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UK Seeks To Balance Asset Protection And Protectionism

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In proposals for the most wide-ranging revisions to the U.K.'s takeover regime in over 15 years, on July 24, 2018, the government launched a 12-week consultation on draft rules aimed at enhancing its powers to review or block foreign acquisitions of sensitive British assets.

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An Open Market

The U.K. is unquestionably one of the world's most open markets for cross-border mergers and acquisitions, and has been for decades. It continues to be one of the most active foreign direct investment destinations, with a cumulative level of inward investment in 2017 of $1.6 trillion, the highest in Europe, and the third highest globally, after China and the U.S. Thomson Reuters reports that the U.K. is the second most active takeover market in the world after the U.S., with 210 billion pounds worth of offers being announced for U.K. assets in the first six months of 2018.

Changing Concerns

Despite this boom, the government has for a while signaled that it would consider the security implications of foreign ownership of strategic assets. Ministers have been acutely aware that certain transactions could put the integrity of critical national infrastructure at risk, expose it to espionage, or even turn it into a tool that may be used for leverage. In 2016, the prime minister reviewed the purchase of a stake in the nuclear power station at Hinkley Point by a Chinese state-controlled entity, China General Nuclear. Although that deal was ultimately approved, since then, similar transactions have been increasingly on the radar. In 2017, the government investigated and cleared the sale of police walkie-talkie manufacturer Sepura to the Chinese company Hytera Communications, and at the same time, lawmakers expressed frustration over their inability under existing rules to review the takeover by Canyon Bridge of the U.K. chipmaker Imagination Technologies.

At present, the U.K. authorities may only intervene in takeover scenarios outside of antitrust reasons if the transaction creates a group with 25 percent market share, or one with a turnover that exceeds 70 million pounds. The latter threshold was reduced in June 2018 to 1 million pounds for companies that make military or dual-use technology, computing hardware and quantum technology, with the aim of increasing government scrutiny in areas that are linked to national security.

The New Regime

The current proposals follow in the same vein, and are set out in a white paper on national security and investment published by the Department for Business, Energy and Industrial Strategy.

- Voluntary notification, discretionary government review: Instead of requiring mandatory reporting, the government would encourage parties to a transaction to provide a voluntary prior notification where such a transaction could give rise to a national security risk. The government would also have the power to "call-in" transactions in order to assess them.

- Wide range of transactions: The revised rules would focus not just on takeovers, but would apply to the acquisition of interests in assets more generally — such as the acquisition of land or intellectual property (where they may be relevant to critical infrastructure or national security assets), or the provision of loan financing, where the facilities are linked to potentially hostile state actors, or the collateral may have a connection to sensitive assets.

- Supplementary and stand-alone: The new regulations would supplement and not supplant the existing public-interest provisions that allow the government to review transactions that engage matters of media plurality or financial stability. Moreover, under the revised regime, the government would be able to override the decisions of the existing merger control regulator, the Competition and Markets Authority, although such powers would not extend to extraterritorial authorities such as the European Commission. This would be a sword as well as a shield, as it would also mean that the government could clear an anti-competitive transaction for reasons of national security.

- Three-fold path: Upon the completion of a review, three outcomes would be possible: first, clearance to proceed; second, approval subject to certain conditions being satisfied; and third, the blocking of a deal or its unwinding if it has already taken place. The government has been at pains to clarify that the third and most extreme course of action would only be taken in the rare circumstances where it is the only available course of action. Breaches of the government's recommendations will for the first time in such an M&A context give rise to criminal as well as civil sanctions.

Implications for Practice

While the revised rules are currently in draft form, and the final form will only be published following the end of the consultation in mid-October, there are three clear implications for legal practitioners and clients.

First, the broad nature of transactions liable to scrutiny and the lack of monetary or market-share thresholds means that governmental consent will not just be a matter for takeovers of public companies, but will apply to acquisitions of interests in a wide range of asset classes, and also to lending transactions. This will mean potentially increased and certainly more nuanced due diligence from a regulatory consent perspective will be required even in deals that do not engage the U.K.'s takeover rules.

Second, the number of deals under review will rise. In the past 18 months, there have only been five reviews of transactions under public interest grounds, and only two of these were for reasons of national security. The government estimates around 200 deals per year to fall within the new requirements, with 50 of these requiring remedies or conditions. In itself this does not mean that more acquisitions of U.K. assets will be blocked by the government, but it is certain that more will be reviewed, and it is likely that more will have conditions attached to them.

Third, the new rules will without doubt have an impact on the time-table for transactions. The government could take up to 30 working days following a voluntary notification to decide whether a full assessment is required, and such an assessment could take a further 30 to 75 working days, with powers to stop the clock. This will have the effect, already common in jurisdictions like the U.S., of front-loading the review process, and increasing the prevalence of informal discussions with the authorities prior to a notification that starts the clock, particularly given the potential of criminal sanctions for breach of a requirement once an official decision has been reached.

Striking a Balance

The U.K. is not alone in setting out these proposals — indeed, on the same day as the British government's announcement, the House of Representatives passed a bill enhancing the powers of the long-standing Committee on Foreign Investment in the United States with the stated aim of clamping down on Chinese investments in U.S. assets. Similar legislation was passed in Germany last year, and is afoot in France and Australia.

Against the backdrop of the U.K.'s reputation as a free market champion, it also has a long history of safeguarding strategic national assets from foreign control, and the mechanism of the "golden share" was pioneered during the privatization era, simultaneously with the opening out of the British economy to global trade.

And yet, as Brexit Britain seeks to project itself as a global trading nation, the government is also no doubt aware that while protection is one thing, protectionism is likely to be at odds

with this image. Therefore, rather than create a bureaucratic and top down system of mandatory notifications and approvals, the proposals envisage a two-way process of voluntary referral coupled with an increased ability on the part of the government to review transactions of demonstrable national strategic importance with wider discretion than exists presently under the U.K.'s extremely investor-friendly rulebook.

In doing so, the U.K. is moving consistently with its peers in responding to the changing nature of geopolitical threats of the 21st century. Its challenge will be to follow through in implementation to show that it is acting proportionately and succeeding in striking a delicate balance between protecting its legitimate strategic concerns, and maintaining its position as one of the most favored landing grounds for international investment.

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