EXPLANATORY MEMORANDUM TO

THE ENTERPRISE ACT 2002 (SHARE OF SUPPLY TEST) (AMENDMENT) ORDER 2018

2018 No.

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 into which he would not otherwise be able to intervene.

2.2 Specifically, this affirmative instrument amends the share of supply 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 amends the share of supply test so that it is met where a merger or takeover involves a target 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.

2.3 Subject to Parliamentary approval being obtained for this affirmative procedure statutory instrument, a second, negative procedure statutory instrument will be laid to amend the turnover test to allow the scrutiny of more mergers in the same three areas of the economy. The second instrument will lower the threshold which the target business's UK turnover must exceed from £70 million to £1 million. We intend that both instruments would come into force on the same day, subject to scrutiny of the House. A draft of the second statutory instrument is annexed to this memorandum.

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 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland.

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 (s. 22 and s. 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 s. 26 of the Act) and the jurisdictional thresholds are met.

4.2 There are two alternative thresholds, both specified in s. 23:

- The target's UK turnover exceeds £70 million (s. 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 (s. 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 The draft Order is one of a package of two proposed instruments intended to amend the jurisdictional thresholds. This Order is made under s. 123 of the Act and is subject to the affirmative procedure. It removes the requirement for the merger to result in an increment in the share of supply for businesses in certain specified areas of the economy. Subject to Parliamentary approval of this Order, a separate Order under s. 28 of the Act (subject to the negative procedure) will be laid which, for those same businesses, reduces the threshold that the UK turnover of the enterprise being taken over must exceed £1 million instead of £70 million.

4.5 There is a power in section 123(1) (read with section 123(2) and (3) and section 124(3)) to amend or replace section 23(2)(b), (3) and (4) so as to specify a different share of supply test. This power can be exercised so as to specify different shares of supply, for different cases or purposes (section 124(2)(a)). This must include the power to set different thresholds for different industries. The Order inserts a new section 23A into the Act which defines those enterprises to which the revised threshold will apply. The amendment to the turnover test which is proposed to be included in the separate Order under s. 28 of the Act will also apply in relation to enterprises defined in the new section 23A. The powers in section 28(6) and section 123 have not been exercised before.

4.6 Section 123(3) of the Act includes a requirement that in amending the share of supply test the Secretary of State must in particular, have regard to the desirability of ensuring that any new test continues to operate by reference to the degree of commercial strength which results from the enterprises concerned having ceased to be distinct. Paragraph 7.15 below explains the Secretary of State's approach in relation to the amendments to the share of supply test.

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 (Share of Supply 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 action through this Order and the proposed related Order amending the turnover test.

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 proposed Order amending the turnover threshold) relate to mergers involving businesses active in three areas of the economy: military and dual-use items, computing hardware and quantum technology[1]. 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 equals.[2] This means that mergers involving relevant enterprises acquiring non-relevant enterprises are not covered by the revised thresholds.

[1] Businesses which undertake this activity are referred to as "relevant enterprises" in the new s. 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 issues by the new company.

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.

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

7.7 The 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 share of supply threshold is to apply[3].

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 proposed Order amending the turnover threshold.

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 inserted by the Order 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

[3] The amendment to the turnover threshold in the proposed Order to be made under s. 28 of the Act would also apply only to businesses in these sectors.

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 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 The Government is concerned about possible scenarios where a business with no existing share of supply in the UK buys a relevant enterprise. As such a merger would not result in an increase in the share of supply in the UK, the current share of supply test would not be met. As a result of the changes made by the Order, (in the case of transactions in which a relevant enterprise is acquired or in a pure merger or other transaction involving a change of control or the acquisition of material influence over a relevant enterprise) the Government will be able to intervene in a merger if those carrying on the relevant enterprise had an existing share of supply of at least 25% before the merger. The acquiring party, or any other party in a pure merger/merger of equals, need not have any share of the supply of the same goods or services for test to be met.

7.16 The Enterprise Act 2002 requires that in making changes to the share of supply test the Secretary of State must have regard to the desirability of the test continuing to operate by reference to the degree of commercial strength which results from the merger of the businesses concerned. The Government considers that national security concerns could legitimately arise in relation to a purchaser with little or no current market share in the relevant UK market. In the light of these legitimate national security concerns the Secretary of State has concluded that it is necessary to remove the requirement for the merger to result in an increased share of supply in the case of businesses active in the specified areas of the economy, even though this means that in this category of cases the test will not operate by reference to any increase in commercial strength/share of supply arising out of the merger.

7.17 For those businesses which undertake the defined activities, the amendments made by the proposed second, negative statutory instrument 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.

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

7.19 The Government has published clear guidance alongside the Order to advise businesses how to check whether they are in scope of the reforms and the necessary steps to take and this will be placed on the Department's website.

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 amendments to the share of supply test, and the definitions of the three areas to which they would apply. The consultation also sought views on the amendments to the turnover threshold, which we are proposing to bring forward by a separate negative 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 s. 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 s.28 or s.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. an additional share of supply test removing the requirement for the merger to lead to an increase in the parties' combined share of supply and the £1 million turnover threshold to be brought forward by a second statutory instrument.

9. Guidance

9.1 The Government has issued guidance alongside the order and this will be placed on the Department's website at https://www.gov.uk/government/consultations/national-security-and-infrastructure-investment-review.

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 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£190,000per 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 is submitted with this memorandum and is published alongside the Explanatory Memorandum 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

STATUTORY INSTRUMENTS

2018 No.

COMPETITION

The Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018

Made - - - -	***
Laid before Parliament	***
Coming into force in accordance with article 1(2)	

The Secretary of State makes this Order in exercise of the powers conferred by sections 28(6) and 124(2) of the Enterprise Act 2002([4]).

Citation and commencement

1.—(1) This Order may be cited as the Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018.

(2) This Order comes into force immediately after the commencement of the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018([5]).

Amendment of the Enterprise Act 2002

2.—(1) Section 23 of the Enterprise Act 2002([6]) is amended as follows.

(2) In subsection (1)(b), after "exceeds" insert—

"(i) £1 million, if in the course of the enterprises ceasing to be distinct, a person or group of persons has brought a relevant enterprise (see section 23A) under the ownership or control of the person or group; or

(ii) £70 million, in any other case.".

Transitional provision

3. The amendments made by article 2 apply only in relation to cases where enterprises cease to be distinct after the commencement of this Order.

([4])2002 c. 40; section 28 was amended by paragraphs 59 and 71 of Part 2 of Schedule 5 to the Enterprise and Regulatory Reform Act 2013 c. 24 and section 124(3) was amended by paragraph 24(1) and (2) of Schedule 16 to the Communications Act 2003 c.21.

([5])S.I. 2018/xxx.

([6])Section 23 was amended by paragraphs 59 and 68 of Part 2 of Schedule 5 to the Enterprise and Regulatory Reform Act 2013 c. 24 and by S.I. 2018/xxx. Section 23A was inserted into the Enterprise Act 2002 by S.I. 2018/xxx.

Name
Parliamentary Under Secretary of State for Business and Industry
Date Department for Business, Energy and Industrial Strategy

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends section 23 of the Enterprise Act 2002 (c. 40) (the Act) which sets out the criteria for a merger to be a "relevant merger situation", thereby qualifying it for investigation by the Competition and Markets Authority. The Secretary of State has the power under section 42 of the Act to intervene in a "relevant merger situation" on the grounds of specified public interest considerations, where appropriate.

A "relevant merger situation" is created if: two or more enterprises have ceased to be distinct at a time or in circumstances set out in section 24 of the Act, and at least one of the following thresholds is met:

(a) the value of the turnover in the UK of the enterprise being taken over exceeds £70m (the "turnover test"); or

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

This Order comes into force immediately after the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 (S.I. 2018/xxx) (the Share of Supply Test Order). The Share of Supply Test Order which comes into force on [xxx] amends the share of supply test so that, in cases where the enterprise being taken over is a "relevant enterprise" that test is additionally met, if the relevant enterprise has a 25% share of supply of goods or services in the UK before the merger. The relevant goods or services for this purpose are those by virtue of which it qualifies as a "relevant enterprise". The Share of Supply Test Order also inserts a new section 23A into the Act which defines a "relevant enterprise". The definition covers enterprises which are involved in specified activities in connection with the following: military or dual-use goods which are subject to export control, computer processing units and quantum technology.

Article 2 of this Order amends the turnover test 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 £1m instead of £70 million.

Article 3 makes transitional provision to the effect that the amendments made by this Order apply only in cases where enterprises cease to be distinct after the Order comes into force.

A separate impact assessment has not been prepared for this instrument but a full impact assessment of the effect that the Share of Supply Test Order and this Order will together have on the costs to business and the public sector is available from the Department for Business, Energy and Industrial Strategy, 1 Victoria Street, London SW1H 0ET and is also published alongside the Share of Supply Test Order on the UK Legislation website www.legislation.gov.uk.