairs of the entity.

The 17 areas of the economy are:

- Advanced Materials
- Advanced Robotics

- Artificial Intelligence
- Civil Nuclear
- Communications
- Computing Hardware
- Critical Suppliers to Government
- Cryptographic Authentication
- Data Infrastructure
- Defence
- Energy
- Military and Dual-Use
- Quantum Technologies
- Satellite and Space Technologies
- Suppliers to the Emergency Services
- Synthetic Biology
- Transport

The Notifiable Acquisitions Regulations set out the relevant activities within each sector that require a mandatory notification. BEIS has provided helpful additional guidance on the kinds of activities intended to be covered.[7] In some sectors, the relevant activities are narrowly defined. In other sectors, however, tangential activities with no apparent national security implications are also captured. Prospective acquirers and their advisers may need to undertake detailed diligence to determine whether a notification is required. This process can require extensive technical discussions with the target business. Such diligence is important because, if a mandatory notification is required, there are civil and criminal penalties for closing a transaction prior to obtaining the necessary approval.

Helpfully, the ISU has been open to consultation and willing to provide parties and advisers with informal guidance on the interpretation and application of the NSI Act and Notifiable Acquisition Regulations.

Where there is no mandatory notification requirement, it may still be advisable to make a voluntary notification, to avoid the risk of the transaction being subsequently called in for review. A transaction can be called in for review if BEIS reasonably suspects that the transaction has given, or may give, rise to a risk to national security (a term that is not defined in the NSI Act), and the transaction gives rise to a 'trigger event'.[8]

A transaction that does not meet the 25%, 50% and 75% thresholds set out above, or enable the acquirer to secure or prevent the passage of any class of resolution governing the affairs of the entity, may nevertheless give rise to a 'trigger event' if the acquisition would enable the acquirer to materially influence the policy of the target.

In addition, asset acquisitions are not subject to the mandatory notification requirement but can be in the scope of the call-in power. This is principally so that acquisitions may be called in if control of an asset is acquired instead of an entity that owns it, or in the event that an asset, such as land, is located near a sensitive site, which may give rise to a national security risk.

Transactions giving rise to a trigger event that are not subject to a mandatory notification are more likely to be called in if the target is engaged in one of the relevant activities in the Notifiable Acquisition Regulations, or in an activity that is closely linked (such as where the target's activities are related to transport but are not within the definition of transport in the Notifiable Acquisition Regulations).[9]

Decisions on whether to exercise the call-in power will be made by the Secretary of State for BEIS on a case-by-case basis. In order to assess the likelihood of a qualifying acquisition giving rise to a risk to national security (and therefore whether to call in the acquisition), the Secretary of State expects to consider primarily three risk factors: (a) **target risk**, *i.e.*, whether the target is being used, or could be used, in a way that raises a risk to national security; (b) **acquirer risk**, *i.e.*, whether the acquirer has characteristics that suggest there is, or may be, a risk to national security from the acquirer having control of the target; and (c) **control risk**, *i.e.*, the amount of control that has been, or will be, acquired through the qualifying acquisition (a higher level of control may increase the level of national security risk).[10]

III. CLOSING REMARKS

The upcoming reform of the merger control thresholds, especially the addition of an acquirer threshold, and the onset of the new FDI regime, mean that, going forward, transaction parties will need to consider even more carefully the potential impact of prospective mergers in the UK. The filing analysis is not as straightforward as for jurisdictions with bright line tests, and even transactions with a very limited or only tangential UK nexus may be scrutinised by the CMA and ISU. This can have implications for deal certainty and timing.

Furthermore, the voluntary nature of the merger control system, and hybrid voluntary and mandatory nature of the FDI regime, mean that UK merger control and FDI implications often cannot be dealt with in the same way as other (mandatory) notification requirements when drafting and negotiating the merger agreement. Therefore, transaction parties are advised to commence this analysis early on in the M&A process.

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ENDNOTES

1 *See* Reforming Competition and Consumer Policy (publishing.service.gov.uk).

2 *See* Reforming competition and consumer policy: government response - GOV.UK (www.gov.uk).

3 For example, ME/6831/19 - *Roche Holdings, Inc. / Spark Therapeutics, Inc*. (2019), ME/6806/19 - *Sabre Corporation / Farelogix Inc* (2020) and ME/6891-20 – *Facebook, Inc. / GIPHY, Inc.* (2021).

4 Public interest interventions in media mergers will be exempted from the small merger safe harbour.

5 The government indicated that there will also be a UK nexus criterion, but it remains to be seen what this will require.

6 A qualifying entity is any entity other than an individual, including a company, a limited liability partnership, any other body corporate, a partnership, an unincorporated association and a trust.

7 *See* National Security and Investment Act: guidance on notifiable acquisitions - GOV.UK (www.gov.uk).

8 The meaning of ‘trigger event’ is set out in section 5 of the NSI Act.

9 *See* National Security and Investment Act 2021: Statement for the purposes of section 3 - GOV.UK (www.gov.uk).

10 *Ibid.*

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