

**Title:** The Enterprise Act 2002 (Turnover and Share of Supply Test) (Amendment) Order 2018

**IA No:** BEIS008(C)-17-CCP

**RPC Reference No:** N/A

**Lead department or agency:** Department for Business, Energy and Industrial Strategy

**Other departments or agencies:**

## Impact Assessment (IA)

**Date:** 14/03/2018

**Stage:** Final

**Source of intervention:** Domestic

**Type of measure:** Secondary legislation

nsiireview@beis.gov.uk

**Summary: Intervention and Options**

**RPC Opinion:** Not in scope.

### Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year (EANDCB in 2014 prices)	One-In, Three-Out	Business Impact Target Status
-£9.2m	-£7.6m	£0.8m	In scope	Qualifying provision, £4m

### What is the problem under consideration? Why is Government intervention necessary?

Hostile ownership or control of certain businesses obtained through mergers and acquisitions (M&A) activity may lead to national security risks, namely an enhanced ability to undertake espionage; undertake disruptive or destructive actions; or to exploit an investment as inappropriate leverage in other negotiations. Government intervention is required to ensure the necessary legislative powers are in place to monitor risks to businesses operating in certain key areas of the economy and to provide appropriate mitigations and reduce national security risks if necessary.

### What are the policy objectives and the intended effects?

The Government wants to ensure that it has clear and consistent means available to take necessary and proportionate steps to protect national security where required. In particular, ensuring adequate scrutiny of whether M&A within three key areas of the economy, namely dual-use and military technologies, computing hardware and quantum-based technology, raises any national security concerns, and that Government is able to act in the extremely rare circumstances where this might be the case. The reforms are concerned only with national security and are designed to be proportionate to the risks described, while minimising the impact on legitimate investors. In the longer term, the Government wishes to make a more comprehensive package of reforms. The Government will set out its proposed next steps to bring about these long-term changes in due course. The Government will continue to assess risks in other sectors, including emerging technologies. If there is evidence to suggest that Government should take action in additional areas of the economy then it will bring forward further legislation.

### What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Options considered are:

- Do nothing in relation to monitoring and scrutinising of M&A for their potential risk to national security
- Reform the turnover and share of supply tests in the Enterprise Act 2002 to enable scrutiny of M&A for national security purposes within three key areas of the economy (preferred option)

Following consultation with relevant stakeholders, Option B has been developed to ensure that any reforms are a proportionate and most likely to be effective in managing foreign investment risks to national security.

### Will the policy be reviewed? It will be reviewed. If applicable, set review date: TBC

Does implementation go beyond minimum EU requirements?	N/A			
Are any of these organisations in scope?	Micro Yes	Small Yes	Medium Yes	Large Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)	Traded: 0		Non-traded: 0	

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible SELECT SIGNATORY:

*Richard Haming*

Date:

14.3.2018

# Summary: Analysis & Evidence

# Policy Option B

## Description:

### FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2018	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£15.3	High: -£2.3	Best Estimate: -£9.2

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
	Low	£0		
High	£0		£1.8	£15.3
Best Estimate	£0		£1.1	£9.2

#### Description and scale of key monetised costs by 'main affected groups'

**Direct Costs to business (£878,500p.a.):** Familiarisation and compliance costs associated with supplying additional information requested by the Government's M&A assessment process (when relevant) and the Competition and Markets Authority (when relevant).

**Direct Cost to Government (£64,500 p.a.):** Monitoring and assessing relevant transitions.

**Direct Cost to Competition and Markets Authority (£130,000 p.a.):** Investigation of Public Interest Notice cases (when relevant).

#### Other key non-monetised costs by 'main affected groups'

Whilst consultation responses of some legal and advisory firms suggested the scrutiny process may deter foreign direct investment (FDI) and undermine investor confidence, the Government has concluded, informed by the findings of externally produced research, that any potential impact on FDI into the UK will be very limited, given the transparent, proportionate and wholly national-security focused nature of the regime. The Government aims to mitigate any potential negative impact on M&A and FDI into the UK through providing comprehensive guidance.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
	Low	N/A		
High	N/A		N/A	N/A
Best Estimate	N/A		N/A	N/A

#### Description and scale of key monetised benefits by 'main affected groups'

We have not been able to monetise benefits.

#### Other key non-monetised benefits by 'main affected groups'

The primary benefits from this regime arise from the Government's enhanced ability to identify and act upon risks to the UK's national security. Wider benefits of the regime are difficult to quantify and monetise - the proposals are likely to benefit society and the wider economy by providing clear information and reassurance to investors, consumers and businesses about the relevant rules; ensuring that UK economy is supported by well-functioning infrastructure and key services; and providing UK citizens with greater confidence that Government can take steps to mitigate potential threats to safety and security. For further details see page 25.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

Due to the nature of the areas of the economy this legislation is focused on, no single comprehensive dataset was available - the technologies in question could not be identified using the standard industry classification (SIC) method. An alternative approach was adopted to address data availability issues. Sensitivity analysis was carried out on our key assumptions.

### BUSINESS ASSESSMENT (Option B – Preferred Option)

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>Score for Business Impact Target (qualifying provisions only) £m:</b> £4m
<b>Costs: £0.8m</b> 2014 prices, 2015 present value	<b>Benefits:</b> N/A	<b>Net: -£0.8m</b> 2014 prices, 2015 present value	

# **National Infrastructure and National Security: The Enterprise Act 2002 (Turnover and Share of Supply Test) (Amendment) Order 2018, Impact Assessment – Evidence Base**

## **Section 1: Strategic overview**

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The United Kingdom follows an economic model that thrives on openness to trade. This has served our country well over the years. The vast majority of investment into the UK's economy raises no national security concerns. However, obtaining ownership of critical businesses could provide opportunities to hostile actors to undertake espionage, sabotage or exert inappropriate leverage. This is an issue already recognised by our international partners in their equivalent regimes. In recent years there have been a small number of transactions which have raised questions about whether the powers within the Enterprise Act 2002 are sufficient to protect our national security. To ensure national security cannot be undermined, Britain's rightly-praised openness to foreign investment also needs to be accompanied by appropriate and effective safeguards.

The Government has therefore carefully reviewed the national security implications of ownership of businesses within certain areas of the economy and considered further actions. It consulted on the secondary legislation proposals as part of the Green Paper "National Security and Infrastructure Investment Review" published on 17<sup>th</sup> October 2017. Changes in technology since the Enterprise Act 2002 mean that control of smaller businesses as well as larger businesses can now pose a national security risk as set out in the Green Paper (chapter 3)<sup>1</sup>. The Government's immediate reform is to amend the turnover threshold and share of supply tests within the Enterprise Act 2002 for three key areas of the economy (the dual-use and military technologies, computing hardware, and quantum-based technology). This will allow the Government to examine and potentially intervene in mergers and acquisitions (M&A) for national security purposes that currently fall outside the existing thresholds.

This Impact Assessment presents a discussion of the costs and benefits of the proposals laid out in the Enterprise Act 2002 (Turnover and Share of Supply Tests) (Amendment) Order 2018. To ensure reforms are proportionate to protect UK's national security while retaining an open approach to trade and investment, the Government proposals have been informed by the views and evidence expressed by businesses, investors and other stakeholders, received as part of the consultation and official meetings.

The Green Paper also set out proposals for long-term reforms in this area. The consultation on this closed on 9 January 2018 – the Government is considering the responses, and will set out its view about long-term reform in a White Paper later this year. A separate Impact Assessment will accompany that document.

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<sup>1</sup> <https://www.gov.uk/government/consultations/national-security-and-infrastructure-investment-review>

## **Section 2: Problem under consideration**

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### **National security risks**

The 2015 UK National Security Risk Assessment shows that the country faces greater and more complex threats compared to the last assessment published in 2010. Foreign intelligence agencies continue to engage in hostile activity against the UK and our interests. This includes human, technical and cyber operations at home and overseas to compromise the Government, diplomatic missions, Government-held information and critical national infrastructure; attempts to influence Government policy covertly; and operations to steal commercial secrets and disrupt the private sector.

The Government has a well-developed and well-co-ordinated approach to protecting our national security, including in the area of critical national infrastructure. The Government works with businesses to ensure that they have the necessary knowledge and tools to reduce risks. However, it lacks comprehensive statutory powers in relation to business ownership and control.

### **How control of businesses can raise national security concerns**

In considering where national security risks relating to ownership or control are most likely to arise, the Government is most focused on national infrastructure. It is these businesses, and critical parts of their supply chains, where the loss or compromise of a service would give rise to a major detrimental impact on essential services, with severe economic or social consequences or loss of life.

These national security risks are, broadly, as follows:

- increased access (to businesses, physical assets, people, operations or data) and ability to undertake espionage;
- greater opportunity to undertake disruptive or destructive actions or an increase in the impact of such action; and
- the ability to exploit an investment to dictate or alter services or to utilise ownership or control as inappropriate leverage in other negotiations.

However hostile control of businesses which operate outside national infrastructure also raise national security concerns. The proliferation and growing importance of technology and advanced engineering know-how means that threats are not necessarily confined to large businesses with high turnover. For example, as technology has evolved, small businesses which undertake niche activities or produce specialised products in the military and dual-use sector increasingly hold information or items which carry significant national security risks.

In addition, many highly innovative businesses in the military and defence sector are thought to have operational advantages over their international competitors. The acquisition of UK businesses with this expertise and intellectual property can therefore raise legitimate and significant national security concerns for the country as a whole. Moreover, cyber security is now a real concern for almost every business and consumer. Advances in technology now mean that there are ubiquitous goods with the potential to be directed remotely should a hostile actor obtain access or control. This poses further challenges to the Government's ability to monitor and respond to emerging threats.

The risk of espionage may be intensified where a single investor has multiple areas of investment or ownership across a sector (or across areas of the economy or supply chains). This cumulative investment could enable an organisation with malign intent to build a complex and detailed understanding of national infrastructure within a single sector, or indeed multiple areas of the economy. Having these ownership stakes might also confer the ability to identify key vulnerabilities in the supply chain and engage in the theft of intellectual property.

## Current powers

The Government is currently able to intervene in certain mergers or takeovers under the Enterprise Act 2002 but only where clear public interests are raised: either in relation to national security, media plurality or financial stability. These interventions are limited to mergers in scope of the Act (specifically the merger must meet certain share of supply and/or turnover thresholds<sup>2</sup>). An exception is made for certain mergers in relation to defence contractors<sup>3</sup> or media businesses, where the usual thresholds do not apply (the Special Public Interest Intervention Notice regime). This means that most mergers involving small and medium-sized target businesses<sup>4</sup> are outside the scope of the Act.

The Government considers that the most pressing gaps relate to businesses who manufacture military and dual-use items, and certain advanced technologies (computing hardware and quantum-based technology) where there may be risks to national security. The Government will continue to assess risks in other sectors, including emerging technologies. If there is evidence to suggest that Government should take action in additional areas of the economy then it will bring forward further legislation.

Overall, we find that the legislative powers the Government has at its disposal are currently **limited in places** – while the Enterprise Act 2002 powers enable the Government to intervene in mergers across the economy, interventions are, as described above, only permitted in mergers involving a target business above certain turnover and share of supply thresholds. However, technological change means that thresholds designed at the turn of the century are no longer appropriate for the current economic, social or national security context - potential national security threats are not necessarily confined to large businesses with high UK turnover.

The Government's view is that it should be able to act where necessary to protect national security. National security risks related to ownership can arise outside of regulated areas of the economy; can arise in relation to both small and large businesses; and may not necessarily lead to an increase in the share of supply. The Government therefore sets out proposals for short-term steps necessary to reform the existing regime to ensure that it is able to take action to protect national security where required.

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<sup>2</sup> For the Competition and Markets Authority (CMA) to assess a proposed merger and for the Secretary of State to intervene on public interest grounds, the acquired business must have an annual turnover of more than £70 million and / or the merger must result in the creation of, or increase in, a 25% or more combined share of sales or purchases in the UK (or in a substantial part of it), of goods or services of a particular description.

<sup>3</sup> However, not all businesses that design or produce military items are defence contractors or hold confidential defence material, so are not subject to the special public interest regime.

<sup>4</sup> That is, if they do not meet requirements described in footnote 2 above.

## **Section 3: Rationale for intervention**

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### **National infrastructure and national security**

The Government's rationale for intervention is based on the following:

- i. Ensuring that the Government has all the necessary legislative powers in place to protect **national security** in relation to M&A of target businesses within three key areas of the economy whose acquisition may pose national security risks. The Government needs to have sufficient legislative powers in place to monitor risks to businesses operating in certain key areas of the economy and to be able to mitigate such risks and act upon them if necessary.
- ii. Ensuring that **legislation is proportionate** across areas of the economy. Businesses need to be treated fairly and proportionately; the Government should aim its scrutiny at the areas where it knows national security risks are most likely to arise, balancing the need to know and the ability to act against the potential burden on business.

## **Section 4: Policy objective**

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The Government wants to ensure that it has clear and consistent means available to take necessary and proportionate steps to protect national security where required.

In the short term, the Government wishes to amend the existing Enterprise Act 2002 through secondary legislation in order to address immediate gaps. The Government considers that the most pressing gaps relate to businesses in key parts of the military and dual-use and advanced technology areas of the economy.

In the longer term, the Government wishes to make a more comprehensive package of reforms to allow the Government to act across a wider range of transactions where national security concerns arise to ensure that national infrastructure is protected and to safeguard national security. The Government will set out its proposed next steps to bring about these long term changes in due course.

## **Section 5: Options considered**

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### **National infrastructure and national security**

On critical infrastructure and national security, the Government has identified two different options:

- A. Do nothing in relation to the scrutinising of M&A for their potential risk to national security
- B. Reform the turnover and share of supply tests in the Enterprise Act 2002 to enable scrutiny of additional M&A for national security purposes within key areas of the economy (preferred option)

## **A. Do nothing**

In this option we would rely on the current powers to intervene informed by expertise and intelligence held in Government departments and agencies. However, as identified earlier, there are gaps in the Government's current powers to intervene in relatively smaller mergers in certain parts of the economy. This will, therefore, not meet the policy objective ensuring that the Government has the means available to take necessary steps to protect national security. In particular, ensuring adequate scrutiny of whether M&A activity raises any national security concerns.

## **B. Reform the Enterprise Act 2002 to enable scrutiny of additional M&A for national security purposes within key areas of the economy (preferred option)**

The proposals are designed solely to ensure that the Government has clear and consistent means to take necessary and proportionate steps to protect national security where required.

The Government proposes to amend the turnover threshold and share of supply tests within the Enterprise Act 2002 to allow Government to intervene in smaller mergers involving a target business operating within three areas of the economy: (i) dual-use and military technologies, (ii) computing hardware and (iii) quantum-based technology where new risks to national security have emerged since the introduction of the Act<sup>5</sup>.

The Government has undertaken a four-week-long public consultation and sought stakeholders' views on the precise form of words used to define these areas of the economy and the specific technologies that will be brought into scope by the proposals. Acting on the views expressed, the definitions have been revised to provide greater clarity.

The reforms are necessary as at present the Enterprise Act 2002 does not allow Government to intervene in mergers for national security reasons unless they relate to target businesses with a turnover of more than £70 million, or take the combined share of supply in the UK to 25% or more. As technology has changed and national security risks have become more complex, these have become less appropriate thresholds for national security interests.

For the three specified areas of the economy, the Government is reducing the turnover test threshold to cover small and medium-sized target businesses (those with a turnover greater than £1million) and amending the share of supply test to remove the requirement for the merger to result in an *increase* in share of supply, whilst still keeping the 25% threshold. This is because, in some specified areas of the economy, it is feasible for a small business to hold the rights to key technologies which are critical for defence or underpin the operation of key systems within the economy. It is also possible for a transaction of interest not to lead to an increase in the merger parties' combined share of supply in the UK, for example because the acquiring business is not already active in the relevant sector in the UK.

These changes will expand the scope of the Government's powers to intervene in mergers under the Enterprise Act 2002 to smaller businesses in these three areas of the economy meeting the revised thresholds.

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<sup>5</sup> See Section 6 for further description and discussion.

All other smaller businesses (other than those already covered by the special public interest regime) would remain outside the scope of the Act, as is currently the case.

During consultation, legal and advisory businesses raised some concerns about the reform's implications for the competition assessment of mergers. Specifically, they raised concern that there would be a large increase in the number of referrals to the Competition and Markets Authority (CMA) for competition assessments. Due to the nature of the mergers brought into scope of the regime (i.e. those involving businesses with a small turnover and/or not involving an increase in the share of supply) neither the Government nor the CMA expects the reform to bring about any material change in its approach to assessment of mergers on competition grounds.

The CMA's response to the Green Paper<sup>6</sup> noted the following:

*“The CMA does not expect that the proposals outlined in the Green Paper will bring about any material change in its approach to the assessment of mergers on competition grounds”*

Any mergers where the Government intervenes on public interest grounds as a result of the new provisions will follow the same clear and transparent process as all others do under the Enterprise Act 2002, involving the CMA and independent judicial review as appropriate.

The Government and the CMA undertake merger monitoring to identify mergers which may have potential national security risks. The Government's M&A assessment process for national security risks co-ordinates the assessment of M&A with input from relevant departments and bodies (departmental sector leads, security agencies, regulators etc). If national security risks arising from a merger are identified then the Secretary of State may issue a public interest intervention notice.

On receipt of the public interest intervention notice the CMA will provide a report to the Government on jurisdictional and competition issues which will identify if a relevant merger situation has arisen and the turnover and/or share of supply thresholds are met. If any voluntary undertakings proposed by the parties (i.e. acquirer and target) in order to deal with national security concerns prove insufficient (and following a CMA-led Phase 2 investigation), the Government may issue orders to ensure the merger does not undermine national security.

Based on historic use of current powers, the Government expects only a small proportion of M&A would be subject to conditions or, in extremis, blocked outright. For each of the seven national security related interventions to date (which is equivalent to around one intervention every two years) voluntary undertakings were considered sufficient.

The Government recognises that parties to an investigated merger may incur costs associated with supplying any necessary information requested by the Government's M&A assessment process for national security risks or the CMA (outlined in section 6).

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<sup>6</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/657894/cma-response-national-security-and-infrastructure-investment-review-green-paper.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/657894/cma-response-national-security-and-infrastructure-investment-review-green-paper.pdf)



In relation to changes to the turnover test thresholds, certain trade associations felt the proposed £1m turnover threshold was too high. They suggested that a turnover threshold of £1m will exclude micro-businesses that are likely to own intellectual property of interest from a national security perspective. Other stakeholders advised that the turnover threshold was too low, potentially bringing a disproportionate number of businesses into scope. The Government has concluded that the £1m threshold is a well-established regulatory threshold (the upper limit of ‘micro-businesses’) and is well-understood by business. It also considers it to be an appropriate measure and threshold for the turnover of businesses in these three areas of the economy whose acquisitions may raise national security concerns.

A small number of consultation responses queried the proposed amendment to the share of supply test. For example, they highlighted that the share of supply threshold is complex and involves complex assessments, which would lead to disproportionately high costs for smaller businesses. No quantitative evidence was provided to support this view. The Government has concluded that covering deals involving a buyer with no footprint in specific markets is critical to achieving the policy intent, and so will retain the additional test.

The Government’s view is that the revised turnover threshold alongside the revised share of supply test is a proportionate measure. Our analysis of the number of affected businesses and mergers is outlined in section 6.

## **Section 6: Costs and benefits of each option**

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### **The Enterprise Act 2002 (Turnover and Share of Supply Test) (Amendment) Order 2018**

#### **Option A: Do nothing scenario**

Under the ‘do-nothing’ option there would be no additional costs or benefits to business, individuals or society. We would continue to rely on the current powers to intervene, and would not expect to meet the policy objective of ensuring that the Government has clear and consistent means available to take necessary steps to protect national security stemming from M&A activity.

#### **Option B: Reform the Enterprise Act 2002 to enable scrutiny of M&A for national security purposes within key areas of the economy (preferred option)**

This section examines the direct costs and benefits from amending the thresholds in the Enterprise Act 2002, for public interest assessment purposes, solely for the three areas of the economy of interest, namely:

- Computing hardware;
- Quantum-based technology, and;
- Dual-use and military technologies.

We begin by outlining the definitions for the three areas of the economy of interest, followed by identification of the businesses and mergers potentially in scope of the proposals. We finish with a qualitative assessment of the indirect impacts of the policy on wider economy, including competition and investment.

## Direct impacts as a result of amending the turnover threshold and share of supply test

Our assessment indicates that the impact of lowering the threshold(s) on businesses would be minimal. The amendments to the Enterprise Act 2002 would refer only to three specific areas of the economy, namely:

Area of the Economy	Definitions:
Military and dual-use technology	Enterprises that design or manufacture or hold related software and technology for items which have military use or could have both military and civilian use as specified on the UK Strategic Export Control Lists (SECLs) specifically including the UK Military List, UK Dual-Use List, UK Radioactive Source List and the EU Dual-use List.
Computing hardware	<p>Enterprises that undertake the following activities:</p> <ul style="list-style-type: none"> <li>(i) The ownership, creation or supply of intellectual property in the functional capability of computing hardware;</li> <li>(ii) The design, maintenance or support of the secure provisioning or management of roots of trust or computing hardware.</li> </ul> <p>Note:</p> <ul style="list-style-type: none"> <li>• “Computing hardware” means processing units (including their instruction set architectures), and firmware related to such units;</li> <li>• “Firmware” in relation to a device means computer code that provides low level control for the device’s hardware;</li> <li>• “Roots of trust” are hardware, firmware, or software components that are inherently trusted to perform specific, critical security functions, (including, for example, cryptographic key material bound to a device that can identify the device or verify a digital signature to authenticate a remote entity).</li> </ul>
Quantum-based technology	<p>Enterprises who undertake following activities:            Research into, the development or production of goods intended for use in, or the supply of services employing</p> <ul style="list-style-type: none"> <li>(i) quantum computing or simulation;</li> <li>(ii) quantum imaging, sensing, timing or navigation;</li> <li>(iii) quantum communications; or</li> <li>(iv) quantum resistant cryptography;</li> </ul> <p>Note:</p> <ul style="list-style-type: none"> <li>• This definition will include the creation of intellectual property for these areas as intended (through use of term research/development).</li> </ul>
<p>For a fuller explanation of the technologies and areas of the economy of interest, including examples of what is ‘in scope’ and ‘out of scope’ please refer to the guidance accompanying the new provisions.</p>	

## Types of direct compliance costs to businesses affected by the regime

In this section we provide a breakdown and description of the potential direct costs to business within scope of the three definitions that are subject to a revised turnover and share of supply tests.

For businesses that may fall in scope of the definitions outlined above, we anticipate that the following costs could be incurred when an M&A event takes place:

1. Familiarisation with the guidance published by Government;
2. Accessing legal advice to determine if activities are 'in scope';

For a small subset of the businesses falling in scope of the definition outlined above there may be some additional costs stemming from:

3. Engaging with the Government's M&A assessment process for national security risks and/or the CMA;
4. Collating merger and business activity information requested by Government's M&A assessment process for national security risks or the CMA.

## Number of businesses in scope

We have conducted internal analysis to ascertain the number of businesses that will be captured by the revised turnover thresholds.

It is difficult to estimate the precise number of businesses in the areas of the economy of interest due to data limitations. We looked into ONS data extracted from the Inter-departmental Business Register (IDBR) using standard industry classification (SIC) codes<sup>7</sup>. However, this data is subject to many limitations for the purpose of our analysis as SIC codes do not provide sufficient granularity to meet our definition needs and include businesses which provide other activities than those specified in our definitions<sup>8</sup>. SIC codes are also better suited to identify traditional industries rather than emerging and advanced technologies. Sampling<sup>9</sup> of the businesses meeting a particular definition indicated that the primary reported SIC code varied across businesses falling in scope of the definition.

In response, an alternative method was adopted to identify businesses in scope of the three definitions. Drawing on Government and external expertise, search lists were developed for each definition<sup>10,11</sup> and then used to search FAME<sup>12</sup>, Pitchbook<sup>13</sup>, Beauhurst<sup>14</sup> and CapitalIQ<sup>15</sup> to establish how many businesses met the definitions.

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<sup>7</sup> <https://www.ons.gov.uk/methodology/classificationsandstandards/ukstandardindustrialclassificationofeconomicactivities/uksic2007>

<sup>8</sup> For example design of processing units is an activity meeting the "computing hardware" definition. However, some businesses engaged in the design of processing units list themselves within the UK 2007 SIC "manufacture of electronic components", a category broader than processing units.

<sup>9</sup> Sampling was carried out separately for each technology. Results indicated businesses primary SIC code was not consistently reported. For example three semiconductor companies listed their UK 2007 SIC as "Other business support service activities n.e.c", "Other information technology service activities" and "Manufacture of electronic components" respectively.

<sup>10</sup> This approach was adopted for "computing hardware", "quantum-based technology" and the "military sector"

<sup>11</sup> In the case of dual-use and military technologies the FAME key word search was complemented by a search of identifiable relevant SIC codes

<sup>12</sup> FAME is a platform produced by Bureau van Dijk which covers over 11 million businesses and unincorporated businesses in the UK and Ireland (<https://fame.bvdinfo.com/version-20171127/Home.serv?product=fameneo>).

<sup>13</sup> Pitchbook is a platform which tracks venture capital, private equity and M&A (<https://pitchbook.com/about>).

<sup>14</sup> Beauhurst is a platform which tracks UK high-growth businesses (<http://about.beauhurst.com/>).

The extracts were combined and underwent manual validation to remove duplicate and false positives<sup>16</sup>. These results were combined with Department of International Trade data on the number of businesses either applying for an Individual Licence or registering for a General Licence for the export of dual-use items.

The estimated number of businesses potentially in scope was adjusted to exclude those covered by existing regimes, that is:

- i) The Enterprise Act 2002 for businesses with turnover above £70m<sup>17</sup>, and;
- ii) Businesses covered by the Special Public Interest Regime<sup>18</sup>.

For these businesses, if they were the target of M&A activities, the Government already has the power to intervene in those cases which pose potential risks to national security. Therefore, the statutory instrument does not bring these businesses into scope for potential additional Government interventions.

Our best estimate is that the reduction to the turnover test threshold (from £70m to £1m) and changes to the share of supply test could bring **an additional 2,500 businesses into scope**<sup>19</sup>, with an upper bound estimate of 4,500<sup>20</sup> and a lower bound estimate of 1,200<sup>21</sup>. This is based on the combined results from FAME, Beauhurst, Pitchbook, and holders of General and Individual Licences for exports of dual-use items with an annual turnover of £1m to £70m.

### Frequency of M&A activity for businesses in scope

Our analysis suggests that only a very small proportion of identified businesses within the three areas of the economy would be actually affected by the policy. The reason for this is that an assessment of potential national security risks from a M&A would only take place if a business, operating in one of the three areas of the economy of interest, were to become a target of M&A activity (or the formation of joint venture) which had an associated potential national security risk.

In order to estimate the number of additional mergers potentially subject to a national security assessment we adopted the following approach:

1. Estimate the annual frequency of completed M&A involving a target business that are in scope of the definitions;

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<sup>15</sup> <https://www.capitaliq.com> CapitalIQ is a platform produced by Standard & Poor's which organises historical information on businesses, markets, and transactions worldwide.

<sup>16</sup> False positives refer to results which are not related to the technology of interest.

<sup>17</sup> We have assumed that identified businesses follow the same distribution by turnover as UK headquartered businesses identified using CapitalIQ. For "dual-use and military" 31% reported turnover >£70m, 67% had turnover <£70m and >1£m, and 3% had turnover lower than £1m. Similarly for "computing hardware" and "quantum-based technologies" 19% reported turnover >£70m, 79% had turnover <£70m and >1£m, and 3% had turnover lower than £1m.

<sup>18</sup> Government contractors holding confidential material

<sup>19</sup> The best estimate includes the combined results from FAME, Beauhurst, Pitchbook (for "Computing Hardware", "Quantum-based technology" and "dual-use and military" technologies) and holders of General and Individual Licences for export of dual-use export list items. The combined list minimises inclusion of duplicate results or businesses engaged in unrelated activities.

<sup>20</sup> In addition to business captured in the best estimate the higher estimate includes the whole photonics industry (which will include businesses potentially engaged in unrelated activities) and businesses identified using CapitalIQ (in part duplicating results from other database searches) (Please see footnote 25 and 26 for a full list of the CapitalIQ primary industry categories that were included).

<sup>21</sup> The lower estimate includes holders of General and Individual Licences for export of dual-use export list items, semiconductor and semiconductor equipment manufacturing businesses, potentially relevant laser manufacturers, and quantum technology related businesses with annual turnover less than £70m.

2. Adjust estimate of completed M&A to include announced mergers that failed to complete<sup>22</sup>;
3. Exclude those M&A covered by the current Enterprise Act 2002<sup>23</sup> thresholds;
4. Exclude those M&A covered by the Special Public Interest Intervention Notice Regime (when data permitting);
5. Exclude those M&A which have been identified by the Government's M&A monitoring and assessment activities as clearly posing no risk;
6. Of those M&A which undergo an in-depth national security assessment, M&A were separated based on the assumed outcome of the Government's national security assessment process.

As follows, our estimate of the additional M&A activity potentially subject to Government's M&A assessment process for national security risks:

**Step 1:** To estimate the number of mergers expected to occur per annum in future years (for mergers involving target businesses in scope of the definitions), we mapped the definitions of interest to CapitalIQ primary industry categories<sup>24,25,26</sup>. Then, using data from CapitalIQ, we identified for each category the minimum and maximum completed M&A occurring between 2014 and 2017. This gave us a range of **6 to 35 M&A per annum**.

**Step 2:** Once an adjustment was applied to include announced mergers that failed to complete, this gave us a range of **8 to 44 M&A per annum** for target business in scope of the definitions.

**Step 3:** Out of the 8 to 44 M&A identified in Step 2, we estimated between 3 and 15 M&A per annum would meet the existing Enterprise Act 2002 turnover threshold. Therefore, **5 to 29 M&A per annum** would be brought into scope for Government intervention as a result of the statutory instrument<sup>27</sup> - this is equivalent to around 0.5% of businesses in scope of the definitions.

While the analysis of past trends provides a good indication on the number of future transactions, it is important to note that M&A activity is difficult to predict year-on-year as M&A are (by their nature) high value but low frequency events. Indeed, the number of inward M&A investments are thought to be sensitive to highly variable factors such as changes in relative economic growth, interest rates, exchange rates, tax rates and prices on the stock market<sup>28, 29</sup>.

<sup>22</sup> Depending on when the merger was abandoned merger parties may have already incurred most of the direct costs to business associated with the regime.

<sup>23</sup> For those M&A involving target businesses with UK turnover above £70m or M&A which *increase* share of supply above 25%.

<sup>24</sup> Categories selected i) included businesses of interest or ii) were suitable proxies for emerging technologies.

<sup>25</sup> The following categories were used for "computing hardware" and "quantum-based technologies": Semiconductor and Semiconductor Equipment (Primary), Electrical Components and Equipment (Primary), Computer Components (Primary), Electronic Components (Primary), Modems (Primary), Networking Equipment (Primary), Satellite and Microwave Equipment (Primary), Precision Measuring Devices (Primary), Laboratory Apparatus (Primary), Measuring and Dispensing Pumps (Primary), Time Clocks and Other Time Recording Devices (Primary), and a screened sub set of relevant businesses for Application and Systems Software categories.

<sup>26</sup> The following categories were used for "dual-use and military" technologies: Industrial Inorganic Chemicals (Primary), Explosives (Primary), Industrial Gases (Primary), Aerospace and Defense (Primary), Biotechnology: rDNA Pharmaceuticals (Primary), Gene Research and Development (Primary), Orthobiological Products (Primary), Protein and Genome Sequence Products (Primary), Biotechnology Research Equipment Manufacturers (Primary), Combinatorial Chemistry and Other Lead Generating Technologies (Primary), Microbiology (Primary), In Vivo Diagnostic Substances (Primary), Biological Products (Primary), Drug Delivery Technologies (Primary), Medical Device Research and Development (Primary)

<sup>27</sup> Some of the mergers brought into scope under the turnover test may meet the current share of supply test; this potential overlap has not been taken into account due to insufficient information concerning respective shares of supply.

<sup>28</sup> <https://www.ifama.org/resources/Documents/v6i4/Reed.pdf>

<sup>29</sup> <http://u.osu.edu/weisbach.2/files/2015/01/ELWJFfinalpdf-16sy82h.pdf>

**Step 4:** Government contractors holding confidential material are covered by the Special Public Interest regime. For our purpose this is expected to cover some M&A occurring within the dual-use and military technologies. Due to data limitations the M&A in relation to these businesses were removed.

**Step 5:** Whilst we estimated between 5 and 29 M&A per annum could be expected to meet the revised Enterprise Act 2002 turnover threshold, based on internal analysis, we anticipate between 3 and 17 merger cases per year will be identified as no risk by Government M&A monitoring and assessment activities. The remaining cases, between **2 and 12 cases per annum**, will require a more in-depth assessment by the Government to review potential national security risks.

**Step 6:** In order to quantify the direct costs to business we made assumptions, informed by internal analysis, regarding the potential outcome of the 2 to 12 cases which we estimate would be reviewed by Government's national security assessment process:

- For **1-6 cases per annum** we have assumed that the Government's assessment of M&A for national security risks would identify them as **no risk**. For such cases, we assume no further action is taken.
- For **1-6 cases per annum** we have assumed that the Government's assessment would conclude that there may be a risk to national security such that the Secretary of State issues a public interest intervention notice to more closely and formally examine the transaction.

It is important to note that these are **analytical assumptions** used for the purpose of the Impact Assessment to estimate the impact on business. When the regime comes into effect M&A will be reviewed on a case-by-case basis to determine if the transaction raises any potential national security concerns.

### **Estimated additional mergers potentially assessed for competition concerns**

There are two ways in which businesses could be affected by the policy: either because they were party to a merger or acquisition that raised potential national security concerns, or, if the merger or acquisition leads to further investigation by the CMA for competition reasons. On the latter, as outlined in section 5, neither the Government nor the CMA expects the reform to bring about any material change in the number of merger cases investigated by the CMA solely for competition reasons.

The reasons for this are threefold:

1. Firstly, due to the nature of mergers brought into scope of the regime (i.e. those M&A involving smaller businesses);
2. Secondly, given that the changes only affect three areas of the economy, and;

3. Thirdly, considering the low number of cases at present (in 2016, the CMA undertook 57 phase 1 investigations<sup>30</sup> where businesses were involved in mergers that were in (or likely to be in) scope of the Enterprise Act 2002).

If businesses choose to self-refer their case to the CMA the affected merger parties will incur costs to i) familiarise themselves with the process, ii) assist with the CMA investigation and iii) pay a fee to the CMA. The Government does not expect businesses to self-refer cases on the basis of potential national security concerns.

### Direct Cost to Businesses in Scope

The Government anticipates that UK businesses undergoing a relevant merger situation within scope of the defined areas of the economy of interest will incur costs to familiarise themselves with the guidance, access legal advice to determine if their activities are ‘in scope’, and costs to engage with, and comply with Government and/or CMA information requests.

The Government is of the view that familiarisation and compliance costs will be relatively minimal for affected businesses. Investors interviewed for the “Sources of Capital” report were generally of the view that the administration costs are likely to be low and incremental to the other procedures and legal compliance work that is conducted in any event.

### Labour Wage Costs inclusive of Non-Wage uplift used for Monetising Direct Costs to Business

Tables 1a and 1b outline the labour cost assumptions (covering wage and non-wage labour costs) which have been applied to the assumed time burden to business (for either staff or external advisors) in order to monetise the cost to business. To estimate the average hourly rate for a senior lawyer providing external legal advice, we have taken the guideline hourly rate<sup>31</sup> for solicitors and legal executives with over 8 years’ experience (London Grade 1) as set out by HM Courts and Tribunal Service. The Government recognises some businesses may have access to internal legal advice who will therefore incur lower legal advice costs than the identified cost.

**Table 1a: Business Labour Wage Costs per Hour**

Occupation:	Mean Hourly Pay (Excluding Overtime) for Full-Time Employees	Including Non-Wage Uprating
Chief executives and senior officials	£54.16	£64.83
Financial managers and directors	£38.81	£46.46
Company secretaries	£18.25	£21.85
Internal Legal Advice (Solicitor)	£29.60	£35.43

Cost of labour based on estimates of hourly pay taken from the Annual Survey of Hours and Earnings (ASHE)<sup>32</sup>. These are uprated by 19.7 per cent<sup>33</sup> to include non-wage labour costs based on Eurostat<sup>34</sup> data on wages and labour costs.

**Table 1b: Business Costs to Access External Legal Advice**

Occupation:	Charge per Hour:
Charge for solicitors providing external legal advice	£409

Charges for external legal advice sourced from the HM Courts and Tribunal Service.

<sup>30</sup> Competition and Markets Authority’s Annual Report and Accounts 2016 to 2017

<sup>31</sup> <https://www.gov.uk/guidance/solicitors-guideline-hourly-rates>

<sup>32</sup> Annual Survey of Hours and Earnings: 2017 provisional and 2016 revised results (October 2017) Table 14.6a Hourly pay - Excluding overtime (£) - For all employee jobs: United Kingdom, 2017

<sup>33</sup> Estimated hourly total labour cost in the UK (2016) estimated at €26.70 of which €22.30 (83.52 per cent) is made up of wages and salaries and €4.40 (16.48 per cent) is made up of other labour costs. Total labour cost therefore represents 26.70 / 22.30 = 1.197 of wages and salaries. We therefore uprate an estimate of hourly wages by a factor of 1.197 to derive an estimate of total hourly labour cost to businesses.

<sup>34</sup> Eurostat data extracted April 2017: [http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages\\_and\\_labour\\_costs#Labour\\_costs\\_2](http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages_and_labour_costs#Labour_costs_2)

## Guidance Familiarisation Costs and Legal Advice Costs

For those mergers which meet the revised turnover test threshold (5 to 29 mergers per annum) we expect both merger parties to incur costs to familiarise themselves with the guidance as well as costs to access external Legal Advice to determine if activities of the merger target are ‘in scope’ of the definitions. The time and direct cost burden to an affected business for Guidance Familiarisation and accessing Legal Advice is outlined in table 2a.

**Table 2a: Time and Direct Cost Burden to Businesses for Guidance Familiarisation and Legal Advice**

Activity Stage	Sub-stage \ Time (hrs) per person	Chief executives and senior officials	Financial managers and directors	Company secretaries	External Legal Advice	Total Time (hrs)	Cost (Total Hours x Relevant Wage Rate)
Familiarisation	Guidance Familiarisation	5	5	5		15	£666
	Determining if activities are 'in scope'			5	5	10	£2,154
<b>Total</b>						<b>25</b>	<b>£2,820</b>

The estimated time burden to business is based on an internal assessment as quantified estimates were not received as part of the consultation.

In total<sup>35</sup> we anticipate familiarisation and legal advice costs to businesses operating in the UK<sup>36</sup> will range between £28,000 and £163,500 per annum (for 5 to 29 M&A, that is 10 to 58 merger parties at a cost of £2,820 per party), with a central estimate of £96,000 per annum.

## Administrative Costs from notification, compliance and engagement

As outlined previously, we estimate that between 2 and 12 mergers cases per year will require a more in-depth assessment by the Government to review potential national security risks, some of which may involve formal scrutiny following service of a public interest intervention notice.

We expect merger parties assessed by the Government to incur costs associated with:

- i) Collating and supplying any merger and business activity information requested by the Government’s M&A assessment process for national security risks;
- ii) Engaging Government departments and the Government’s M&A assessment process for national security risks, and;
- iii) Post-decision discussions, administration of conditions and monitoring to ensure conditions are fulfilled.

Table 2b outlines the time and direct cost burden to businesses party to a merger which is assessed by Government. In total we estimate that the direct costs to business for administrative costs (associated with notification, compliance and engagement with the Government) will range between £12,000 and £73,500 per annum (for 2 to 12 M&A, that is, 4 to 24 merger parties at a cost of £3,060 per party), with a central estimate of £43,000 per annum.

<sup>35</sup> Presented rounded to the nearest five hundred pounds.

<sup>36</sup> We have assumed that all of the 5-29 mergers involve UK based businesses, including subsidiaries of foreign headquartered businesses.



**Table 2b: Time and Direct Cost Burden to Businesses for Compliance and Engagement with Government**

Activity	Sub-stage \ Time (hrs) per person	Chief executives and senior officials	Financial managers and directors	Company secretaries	External Legal Advice	Total Time (hrs)	Cost (Total Hours x Relevant Wage Rate)
Assessment	Responding to Government information requests	4	4	5	1	14	£963
	Merger parties engage informally with Government	6	6	4	1	17	£1,164
Post Assessment Engagement, and Monitoring	Engagement to explain decision and conditions	1		1	1	3	£496
	Monitoring to ensure conditions fulfilled			10		10	£218
	Administration of conditions			10		10	£218
<b>Cost of Government Stages</b>						<b>54</b>	<b>£3,060</b>

The estimated time burden to business is based on an internal assessment as quantified estimates were not received as part of the consultation.

Out of the 2-12 cases subject to an in-depth assessment for national security concerns, we assume that the Government would conclude that **1-6 cases** would pose **no risk** to national security. In these cases, we assume that no further action would be taken<sup>37</sup> and, therefore, there would not be additional costs to businesses. The remaining **1-6 cases** would pose potential **risks** to national security and a public interest intervention notice (PIIN) would be issued by the Secretary of State in order to scrutinise this further. These businesses would incur further costs associated with:

- i) Collating and supplying any merger and business activity information requested by the CMA, and engaging when necessary with the CMA.
- ii) Accessing external advice and consultancy services, during the Phase 1 investigation, covering competition law and sector specific regulations on national security.

We did not receive quantified estimates on the costs to businesses as a result of a PIIN as part of the consultation. However, since the consultation was closed, we have engaged with legal firms to gather evidence on these costs. Based on the evidence they provided we have estimated a cost to each merger party in the range of £80,000-£105,000 per PIIN case, with a mean average of £92,500.

Table 2c provides an overview of those stages of a CMA Phase 1 investigation which involve, information gathering, participation or engagement by an investigated merger party.

In total we anticipate direct costs to business for administrative costs (associated with notification, compliance and engagement with the CMA) as well as accessing external advice and consultancy services will range between £160,000 and £1.26 million (for 1 to 6 mergers respectively, 2 to 12 merger parties), with a central estimate of £740,000 per annum.

<sup>37</sup> These are additional to the 3-17 mergers per year identified as no risk by Government M&A monitoring and assessment activities.

**Table 2c: Stages of a Phase 1 CMA Investigation**

Activity	Phase 1 Stages
CMA initiative investigation	1. Merger parties respond to CMA enquiry letter and CMA information requests.
	2. Ongoing liaison between case team and merger parties.
	3. Merger parties respond to information request.
CMA Phase 1 Investigation, Decision, and Voluntary Remedies	4. Merger parties participate in state of play discussions
	5. Merger parties attend issues meeting and respond to issues letter
	6. Merger parties decide whether to offer voluntary mitigation measures
	7. Merger parties respond to any CMA proposed modifications of voluntary measures

### Summary of Total Direct Costs to Business:

Following implementation, those businesses involved in mergers which are identified by Government M&A monitoring and assessment activities as no risk to national security<sup>38</sup> (3-17 mergers per annum, 6-34 merger parties) would only incur costs to familiarise themselves with the guidance and access external legal advice to determine their in scope status (estimated at £2,820). For those mergers that undergo a more in-depth assessment by the Government<sup>39</sup> (2-12 mergers per annum, 4-24 merger parties) each merger party is expected to incur additional costs of £3,060. Finally, for those mergers issued with a public intervention notice and subject to a Phase 1 CMA investigation (1-6 mergers per annum, 2-12 merger parties) each merger party is expected to incur further costs of £92,500.

In total we estimate that direct cost to business<sup>40</sup> (covering guidance familiarisation, accessing legal advice, and compliance, notification and engagement) would range between £200,500 and £1.49 million per annum with a central estimate of £878,500.

### **Sensitivity Analysis**

As quantified estimates of the time burden to business were not received as part of the consultation, we have made assumptions on the time burdens to business and the types of business staff involved with each sub-stage.

We have tested the sensitivity of our estimates to the core assumptions underpinning the calculation of direct cost to business, focusing on 1) the time burden from familiarisation, and notification, compliance and engagement with the Government, and 2) the wage rate assumptions used for senior business officials.

#### 1) Time Burden Sensitivity Analysis:

If we were to assume that the time taken (or the number of staff required) for businesses to i) familiarise with the guidance, ii) access legal advice to determine their 'in scope' status, and iii)

<sup>38</sup> Out of the 5 to 29 additional mergers brought into scope by the reduction to the turnover test, between 3 and 17 mergers per annum, with a central estimate of 10 are assumed to be identified as no risk to national security based on a preliminary assessment by the Government M&A monitoring and assessment activities.

<sup>39</sup> As outlined previously, between 2 and 12 mergers per annum are assumed to undergo a more in-depth investigation for potential national security risks.

<sup>40</sup> Presented rounded to the nearest five hundred pounds.

notify, comply and engage with Government, were double the time shown in table 2a and table 2b, the costs would double (see Table 3a).

Total direct costs for familiarisation and compliance, notification and engagement with Government would increase from the current estimated range of £40,500-£237,000 per annum per annum to £81,000-£474,000.

**Table 3a: Time Burden Sensitivity: Time and Direct Cost Burden to a Business Party in a Merger**

Activity Stage	Total Time (all staff)	Cost per Business party to a merger (hours x relevant wage rate)	Cost of "Low" Cases 5 - Familiarise 2 – Assessed	Cost of "Medium" Cases 17 - Familiarise 7 – Assessed	Cost of "High" Cases 29 – Familiarise 12 – Assessed
Guidance familiarisation and accessing legal advice	50 (25)	£5,640 (£2,820)	£56,500	£192,000	£327,000
Compliance, notification and engagement with Government	108 (54)	£6,120 (£3,060)	£24,500	£85,500	£147,000
<b>Total Direct Cost</b>			<b>£81,000</b>	<b>£277,500</b>	<b>£474,000</b>

Direct cost burdens to business are presented rounded to the nearest £500. Time and direct cost burdens from tables 2a & 2b are in brackets. Within the table "Low" cases refers to 5 mergers undergoing guidance familiarisation and accessing legal advice and 2 mergers undergoing compliance, notification and engagement activities. For "Medium" the mergers case numbers are 17 and 7, and for "High" 29 and 12.

## 2) Wage Rate Sensitivity Analysis for Senior Business Staff

We have tested the sensitivity of our estimated direct costs to business to the wage rate assumptions used for Chief executives and senior officials and financial managers and directors. For this purpose we have used data on the 'Single Figure for Total Remuneration'<sup>41</sup> for FTSE 350 board members. These are, respectively, £2.1m for a Chief Executive Officer (CEO) and £1.3m for a Chief Financial Officer (CFO)<sup>42</sup> based on financial years ending between 31/12/2015 – 04/09/2016.

These are median figures, which we feel are a better reflection of average executive remuneration in this context as the mean is skewed by a small number of very high pay awards. It should be highlighted that the total package is broader than salary and as such was considered ill-suited to valuation of the time burden on business staff.

We divided total remuneration by the expected number of hours an average FTSE 350 board member will work per year, which we have estimated at 35 hours per week (or 1,820 per year when multiplied by 52) based on data from the Annual Survey of Hours and Earnings<sup>43</sup>.

- Average hourly rate for a CEO = £1,154, used for Chief executives and senior officials.
- Average hourly rate for a CFO = £714, used for Financial managers and directors.

Table 3b shows the estimated direct cost per business and total direct cost assuming that:

<sup>41</sup> All UK quoted companies have to report on SFTR as part of their annual reporting, SFTR takes into account base salary, pension, share rewards, bonus payments

<sup>42</sup> BEIS analysis based on Manifest data on executive remuneration covering 2015/16 financial years.

<sup>43</sup> <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation4digitsoc2010ashtable14>  
- Table 14.9a Paid hours worked - Total - For all employee jobs: United Kingdom, 2016 (Chief executives and senior officials – code 1115)

- i) Hourly wage rates for chief executives and senior officials are £1,154 (£1,381<sup>44</sup> after uplift);
- ii) Hourly wage rates for financial managers and directors are £714 (£855<sup>44</sup> after uplift), and;
- iii) Assuming time burdens for business to undertake administrative activities (familiarisation, compliance etc.) are consistent with those in table 2a and 2b.

Due to the lack of evidence on the direct cost to business from a CMA Phase 1 investigation this sensitivity analysis is restricted to i) Guidance familiarisation and accessing legal advice and ii) Compliance, notification and engagement with Government.

Total direct costs to business for familiarisation and compliance, notification and engagement with Government would increase from the current estimated range of £40,500-£237,000 per annum to £237,000-£1,394,500.

**Table 3b: Wage Rate Sensitivity for Senior Business Staff: Direct Cost Burden to Businesses**

Activity Stage	Total Time (all staff)	Cost per Business party to a merger (hours x relevant wage rate)	Cost of "Low" Cases 5 - Familiarise 2 - Assessed	Cost of "Medium" Cases 17 - Familiarise 7 - Assessed	Cost of "High" Cases 29 - Familiarise 12 - Assessed
Guidance familiarisation and accessing legal advice	25	£13,443 (£2,820)	£134,500	£457,000	£779,500
Compliance, notification and engagement with Government	54	£25,624 (£3,060)	£102,500	£358,500	£615,000
<b>Total Direct Cost</b>			<b>£237,000</b>	<b>£816,000</b>	<b>£1,394,500</b>

Direct cost burdens to business are presented rounded to the nearest £500. Time and direct cost burdens from tables 2a & 2b are in brackets. Within the table "Low" cases refers to 5 mergers undergoing guidance familiarisation and accessing legal advice and 3 mergers undergoing compliance, notification and engagement activities. For "Medium" the mergers case numbers are 17 and 12, and for "High" 29 and 20.

The results of the sensitivity analysis indicate that even under more conservative assumptions, the direct costs to business remain proportionate in consideration of the benefits from enhancing the Government's ability to assess and potentially intervene in mergers which raise national security concerns.

### Direct Cost to Government

The amendments to the Enterprise Act for the three areas of the economy of interest and associated increase in case load volume are anticipated to lead to direct cost to Government associated with administering the regime. The costs will depend on the estimated number of mergers expected to undergo national security assessments.

The following types of activity are expected to be undertaken to vary degrees dependent on the complexities of each individual case:

1. Regular tracking of M&A activity in the three areas of the economy of interest;
2. Responding to business queries regarding if they fall within the three areas of interest;
3. Obtaining and scrutinising information related to a transaction of potential interest;

<sup>44</sup> After uprating for national insurance contributions and non-labour costs

4. Corresponding with affected parties to seek additional information;
5. Identification of any national security concerns associated with a merger.
6. Discussions with merger parties regarding potential voluntary undertakings to address national security concerns.

Table 4 shows the estimated Government staff time and direct cost associated with the estimated number of merger cases subject to a national security assessment. Staff costs include adjustments to standard wage costs to allow for national insurance and pension contributions, in line with standard practice.

Based on evidence from the Government’s M&A assessment process for national security risks previous cases, we have assumed that 100% of the lower estimate of cases handled (2 out of 2) are complex and 50% of the higher estimate of cases handled (6 out of 12) are complex.

Based on a central assumption of 7 cases (the mean average of the 2 to 12 cases subject to a national security assessment of which 75% are complex) the annual direct cost to Government is estimated at £64,500.

**Table 4: Time and Direct Cost Burden to Government**

Activity Stage	Time per Case per Person	Cost per Case	Cost for 2 cases (both complex cases)	Cost for 7 cases (75% of them complex)	Cost for 12 cases (6 out of 12 complex cases)
Standard Case	83	£3,435	£0	<b>£6,010</b>	£20,607
Complex Case	184	£8,311	£16,623	<b>£43,635</b>	£49,869
Additional Resource Implications Independent of case numbers	312	£14,920	£14,920	<b>£14,920</b>	£14,920
<b>Total Annual Cost</b>			£31,543	<b>£64,566</b>	£85,396

The estimated time and Cost burdens to Government are based on the current merger monitoring and merger and acquisition assessment process.

### Direct Cost to the CMA

If risks to national security arising from a merger or acquisition are identified then the Secretary of State may issue a public interest intervention notice.

For the purpose of the Impact Assessment we have assumed a public interest intervention notice is issued for 1 to 6 of the cases assessed by the Government for national security risks. It should be emphasised that **these are analytical assumptions** used in order to estimate the likely impact on business. When the regime comes into effect M&A will be reviewed on a case-by-case basis to determine if the transaction raises any potential national security concerns.

On receipt of the public interest intervention notice the CMA will provide a report to the Government on jurisdictional and competition issues which will identify if a relevant merger situation has arisen and the turnover and/or share of supply thresholds are met. If any voluntary undertakings proposed by the parties (i.e. acquirer and target) in order to deal with national security concerns prove insufficient (and following a CMA-led Phase 2<sup>45</sup> investigation), the Government may issue orders to ensure the merger does not undermine security.

<sup>45</sup> If a Phase 2 investigation were undertaken the CMA estimates that the cost to the CMA would be £400,000 per case.

For each of the seven national security related interventions to date voluntary undertakings were considered sufficient. Based on the outcomes of previous interventions, we have assumed that voluntary undertakings proposed by the parties are sufficient to address national security concerns and no Phase 2 investigation would be carried out.

Outlined in Table 5 are the staff time and direct cost implications for the Competition and Markets Authority associated with the estimated number of merger cases requiring a Phase 1 investigation in response to a public interest intervention notice. Staff costs include adjustments to account for the full cost of employing labour (that is, wage costs, national insurance and pension contributions).

**Table 5: Time and Direct Cost Burden to the Competition and Markets Authority (CMA)**

Activity Stage	Cost per Case	Cost for 1 Case	Cost for 4 Cases	Cost for 6 Cases
Phase 1 Public Interest Case (Standard)	£30,000	£30,000	<b>£120,000</b>	£180,000
Additional Resource Implications Independent of case numbers	£10,000	£10,000	<b>£10,000</b>	£10,000
<b>Total Annual Cost</b>		£40,000	<b>£130,000</b>	£190,000

*Cost per case the Competition and Markets Authority provided by the Competition and Markets Authority Markets & Mergers team.*

We have assumed that the Phase 1 Investigations by the CMA for Public Interest cases will incur costs of £30,000<sup>46</sup>. Based on a central assumption of 4 cases (the mean average of case volume estimates), the annual direct cost to the CMA is estimated at £120,000 (with a lower and upper estimate of £30,000 and £180,000 per annum for 1 and 6 cases respectively). In addition to undertaking Phase 1 investigations, we anticipate that the CMA may incur further staff costs (of £10,000) associated with increased M&A monitoring of the areas of the economy of interest and responding to queries by Government departments.

The purpose of the Phase 1 investigation for a public interest case is to ascertain if a relevant merger situation has occurred and if the “turnover test” and/or “share of supply test” have been met. As outlined in section 5, the number of merger cases requiring a Phase 1 investigation in response to a public interest intervention notice does not include any Phase 1 investigations solely for competition reason. In addition, neither the Government nor the CMA expects any material change in the number of merger cases investigated by the CMA solely for competition reasons.

### **Direct Cost to the Justice System**

A separate Justice Impact Test was undertaken to identify the potential impacts of the proposals on the justice system. We do not anticipate any impact on the criminal justice system.

In cases where there are national security concerns, and the new tests are met, the Government could either impose conditions or block the transaction all together. If these conditions were breached, a court order could be sought to require compliance with the

<sup>46</sup> Standard cases are assumed to cost £30,000. Complex cases can cost up to £100,000 per case. We have assumed that the Phase 1 investigations initiated following a public interest intervention notice will incur costs of a standard case handled by the CMA. Costs are based on actual costs of completed public interest cases in Phase 1 provided by the CMA Market and Mergers team.

conditions. If that court order was then breached, the parties would be in contempt of court and would be at risk of a prison sentence of up to two years.

We do not anticipate any criminal or civil cases as result of the proposals. There have been seven instances since 2002 when the Government has intervened in a merger on national security grounds. On no occasion has Government sought to pursue parties for breaching conditions through court action.

While the proposals will slightly expand the number of mergers into which the Government can theoretically intervene on national security grounds (we estimate that this would be an additional 5 to 29 mergers, of which 2 to 12 may undergo an assessment for potential risks to national security), only a proportion of these deals are likely to raise national security concerns. For that small number, the Government is unlikely to have to resort to formal intervention. For any merger where this is the case and undertakings and remedies are imposed, we assess there to be no likelihood that conditions would be breached such as to require a court order to be sought. Government interacts regularly and informally with all parties and that will always be the preferred route for all parties, not least for all parties' presentational concerns.

### Summary of Total Direct Costs

Summarised in table 6 are the total direct costs per annum to each of the four affected groups.

**Table 6: Total Direct Costs to Business, Government, the CMA and the Justice System**

<b>Direct Costs by Affected Group:</b>	<b>Low Estimate</b>	<b>Central Estimate</b>	<b>High Estimate</b>
Business	£200,500	£878,500	£1,497,000
Government (administration of the regime)	£31,500	£64,500	£85,000
The CMA	£40,000	£130,000	£190,000
The Justice System	Impact assumed Negligible		
<b>Total</b>	<b>£272,000</b>	<b>£1,073,500</b>	<b>£1,772,500</b>

### Non-monetised impacts:

#### Impacts on Offer Value:

Theoretically, as a result of the statutory instrument being implemented, there could be a potential impact on the value of takeover offers, as any increase to the perceived likelihood that a deal may fail or be blocked by regulators would have implications for the value of the offer made to the target business. We have not, however, been provided with any evidence about the potential impact on value arising from the proposed reforms. The Government believes that its focus on national security and proportionate and transparent approach will mean that any impacts will be minimised. For example, the guidance published alongside the Order stresses that the new provisions are being pursued only for reasons of national security and not for any wider, protectionist, reasons. The UK's amendments should also be seen in the context of other countries and organisations recently and currently amending their policies and laws in relation to similar national security concerns.

#### Impact on Foreign Direct Investment:

Within this section, the potential relationship between regimes for scrutinising the national security implications of overseas investment and the flow of inward foreign direct investment (FDI) will be briefly discussed.

The findings of the externally produced research paper “Sources of Capital”<sup>47</sup> are outlined in Box 1. This paper, based on 20 investor interviews and a literature review of international investment screening processes, found that clear and predictable national security regimes with transparent and objective criteria are not seen as significant barriers to investment.

### **Box 1. Three Key Findings from 20 Structured Interviews with Investors:**

Main findings in relation to the effect of national security screening:

- 1) Transparent and objective regimes are not seen as significant barriers to investing.** Investors told us that, providing national security regimes are clear and predictable, they do not play a major role in the investment decision making process. However, if regimes are based on ‘political’ decisions, they can be seen as a significant barrier to overcome.
- 2) National security regimes are seen to have a relatively minor effect on the capital supply within a country.** Most investors did not think that national security regimes have a significant effect on the availability of capital within a country, even when the regimes are more ‘political’. Blocking a transaction can have negative signalling effects, and investors are keen for there to be transparency of decisions.
- 3) Administration costs of complying with regimes are seen as low, but significant total bid costs will be lost if a deal is blocked.** Investors were generally of the view that the immediate costs of complying with national security regimes are low. However, total bid costs are significant, and would be lost if a deal is blocked. Investors reported a high willingness to engage with authorities in relation to national security regimes, particularly those seen as fair and transparent.

Findings from “Sources of Capital” Research Report, (Forthcoming) Economic Insight for BEIS

Whilst some legal and advisory firms’ consultation responses suggested the scrutiny process may deter FDI and undermine investor confidence, others agreed with the findings from “Sources of Capital”, assessing that while investors may not always welcome regulatory change, there would not be a deterrent effect on investment.

The Government has concluded that any potential impact on FDI into the UK will be very limited, particularly given that the Government has committed to implementing a transparent, proportionate and wholly national security focused regime targeting those areas of the economy which present heightened risks to national security.

The Government will provide clear guidance on the rationale for the screening of mergers on the basis of their potential risk to national security and information to ensure business can assess whether they are in scope of amended merger thresholds.

The UK’s current performance in attracting FDI and the potential relationship between regimes for scrutinising the national security implications of investments are explored further in the

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<sup>47</sup> (Forthcoming) Produced by Economic Insight for BEIS



National Security and Infrastructure Investment Review Green Paper and accompanying consultation stage Impact Assessment<sup>48</sup>.

### **Benefits to national security**

The principal benefit of the proposals, which was identified by stakeholders in consultation responses and meetings, was that the reforms would improve the Government's ability to intervene in M&A which raise national security concerns. While it is often difficult to assign an exact monetary value to a national security benefit, an improved ability to prevent, detect and mitigate, threats to national security will likely have positive long-term economic, social and reputational impacts. National security is the highest responsibility of any nation state.

The specific benefits of the proposed regime are to provide greater powers, set out in a more transparent and appropriate way, to deal with national security concerns and to take reasonable steps as required mitigating these concerns.

### **Wider benefits to society:**

Although wider benefits of the regime are difficult to quantify, the proposals are likely to benefit the society and wider economy by providing clear information and reassurance to investors, consumers and businesses about the relevant rules. It will also help ensure that citizens and businesses have the necessary confidence that Government can take steps to mitigate potential threats to safety and security.

We anticipate the regime will improve identification, mitigation and thereby avoidance of potential risks to national security, enhancing the stability of the United Kingdom. Given that businesses and investors take into consideration a country's relative stability we believe the regime will support long-term business and investment planning (and subsequent investment, innovation and growth).

## **Section 7: Small and micro business assessment (SaMBA)**

In terms of short-term proposals, our assessment indicates that the impact of lowering the threshold on businesses would be minimal. The change of the turnover test threshold from £70m UK turnover to £1m will continue to exclude micro-businesses with a turnover of less than £1m (the upper limit of 'micro-businesses').

However it is possible that some small and micro-businesses in the three relatively small subareas of the economy could be brought into scope when their M&A activity raises national security concerns. The Government considered excluding all small and micro-businesses from the scope of the regime. However, it believes the measures are proportionate as the proposals only give Ministers the necessary powers to act in case of suspected risks to national security.

The rationale for these proposals is to protect the UK's national security, and the Government would not want to exempt any UK business from the scope of this regime where overseas ownership could be linked to an unacceptable risk to the UK's national security.

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<sup>48</sup> <https://www.gov.uk/government/consultations/national-security-and-infrastructure-investment-review>

## **Section 8: Equality assessment**

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The Department for Business, Energy and Industrial Strategy (BEIS) is required to comply with the public sector duty (PSED) set out in the Equality Act 2010 (“the Act”). The PSED requires the Minister to have due regard to the need to advance equality of opportunity, hinder discrimination and foster good relations between those with and without certain protected characteristics. This due regard is taken to eliminate unlawful discrimination and to tackle prejudice and promote understanding. The characteristics that are protected by the Act are: age, disability, gender reassignment, marriage or civil partnership (in employment only), pregnancy and maternity, race, religion or belief, sex and sexual orientation.<sup>49</sup> As the proposals are aimed at UK businesses, and their prospective (mostly institutional) owners, we would not anticipate these proposals impacting upon people with a protected characteristic.

## **Section 9: Business Impact Target**

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These sets of proposals are expected to affect UK businesses in scope of the regime. The proposals are therefore likely to be in scope of the business impact target and constitute new regulatory burdens for business (an IN).

Due to the limited scope of the proposals (and number of affected businesses) the BIT Score is £4m.

## **Section 10: Rationale and evidence that justify the level of analysis used in the IA**

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The analysis is proportionate to the potential scope of the proposed regime, which is limited to three relatively small areas of the economy of the economy. The population and merger estimates have been informed through the consultation alongside the Green Paper, internal BEIS analysis and external research outlined in the body of this Impact Assessment.

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<sup>49</sup> <https://www.gov.uk/discrimination-your-rights/types-of-discrimination>