

EXPLANATORY MEMORANDUM TO

THE ENTERPRISE ACT 2002 (TURNOVER TEST) (AMENDMENT) ORDER 2018

2018 No. 593

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 The instrument amends section 23 of the Enterprise Act 2002 to extend the powers of the Secretary of State to intervene in mergers which might give rise to national security implications and in which he would not otherwise be able to intervene.
- 2.2 Specifically, this negative procedure instrument amends the turnover test to allow the scrutiny of more mergers in three areas: (i) military and dual-use technologies, (ii) two parts of the advanced technology sector, encompassing computing hardware and quantum technologies. For these areas alone, this instrument will lower the threshold which the target business's UK turnover must exceed from £70 million to £1 million.
- 2.3 Parliamentary approval has already been obtained, during debates held in the Lords on 1 May 2018 and the Commons on 2 May 2018, for a related affirmative procedure statutory instrument (the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 (S.I. 2018/578)) that amends the share of supply test so that it is met where a merger or takeover involves a target in the specified sectors with 25% or more share of supply in the UK, as well as where the deal leads to an increase in the share of supply to, or above, this threshold, which is the current requirement.
- 2.4 We intend that both instruments will come into force on the same day, subject to scrutiny of the House of this negative procedure instrument.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 This Order amends section 23 of the Enterprise Act 2002 (c. 40) (the Act) which sets out the criteria for a merger to qualify as a "relevant merger situation". Transactions which amount to a relevant merger situation are subject to UK merger control rules and may be investigated by the Competition and Markets Authority for any implications for competition (section 22 and section 33 of the Act (for anticipated mergers)).

Equally, for Ministers to be able to intervene in a transaction on specified public interest grounds they must have reasonable grounds for believing that it is a relevant merger situation (s. 42). A relevant merger situation arises when two or more enterprises cease to be distinct (or will cease to be distinct) as a result of being brought under common ownership or control (within the meaning given by section 26 of the Act) and the jurisdictional thresholds are met.

- 4.2 There are two alternative thresholds, both specified in section 23:
- The target's UK turnover exceeds £70 million (section 23(1)(b)).
 - The transaction results in the creation of, or an increase in, a 25% or more combined share of sales or purchases in (or in a substantial part of) the UK, of goods or services of a particular description (section 23(2)(b), (3) and (4)).
- 4.3 Under s. 59 of the Act there is a separate special public interest intervention regime for certain defence contractors holding confidential information relating to defence and for certain media companies. Under this regime, Ministers can intervene in mergers involving relevant enterprises even where the jurisdictional thresholds are not met and there is no question of any scrutiny for competition concerns.
- 4.4 This Order is one of two statutory instruments intended to amend the jurisdictional thresholds. The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 (S.I. 2018/578), an affirmative procedure Order under section 123 of the Act was made by the Secretary of State on 13th May 2018 having received Parliamentary approval, and will come into force on 11th June 2018. That Order amends the share of supply test by removing the requirement for a merger to result in an increment in the share of supply for businesses in certain specified areas of the economy. It also introduces a new section 23A into the Act which defines those enterprises to which the revised threshold will apply. This Order is made under section 28 of the Act (subject to the negative procedure) and for those same businesses, reduces the threshold that the UK turnover of the enterprise being taken over must exceed to £1 million instead of £70 million. This Order will come into force immediately after the affirmative procedure Order.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is England and Wales, Scotland and Northern Ireland.
- 5.2 The territorial application of this instrument is England and Wales, Scotland and Northern Ireland.

6. European Convention on Human Rights

- 6.1 The Parliamentary Under Secretary of State and Minister for Business and Industry has made the following statement regarding Human Rights:

“In my view the provisions of The Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018 are compatible with the Convention rights.”

7. Policy background

What is being done and why

Context

- 7.1 The UK economy is open to the world. Core to our economic approach is to trade with other countries, to invest in other countries, and to welcome foreign investment into our economy. In order to facilitate this open economy, the Government must continue to review and update our framework of laws and policies on protecting national security and on the conduct of mergers. This tradition of periodic refinement and improvement has enabled the UK to remain internationally competitive and a place where people can invest with confidence.
- 7.2 The vast majority of investment into the UK's economy raises no national security concerns. However, the Government needs to be alert to the risk that having ownership or control of critical businesses or infrastructure could provide opportunities to undertake espionage, sabotage or exert inappropriate leverage.
- 7.3 The Enterprise Act 2002 is the current key legal means for Government to examine mergers for the purposes of national security and other specified public interest criteria. In light of technological advancements, economic developments and changes in the national security threat, the Government has concluded that reform is required. Last year, it set out a two-stage approach, beginning with the related Order amending the share of supply test and with action through this Order.
- 7.4 In the longer term, the Government will bring forward primary legislation to make more substantive changes to how it scrutinises national security implications of foreign investment. We consulted on these long-term proposals, and are currently analysing the responses. A White Paper will follow in due course.

The statutory instrument

- 7.5 As outlined above, the changes made by this Order (and the separate Order amending the share of supply threshold) relate to mergers involving businesses active in three areas of the economy: military and dual-use items, computing hardware and quantum technology¹. The new thresholds only relate to mergers when enterprises in the relevant areas of the economy are taken over or are part of a pure merger/merger of equals². This means that mergers involving relevant enterprises acquiring non-relevant enterprises are not covered by the revised thresholds.
- 7.6 The Order does not require any business to take any direct action. The UK operates a voluntary notification mergers system – both for competition, and public interest, including national security considerations. The changes made by the Order will also only relate to mergers that take place after it comes into force.

¹ Businesses which undertake this activity are referred to as “relevant enterprises” in the new section 23A inserted by the Order.

² A merger of equals is when two firms of around the same size come together to form a single, new business. In a merger of equals, shareholders from both firms surrender their shares and receive securities issued by the new company.

The three areas of the economy covered by the changes made by the Order

- 7.7 The affirmative procedure Order inserts a new section 23A into the Enterprise Act 2002 which includes clear and detailed definitions of the areas of the economy to which the revised thresholds are to apply. That Order has received Parliamentary approval. The amendment to the turnover threshold in this Order would also apply only to businesses in these areas of the economy.
- 7.8 The national security interests in relation to **military and dual-use technologies** are obvious – these items can, in the wrong hands, pose clear and immediate risks to the UK, our people and society. In addition, the acquisition of items which provide the UK with its operational advantage can raise legitimate and significant national security concerns. In the case of military and dual-use items, the new section 23A includes definitions covering the development or production of goods on well-known and well-established parts of the UK's export control regime, namely:
- the UK Military List (Schedule 2 to the Export Control Order (ECO) 2008);
 - the UK Dual-Use List (Schedule 3 to the ECO 2008);
 - the UK Radioactive Source List (Schedule to the Export of Radioactive Source (Control) Order 2006); and
 - the EU Dual-Use List (Annex I to the Council Regulation (EC) No. 428/2009).
- 7.9 The Government will seek to lay further secondary legislation under the Enterprise Act 2002 to ensure that as items are added to, or removed from, the list of what is subject to export control the businesses which design or produce them will similarly be brought into, and out of, scope of the changes made by this Order and the separate Order amending the share of supply test.
- 7.10 Advances in the **computing hardware** area now mean there are ubiquitous goods with the potential to be directed remotely should a hostile actor obtain access or control. The new section 23A specifies two activities:
- the ownership, creation or supply of intellectual property in the functional capability of computer processing units;
 - the design, maintenance or support of the secure provisioning or management of roots of trust of computer processing units.
- 7.11 In addition, the new section sets out that the development or production of instruction set architecture and the computer code that provides low level control for such units would also make a business a relevant enterprise. The new section specifies that “roots of trust” includes hardware, firmware, or software components that are inherently trusted to perform critical security functions and include cryptographic key material bound to a device that can identify the device or verify a digital signature to authenticate a remote entity.
- 7.12 This means that enterprises which own, create or supply intellectual property in relation to the way that processing units function will be in scope. Businesses that manage roots of trust in relation to processing units are also in scope. This could include businesses that design firmware containing the cryptographic material for a processing unit.
- 7.13 The Government is aware that the huge potential offered by **quantum technology** presents national security challenges. As UK businesses continue to make breakthroughs, they are increasingly at risk of acquisition by hostile actors who could

use the technology to undermine our national security. The new section 23A inserted by the affirmative procedure Order specifies four particular quantum technology activities:

- quantum computing or simulation;
- quantum imaging, sensing, timing or navigation;
- quantum communications; or
- quantum resistant cryptography.

7.14 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.

Revised mergers thresholds for public interest intervention

7.15 Since the public interest regime was introduced by the Enterprise Act 2002, some far-reaching changes have occurred. There have been considerable technological advances, developments in local, national and global economic structures, and changes in the national security threat facing the UK.

7.16 The businesses that are driving the development of innovative goods and technological advances are not necessarily those with large turnovers. In fact, some of the most radical, far-reaching developments are by made by enterprises with small turnovers.

7.17 Furthermore, since the Act was introduced, the global market has become even more connected. At the same time, industries now have deeper, broader and more complicated supply chains. As a result, essential goods and services are provided by increasingly more diverse networks of businesses, including those specialist in focus with small turnovers.

7.18 The Government wishes to ensure that it has sufficient powers to address national security threats that may arise from mergers involving these businesses or any concerns that may arise when these businesses are acquired.

7.19 For those businesses which undertake the defined activities, the amendment made by this Order will mean that a relevant merger situation will also arise if the ‘target’ firm has UK turnover of over £1 million, rather than the Act’s current £70 million threshold. This excludes micro-businesses from the scope of the revised thresholds, ensuring that the Government take as proportionate and focused approach as possible to delivering our policy intention.

7.20 The process for Government intervention will remain as set out in the Enterprise Act 2002.

7.21 Our intention is to remedy gaps in the Enterprise Act 2002 as soon as possible to mitigate the risks to national security from mergers. The changes to the mergers thresholds will come into force on the same day on 11th June 2018.

8. Consultation outcome

8.1 A public consultation on the proposals was held between 17 October and 14 November 2017. The consultation sought views on the proposed amendment to the turnover threshold, and the definitions of the three areas to which it would apply. The

consultation also sought views on the amendments to the share of supply test, included in the separate affirmative statutory instrument.

- 8.2 We received 27 written responses from the legal and advisory community, trade associations and industry groups, individual businesses, and government and research bodies. Feedback on the proposals was also obtained through meetings with an additional seven organisations during the course of the consultation.
- 8.3 Respondents demonstrated some support for the principle and rationale of the intended action.
- 8.4 Most provided some specific views about the details of the proposals. In particular, the proposed scope of the amendment (i.e. the areas to which amended thresholds would apply) was variously found to be less clear or focused than respondents wished or advised.
- 8.5 As a result of constructive consultation responses and feedback from wider engagement with stakeholders, the Government has made a number of amendments to its proposals. In particular, the Government has refined the proposed area definitions. For example, in relation to advanced technology, the Government will provide greater clarity on the exact definition of ‘hardware’ that will bring businesses within scope of the amended mergers thresholds. The Government has also ensured the quantum technology definition is more closely targeted on the national security issues of concern.
- 8.6 The legal community raised wider concerns, querying whether the Government should make changes to the mergers threshold within the Enterprise Act 2002 using the powers under section 28 and s. 123 of the Act. Some considered that it might be more appropriate to make changes by means of primary legislation to the special public interest regime within the Act instead.
- 8.7 The Government believes that its proposals are within the powers granted under sections 28 and 123 of the Enterprise Act 2002, as well as the spirit of the Act. There is nothing in section 28 or section 123 that suggests that the Government’s powers to amend the thresholds can be exercised only for competition reasons, rather than for covering merger situations that may give rise to all or any of the specified public interest concerns that is capable of leading to a merger being prohibited.
- 8.8 Respondents also raised concerns about the implications of, and costs associated with, additional mergers being subject to scrutiny on competition grounds.
- 8.9 The Government believes that the national security context means that it is important that the reform is made. It does this in the knowledge of the fact that the amended thresholds will also apply to the CMA’s jurisdiction to review a merger involving the relevant businesses on competition grounds, but considers that this aspect of the reform ought to make no material difference in practice. Neither the Government nor the CMA itself expects that there will be a consequential material change in the CMA’s approach to competition scrutiny.
- 8.10 The mergers brought into scope by the new provisions are those which involve enterprises with a lower level of turnover than the £70 million threshold applicable to other enterprises and which do not result in an increase in the share of supply of particular goods or services, because horizontal mergers (i.e. mergers between parties operating at the same level of the market) that might raise competition concerns would typically already fall under the CMA’s jurisdiction through the share of supply

threshold. The CMA does not anticipate opening any own-initiative competition investigations on the basis of horizontal concerns into transactions where it would previously not have had jurisdiction.

- 8.11 In theory, the introduction of separate jurisdictional thresholds for relevant enterprises could enable the CMA to assert jurisdiction over non-horizontal mergers (i.e. mergers between parties operating at different levels of the market) where the enterprise being taken over has a lower level of turnover than the £70 million threshold applicable to other enterprises. The CMA notes that most non-horizontal mergers are benign and does not anticipate any material change to its approach to opening own-initiative competition investigations on the basis of non-horizontal concerns. Therefore, the Government does not expect that competition concerns will arise in connection with these mergers.
- 8.12 Having considered the consultation responses, the Government elected to retain the two amendments proposed in the consultation – i.e. the £1 million turnover threshold and additional share of supply test removing the requirement for the merger to lead to an increase in the parties’ combined share of supply which has been brought forward in an affirmative statutory instrument which has already received Parliamentary approval.

9. Guidance

- 9.1 The Government has issued guidance alongside the order and this has been placed on the Department’s website at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/690627/EA02_guidance_draft_final_for_publication.docx.pdf
- 9.2 The guidance explains why the Government is amending the Enterprise Act 2002, describes the Order’s effects in law and in practice, and offers advice to businesses and other about what they should do (and not do) as a result of the changes.
- 9.3 The guidance will be subject to review and will be updated to ensure it remains relevant and as useful as possible.

10. Impact

- 10.1 The estimated impact on business, charities or voluntary bodies of the package of measures included in this Order and the related Order amending the share of supply test is c£900,000 per annum presented in 2017 real prices.
- 10.2 The estimated impact on the public sector (including costs to Government from administering the regime and the CMA) is c£190,000 per annum presented in 2017 real prices.
- 10.3 The Government believes that the reform should not have any material impact on the number of mergers scrutinised only for competition reasons. The CMA’s response to the Green Paper described its view in similar terms: “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”.
- 10.4 An Impact Assessment was published alongside the Explanatory Memorandum accompanying the related affirmative procedure instrument (S.I. 2018/578) on the legislation.gov.uk website. Hard copies can be obtained from BEIS.

11. Regulating small business

- 11.1 The Government intends that this legislation applies to mergers involving small businesses. The Government has consulted widely and has concluded that the proposed measures are proportionate given the national security risks. To provide clarity and minimise impact, the Government has issued guidance as outlined in section 9.

12. Monitoring & review

- 12.1 A review provision, as required by section 28 of the Small Business, Enterprise and Employment Act 2015, is not appropriate in this instrument. The regulatory provisions that are being amended are contained in primary legislation, and are outside the scope of the policy objectives as set out in the statutory guidance, which relate to the inclusion of review provisions in secondary legislation.

13. Contact

- 13.1 Any queries should be directed to nsiireview@beis.gov.uk