

Conservative Party Win Paves Way for Reforms to UK National Security Reviews

Partners

John Adebisi / London

Bill Batchelor / Brussels

Associate

Jason Hewitt / London

The Conservative Party's conclusive win in the U.K.'s recent general election paves the way for long-anticipated and decisive reforms to the country's national security screening regime. The government first outlined its proposals for a wide-ranging national security screening regime for inward investments in a white paper published in mid-2018. (See "[Foreign Investment Control Reforms in Europe](#).") With Brexit leaving little political bandwidth in the U.K. and the prior government's lack of a majority in Parliament making the successful passage of legislation very uncertain, those reforms have not yet been enacted. However, now armed with an 80-seat majority, the government is well-positioned to ensure the successful implementation of its legislative agenda, and the proposed reforms are likely to be implemented in the near future.

Recent government interventions in high-profile transactions with national security implications highlight the increased focus on national security concerns, provide useful lessons for navigating the future regime and act as a reminder that the existing regime is not without teeth.

Existing Enterprise Act 2002 Regime

The Enterprise Act 2002 allows the U.K. government to intervene in transactions that raise national security concerns, including by attaching a public interest intervention mechanism to both the U.K. and the European Union (EU) antitrust merger control regimes. In 2018, as a stop-gap measure prior to implementing the proposed new national security screening regime, merger control thresholds were lowered to a £1 million turnover or a 25% share of the supply (either buyer or target) for businesses that are active in (i) military or dual-use goods subject to export control, (ii) computer processing units and (iii) quantum technology. No threshold applies for designated U.K. military suppliers, giving the government an ability to intervene in smaller direct suppliers and nascent businesses with national security implications.

After the government issues an intervention notice, the U.K.'s Competition and Markets Authority (CMA) must report on the potential transaction, and the relevant secretary of state must determine whether a more detailed and protracted "Phase 2" review by the CMA is needed. A Phase 2 review can include blocking the transaction in its entirety. The relevant secretary of state generally has allowed transactions to proceed without a Phase 2 referral, subject to the parties to the transaction agreeing to legally binding undertakings to address national security concerns.

The Enterprise Act regime is supplemented by existing nonstatutory measures, including U.K. government-owned "golden shares" in a limited number of U.K. companies considered strategically important, which provide the government with certain governance rights over the company, including the right to restrict shareholdings in the company to 15%. Further, U.K. government departments, in particular the Ministry of Defence, routinely require companies to obtain their consent for proposed changes of control of important suppliers.

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Four Times Square
New York, NY 10036
212.735.3000

Recent Developments

From 2002-2018, the U.K. government brought eight public interest interventions on national security grounds under the Enterprise Act regime. In seven of those cases, the government accepted undertakings and allowed the transactions to proceed; in one case, it did not identify any national security concerns.

Consistent with the increasing focus on national security issues, the U.K. government issued intervention notices in four transactions in 2019 and accepted undertakings from the bidders to address national security concerns in two cases (two are still in the initial review stage).

Notably, one case involved the U.K. government issuing an injunctive order in relation to an acquisition that had not been formally notified: the proposed acquisition of Mettis Aerospace by Aerostar, a fund established in China. This was the first time that the U.K. government issued an injunctive order to prevent completion based on national security grounds.

Advent's Proposed Acquisition of Cobham plc

On July 25, 2019, defense contractor Cobham and funds managed by U.S. private equity firm Advent International agreed to Advent's approximately £4 billion cash acquisition of Cobham.

The U.K. Ministry of Defence identified Cobham as a supplier and subcontractor of products and services of particular importance to national security. On September 17, 2019, U.K. Secretary of State for Business, Energy and Industrial Strategy (BEIS) Andrea Leadsom announced that she would intervene in the transaction. Following a CMA report, engagement with relevant government agencies, including the U.K. Ministry of Defence, and a public consultation

process, the secretary of state announced on December 20, 2019, that she would accept Advent's proposed undertakings to address national security concerns.

The legally binding undertakings are intended to:

- ensure that Cobham's existing security arrangements protecting sensitive U.K. government information will be continued and strengthened, and that, in addition to existing boards, new board structures implemented under the ownership of Advent will comply with national requirements;
- require Cobham's new owners to honor the terms of existing contracts, notify the U.K. Ministry of Defence in advance if a material change would impact Cobham's ability to supply key services, and refrain from withdrawing from any specified service for a set period; and
- require Cobham's new owners to give the Ministry of Defence prior notice of plans to sell all or parts of Cobham's business in order to inform the exercise of Enterprise Act powers designed to protect national security interests in future transactions.

Acquisition of Inmarsat plc

A consortium of private equity firms, including Apax Partners and Warburg Pincus, launched a \$3.4 billion takeover bid on March 19, 2019, for Inmarsat, a British satellite telecommunications company.

On July 23, 2019, then-Secretary of State for Digital, Culture, Media and Sport Jeremy Wright issued a public interest intervention notice on national security grounds under the Enterprise Act. Following a review and public consultation, the secretary of state accepted undertakings intended to require the bidder and Inmarsat to:

- maintain existing security measures and implement enhanced controls to protect sensitive information and technology from unauthorized access, including a high standard of physical security, information technology systems security and personnel security; and
- continue to provide certain capabilities and maintain a U.K.-registered company to ensure that relevant services remain under U.K. jurisdiction.

The undertakings provide rights of access to premises and information and other provisions to enable the U.K. Ministry of Defence and other government agencies to audit compliance with the security measures and undertakings.

Lessons Drawn From the Cobham and Inmarsat Transactions

The outcomes of both the Cobham and Inmarsat transactions highlight particular areas of focus for the U.K. defense establishment in assessing all transactions, in particular, the importance of:

- maintaining strategic capabilities in the U.K., including continuity of development and/or supply of goods and services provided by U.K. companies for military programs;
- retaining the U.K.'s capability to develop, operate and maintain equipment, platforms and technologies independent of other countries so as to preserve the operational capabilities of the U.K. Armed Forces, particularly in the event that the U.K. stands alone in any particular conflict;
- ensuring that the target's capabilities continue to be made available and maintained in the U.K.;
- protecting classified information, including ensuring that military programs and security within the U.K. be maintained in line with U.K. National Security Regulations;

- protecting sensitive information and technology, and keeping confidential and limiting intellectual property use;
- protecting and retaining “U.K. Eyes Only” for classified information; and
- retaining a majority of U.K. security-cleared British citizens on target company boards.

Companies facing a national security review may also find it helpful to emphasize aspects of the proposed deal that would diversify and enhance the U.K.’s supply chain, promote exports from the U.K. target to other markets and close current and future (post-Brexit) capability gaps.

In addition to the Cobham and Inmarsat transactions, the U.K. government recently intervened in two additional transactions on national security grounds.

Proposed Acquisition of Impcross Limited

On December 6, 2019, the CMA announced that it was investigating the anticipated acquisition by Chinese-owned aircraft parts supplier Gardner Aerospace Holdings Limited of aerospace player

Impcross Limited after an intervention notice was issued. The CMA is expected to report early in March 2020.

Proposed Acquisition of Mettis Aerospace

On December 20, 2019, Andrea Leadsom, the U.K. secretary of state for BEIS, announced that she had issued a public intervention notice in relation to the proposed acquisition of Mettis Aerospace, an aircraft parts manufacturer, by Aerostar, a fund established in China.

The secretary of state also issued an injunctive order preventing Mettis Aerospace from taking any actions that might raise national security concerns. This was intended to prevent both the completion of the transaction and the transfer of information know-how or documents to Aerostar. The order also imposes obligations in relation to Mettis’ business operations, safeguarding of assets and reporting. This first use of an injunctive order to prevent a completion on national security grounds demonstrates the U.K. government’s increased readiness to use its powers to stop deals pending national security review.

The CMA is expected to report in the second half of March 2020, after which the secretary of state will decide whether to clear the merger, including by accepting undertakings to address any national security concerns, or refer the merger to a Phase 2 review by the CMA.

This transaction highlights the importance of a proactive approach to national security screening for businesses active in sensitive sectors even in advance of the introduction of the proposed reforms, particularly for potential acquirers based in jurisdictions where the U.K. government’s perceptions of potential risks to national security appear to be heightened.

The New Regime

The new government’s legislative agenda, as laid out in the recent Queen’s Speech, proposes a National Security and Investment Bill, which appears to be consistent with the proposals set out in the 2018 white paper, although the precise details of the proposed legislation, and the timing of its introduction, remain to be seen.