

EXPLANATORY MEMORANDUM TO

THE ENTERPRISE ACT 2002 (SHARE OF SUPPLY) (AMENDMENT) ORDER 2020

2020 No. [XXXX]

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 23A of the Enterprise Act 2002 to extend the powers of the Secretary of State to intervene in mergers on public interest grounds as well as powers of the Competition and Markets Authority (CMA) to assess mergers under competition grounds, by including three new sectors in the definition of a “relevant enterprise”.
- 2.2 This enables the Secretary of State to intervene in mergers involving specific enterprises which might give rise to one of the public interest considerations set out in section 58 of the Enterprise Act 2002. The three categories of enterprise being added are those concerning: (i) artificial intelligence; (ii) cryptographic authentication; and (iii) advanced materials.
- 2.3 This instrument adds the three additional categories to the list of relevant enterprises in section 23A, which may be considered a “relevant merger situation” if the share of supply test in section 23 is met.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments.

- 3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 The territorial application of this instrument includes Scotland and Northern Ireland.
- 3.3 In the view of the Department, for the purposes of House of Commons Standing Order No. 83P of the Standing Orders of the House of Commons relating to Public Business, the subject-matter of this instrument would not be within the devolved legislative competence of any of the Northern Ireland Assembly as a transferred matter, the Scottish Parliament or the National Parliament for Wales if equivalent provision in relation to the relevant territory were included in an Act of the relevant devolved legislature.

4. Extent and Territorial Application

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

5. European Convention on Human Rights

5.1 Nadhim Zahawi MP has made the following statement regarding Human Rights:

“In my view the provisions of The Enterprise Act 2002 (Share of Supply) (Amendment) Order 2020 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 Part 3 of the Enterprise Act 2002 (c. 40) (“the Act”) provides the legislative framework in relation to company mergers concerning the Competition and Markets Authority’s (CMA) powers to intervene on competition grounds and the Secretary of State’s powers to intervene on public interest grounds (under section 42). Such interventions may take place where a “relevant merger situation” arises, as set out in section 23. A relevant merger situation is created if two or more enterprises have ceased to be distinct enterprises at a time or in circumstances set out in section 24 of the Act and either the turnover test (section 23(1)) or the share of supply test (section 23(2)) is met.
- 6.2 The turnover test is met where the value of the enterprise being taken over exceeds £70 million or £1 million, in the case of a “relevant enterprise”. The share of supply test is met where the requirements in section 23(3) or (4) are met or, in the case of a “relevant enterprise”, the requirements of section 23 (4A) or (4B) are met. A “relevant enterprise” is defined in section 23A of the Act, which refers to enterprises active in the following sectors: military or dual use goods subject to export control, computer processing units and quantum computing.
- 6.3 This draft Order is one of two instruments which adds three additional enterprise categories to be subject to the turnover test and share of supply test. Article 3 of this Order amends section 23A of the Act to set out the what are relevant enterprises for the purpose of section 23. The amended section 23A will set out the existing relevant enterprises and include new categories of enterprises concerning artificial intelligence, cryptographic authentication and advanced materials to which the share of supply test in section 23(4A) and (4B) may apply.
- 6.4 A separate Order will be made under section 28(6) of the Act, coming into force immediately after this Order to amend the turnover test in section 23(1)(b) of the Act so that, in cases where the enterprise being taken over is a “relevant enterprise”, the test is met if that enterprise has turnover in the UK of over £1million.
- 6.5 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 (s. 22 and s. 33 of the Act (for anticipated mergers)).
- 6.6 The Secretary of State may intervene in a transaction on specified public interest grounds where there are reasonable grounds for believing that it is a relevant merger situation (s. 42).
- 6.7 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.

7. Policy background

What is being done and why?

- 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 Most 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 As a consequence of the COVID-19 pandemic, the depreciative effect on sterling coupled with financial uncertainty for many enterprises means the risk of hostile actors exploiting the situation through aggressive acquisitions of UK businesses has increased. Furthermore, there is also an increased threat of the UK losing capability to act as a sovereign nation with its own capabilities.
- 7.4 The Order amends the Enterprise Act 2002 to enable the Government to intervene in a merger or acquisition in specific categories of enterprise should a significant national security risk arise. 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.
- 7.5 In light of technological advancements, economic developments and changes in the national security threat, the Government has concluded that reform is required. The Government acted in 2018 to change the share of supply test and turnover test (as described in the legislative background section) for three categories of enterprise, namely (i) military and dual-use technologies, (ii) two parts of the advanced technology sector, encompassing computing hardware and quantum technologies.
- 7.6 This instrument adds three further categories of enterprise to legislative framework to which the share of supply test will apply. A separate Order, the Enterprise Act 2002 (Turnover) (Amendment) Order 2020 subject to the negative procedure, will apply the turnover test to these further categories. These additional sectors contained in this Order stem from national security and investment consultation on proposed legislative reforms published on 24 July 2018. As part of this consultation, the Government identified the additional enterprise categories as parts of the economy where risks to national security were most likely to arise.
- 7.7 To be able to address potential national security risks, the Order will be commenced the day after the day on which it is made. The second Order relating to the turnover test (The Enterprise Act 2002 (Turnover) (Amendment) Order 2020)) will be made and laid immediately after the Share of Supply Order. The Turnover Order will commence the day after it is made.
- 7.8 The Government considers it necessary for the Turnover Order to be commenced in this manner to ensure that the Secretary of State has the ability to scrutinise a merger or takeover which may give rise to national security concerns at the earliest possible date. The Government considers it proportionate to commence the two Orders after

they are made as they do not provide a direct burden on businesses, but rather enable the Government to intervene, if necessary, on a public interest consideration. (Further detail is provided in the ‘Legislative Context’ section.)

- 7.9 The Order has no impact on the forthcoming National Security and Investment Bill, which the Government intends to bring forward when Parliamentary time allows. It is intended as a short-term measure, which will apply until more fundamental reforms can be taken forward through that Bill.

The statutory instrument

- 7.10 As outlined above, the changes made by this Order (and the proposed Order amending the turnover threshold) relate to mergers involving enterprises concerning three areas of the economy: (i) artificial intelligence; (ii) cryptographic authentication; and, (iii) advanced materials.
- 7.11 The addition of these sectors means that they will be subject to the jurisdictional thresholds set out in the Act.
- 7.12 The Order does not require any business to take any direct action. The changes made by the Order will only relate to mergers that take place after it comes into force.
- 7.13 The Order amends section 23A of the Act to add three categories of relevant enterprises to which the share of supply test in section 23(4A) and (4B) may apply.
- 7.14 For those businesses which undertake the defined activities, the amendments made by this Order and the related Order to be made concerning the turnover test will mean that a relevant merger situation will arise if the ‘target’ firm has UK turnover of over £1 million. 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 its policy intention.
- 7.15 The process for Government intervention will remain as set out in the Enterprise Act 2002.

Three areas of the economy covered by the changes made by the Order:

- 7.16 Artificial intelligence (AI) technologies are transforming the global economy. They can be seen as new industries in their own right, but they are also transforming business models across many sectors. They deploy vast datasets to identify better ways of doing complex tasks.
- 7.17 More specifically, the term AI refers to technology enabling the programming, or execution of a computational process capable of undertaking complex tasks commonly associated with human intelligence. These tasks are often data intensive, including but not restricted to analysis, decision-making, image processing and recognition, natural language understanding, autonomous operation in complex domains, reflection, or introspection. Additionally, these tasks may extend to an AI technology’s ability to learn and adapt from its environment and adjust its programming.
- 7.18 AI systems can be trained to employ, for example, machine learning algorithms (algorithms with the ability to learn without being explicitly programmed) in order to deploy adaptable, automated decision-making models for complex tasks. This implies interaction with the digital, and in some cases, the physical environment. AI applications have the potential to be programmed remotely, misdirected or misused in

other ways that raise national security concerns should, for instance, a hostile actor obtain access or control over them.

- 7.19 The opportunity to use AI positively across the UK economy can only be harnessed if sensitive and critical applications of AI, especially in defence and security and national infrastructure, can be protected from the risk of hostile actors intending to do harm to the UK and its interests. The statutory instrument defines the relevant enterprises as those that produce, develop and design digital AI and machine learning technologies (excluding physical robotics), including components and service providers and all relevant intellectual property. This definition ensures that the Government is able to exercise its duty to protect national security in this rapidly developing sector.
- 7.20 Cryptographic technology enables information to be protected whilst in storage or in transit by making it inaccessible or unreadable by everyone except those who have the information needed to access or read it. The technology is integral to a well-functioning economy. The Government recognises the importance of these technologies to the UK and promotes research and innovation in cyber security through research grants and supporting the development of new cyber innovation centres.
- 7.21 Hostile actors may be able to access critical systems and undermine national security if they gain access to this technology by acquiring a business in this sector. Significant damage to the UK could result if authentication systems are compromised or bypassed, including through sabotage and espionage, to allow a hostile actor to gain unauthorised access to systems critical for national security.
- 7.22 As enterprises increasingly rely on advanced, digital means to protect their intellectual property and operational activity, having the ability to intervene against hostile actors to mitigate risk in this area is more pressing than ever. Consequently, this statutory instrument enables Government to intervene on national security grounds where a hostile actor could affect the activities of an enterprise producing solutions, researching technology or providing services relating to cryptographic authentication.
- 7.23 Breakthroughs in materials and manufacturing science are fundamental enablers across all areas of societal and economic development. They have underpinned and continue to underpin advances in the physical and digital world. These all stem from understanding, manipulating and exploiting the composition, arrangement and properties of matter.
- 7.24 The Government will act to maintain advantage in its defence and security capability and there may be a risk of loss in this advantage if UK companies (and the Intellectual Property that they generate) in this area are controlled by hostile actors.
- 7.25 The Government expects that it will update these definitions as technology evolves in this area to reflect the evolving risk to our national security.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

- 9.1 No consolidation required.

10. Consultation outcome

- 10.1 The Competition and Markets Authority was consulted about this Order as required under section 123(4) of the Act. Neither the Government nor the CMA itself expects that there will be a consequential material change in the CMA's approach to competition scrutiny.
- 10.2 No public consultation was undertaken for the formulation of this Order. Given pressing national security concerns, the Government saw it proper to put the relevant enterprise categories to Parliament at speed. In particular, the financial pressures placed on some enterprises by the Covid-19 pandemic has made the likelihood of hostile actor activity in mergers more acute.
- 10.3 The Government sought Parliamentary approval directly, with the intention to minimise the time before the Order can be commenced.

11. Guidance

- 11.1 The Government will be issuing guidance alongside this Order and this will be placed on the Department's website once the Order is commenced.
- 11.2 The guidance explains why the Government is amending the Enterprise Act 2002 and describes the legal and practical effects of this Order.
- 11.3 The guidance will be subject to review and will be updated to ensure it remains relevant and as useful as possible.

12. Impact

- 12.1 This instrument amends the share of supply jurisdictional test within the Act to allow the Government to scrutinise mergers that currently fall outside the share of supply threshold in the three additional areas, enterprises concerning: artificial intelligence (AI); cryptographic technology; and advanced materials. It will also allow the CMA to scrutinise those mergers under competition grounds. The innovation within these areas has often been driven by small businesses and there is a risk that mergers involving these types of businesses, which fall below the current turnover threshold of over £70 million, could raise national security concerns.
- 12.2 A low level of direct costs to business have been identified as a result of this secondary legislation. These consist of familiarisation and compliance costs in relation to the expected 16 additional merger and acquisitions cases that are assumed to fall within the scope of the public interest consideration regime, per year.
- 12.3 It has been assessed that any potential impact on foreign direct investment (FDI) into the UK will be very limited, given the transparent, proportionate and wholly public interest-focused nature of the legislation. The associated benefits of this instrument are difficult to quantify and monetise.
- 12.4 The proposals are likely to benefit society by ensuring that UK economy is supported by well-functioning infrastructure and key services as the Government will have an enhanced ability to act upon risks to the UK's national security. UK citizens are also likely to have greater confidence that Government can take steps to mitigate potential threats to their safety and security.
- 12.5 A 'de minimis' self-certification has been signed off by the Department's Better Regulation Unit to verify that there is reasonable expectation that the net aggregate

impacts would be comfortably below the £5m threshold and therefore a full impact assessment has not been produced.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 13.3 The basis for the final decision on what action to take to assist small businesses is that the Government has concluded that the proposed measures are proportionate given the national security risks. To provide clarity and minimise impact, the Government will issue guidance as outlined in section 11.

14. Monitoring & review

- 14.1 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.

15. Contact

- 15.1 George Kokkinos at the Department for Business, Energy & Industrial Strategy. Email: George.Kokkinos@beis.gov.uk can answer any queries regarding the instrument.
- 15.2 Sarah Mackintosh, Deputy Director for National Security and Investment, at the Department for Business, Energy & Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Minister Zahawi at the Department for Business, Energy & Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.