

UK dramatically lowers threshold for reviewing national security mergers

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1. Introduction

The UK's new thresholds for national security issues will impact startups and small businesses operating in the national security sector. The new rules will mean businesses with turnover as low as £1 million or providing unique defence products (without substitutes) may require clearance from the Secretary of State. This will impact the ability to enter into joint venture arrangements with foreign businesses and obtain foreign investments and may also reduce the desirability of some transactions. It will further impact the timing and cost of any merger involving national security issues and will undoubtedly influence both sellers and prospective purchasers going forward.

In May 2018, the government published two orders¹ amending both the turnover test and the share of supply test for mergers with potential national security implications. The purpose of the orders was to reduce the thresholds for intervention, enabling the government to review more transactions that have a potential national security dimension. The orders, which became effective on June 11, 2018, mark the first substantial amendments of the UK merger control regime since the Enterprise Act 2002 was given royal assent more than 15 years ago. The new thresholds will only apply to mergers taking place in particular sectors and, as they are significantly lower than the thresholds for mergers in other sectors, will bring a large number of deals within the scope of the UK merger control regime.

In addition to the new thresholds, the government is also considering additional reform to increase the scope for intervention in mergers with potential national security implications.

2. Current regime

Under the pre-existing thresholds, which will continue to apply outside of the specific national security sectors, the Competition and Markets Authority (the CMA) can review relevant merger situations² where either:

- Target's turnover in the UK exceeded £70 million in the preceding year or
- The transaction results in the creation of, or increase in, a 25 percent or more combined share of UK sales or purchases of goods or services of a particular description, in the whole or a substantial part of the UK. It is important to note that the share of supply test requires the transaction to create an incremental increase, even if very small, to the parties' share of supply. Therefore, it cannot be satisfied where there is no overlap between the parties in the UK (as the transaction would not create or strengthen the share of supply in such cases).

In addition to the powers of the CMA to investigate qualifying mergers on competition grounds, the Secretary of State (the SoS) can also intervene on the grounds that a merger raises certain public interest considerations. Relevant public interest considerations include, for example, national security, plurality of media ownership and the need to maintain the stability of the UK financial system. The SoS can intervene in mergers by issuing a public intervention notice to the CMA, which triggers

an additional process for considering the public interests raised by the SoS (in addition to the normal competition tests being considered by the CMA).

3. New thresholds for national security mergers

For mergers occurring in the relevant sectors (discussed in section 4, below), the new applicable thresholds are as follows:

- The UK turnover of the target business is over £1 million (down from the normal £70 million) or
- The share of supply threshold, while remaining at 25 percent, does not require any incremental increase to be created as a result of the merger (ie, if the target already has a 25 percent share of supply, the threshold will be satisfied irrespective of whether the acquiring entity is active on the same market).

4. Sectors affected by the new thresholds

The new thresholds will only apply to mergers where the target being acquired is active in one of the following sectors:

- Military and dual-use: covers the development or production of either pure military items or dual-use items (ie, items which can be used for both military and civil purposes) and will also apply to entities which hold certain information capable of use in connection with such development or production.
- Computing hardware: covers businesses which own, supply or create intellectual property rights relating to the functional capability of multi-purpose computing hardware. It will also cover the design, maintenance or support for the secure provision or management of certain computer hardware.
- Quantum technology: covers businesses which research, develop, design or manufacture goods for use in, or supply services employing, certain quantum technologies (widely defined).

As mentioned above, mergers occurring outside of the above sectors will continue to be subject to the pre-existing thresholds described in section 2.

5. Potential for further changes ahead

The government is also considering further, long-term reform to better equip it to review national security mergers, including:

- Expanded voluntary regime with increased powers to call-in non-notified mergers: including a power for the SoS to intervene on national security grounds at any time within three months following completion, where the SoS believes that the acquisition of significant influence or control over any UK business by any investor would raise national security risks; and
- Mandatory notification regime for certain foreign investment: would cover foreign investments into a set of "essential functions" where such foreign ownership could create a national security risk.

The government is currently considering how to proceed in relation to the above proposals, and is expected to issue a White Paper and draft legislation later in 2018.

6. Impact of the new thresholds

In its impact assessment, the government estimates that the new thresholds will result in an additional 5 to 29 mergers and acquisitions being subject to a national security assessment. Out of these, the government estimates that 3 to 17 merger cases per year will be identified as no risk, and the remaining 2 to 12 cases to require a more in-depth assessment by the government to review potential national security risks. Of the 2 to 12 cases which will require in-depth assessment, the government estimates that half (1 to 6) will pose no risk to national security, whereas the remainder may constitute a risk to national security such that the SoS will intervene and examine the transaction more closely and formally. The costs for the CMA, the government and businesses associated with the additional cases to review is estimated at between £1.1 million to £1.8 million per year (with a lower bound estimate of only £0.3 million). The new thresholds do not affect the fees payable to the CMA by notifying parties.³

While the new thresholds only apply to mergers in particular sectors and have been introduced to address national security concerns, both the CMA and the government can theoretically intervene under the new thresholds on purely competition grounds or public interest grounds other than national security concerns. However, the government has confirmed that it does not "foresee instances when it would intervene in mergers brought into scope by the amendments for any other public interest ground than national security."⁴ Similarly, the CMA indicated that it is unlikely to use the new thresholds to call in transactions on purely competition grounds (noting that horizontal mergers would likely already meet the existing share of supply test, and that competition concerns in vertical mergers are unlikely where the target's UK turnover does not exceed £70 million).⁵ However, the CMA will nevertheless have to review transactions which fall under the new thresholds and which have been voluntarily notified to it by the relevant parties.

As mentioned above, the new thresholds will bring transactions within the ambit of the UK merger control regime which would previously not have been subject to potential merger control. Under the new thresholds, parties considering acquiring an entity active in the relevant sectors will have to assess the presence and magnitude of any national security implications of the transaction and determine whether to voluntarily notify it.⁶ The government encourages prospective merging parties whose transaction falls within the new threshold to make contact in advance in order to explore potential national security implications. While each transaction should be approached on a case-by-case basis, the government has indicated that parties should, for example, consider the following when assessing whether a proposed transaction has national security implications:⁷

- The identity of the entity which will acquire material influence or control over the business (including considerations of existing holdings in relevant sectors)
- The form of the material influence or control (eg, share of voting rights, right to appoint board members etc.)
- Ways in which the influence or control can be manifested (eg, access to assets or information that the government may have issues with) and
- Mitigation proposed by the parties to address the government's national security concerns.

It is important to note that the new thresholds do not differentiate between mergers involving domestic and foreign purchasers, and the government has noted that the overwhelming majority of foreign investment poses no national security threat. However, the government also notes that "[f]oreign investors are less likely to have the UK's interests at heart and may be controlled or influenced by hostile state actors."⁸ Therefore, prospective sellers of companies which are active in the relevant sectors are likely to pay closer attention to the identity of the purchaser going forward, as foreign purchasers will have a potential impact on the timeline and cost of the transaction.

7. Summary

The lower thresholds mean that companies involved in computing hardware, quantum technology or the development or production of military items or dual-use items which were previously considered too small to warrant scrutiny under the UK merger control regime are now squarely within the focus of the UK regime and any acquisitions involving such companies will garner the attention of both the CMA and the government.

Even companies whose turnover fall below the new £1 million threshold might find themselves subject to merger control if, for example, they are active in a new, rapidly developing market with relatively few competitors if the company has amassed a 25 percent share of supply (the likelihood of which is higher in nascent markets). This is more common in the defence sector where markets can be very unique and a provider may be one of only two businesses making a product or service that is not substitutable. The fact that the acquiring entity is not active in the same market does not prevent the transaction from falling under the new share of supply threshold.

Prospective purchasers of companies active in the affected industries will need to assess whether there are any potential national security implications and factor this into the timeline and the costs of the deal. Similarly, sellers looking to sell a company active in the relevant industries will pay particular attention to the identity of the purchaser as, for example, foreign purchasers will likely generate increased interest from the government adding potential costs and causing delays.

¹ The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 and the Enterprise Act 2002 (Turnover Test) (Amendment) 2018.

² A "relevant merger situation" is, broadly, where two or more enterprises cease to be distinct, or where arrangements are in place or contemplated, whereby two or more enterprises will cease to be distinct if the arrangements are carried out.

³ The current fees payable to the CMA are set out in the January 2016 Merger Fee Information publication (available [here](#)).

⁴ See publication from the Department for Business, Energy & Industrial Strategy titled "Enterprise Act 2002: Changes to the turnover and share of supply tests for mergers" dated June 2018, paragraph 1.12.

⁵ See publication from the CMA titled "Guidance on changes to the jurisdictional thresholds for UK merger control" dated June 11, 2018, paragraphs 3.1 - 3.4.

⁶ It is important to note that the new thresholds do not change the voluntary nature of UK merger control, whereby parties must assess whether to voluntarily notify a transaction to the CMA. However, the CMA can call-in and investigate transactions on its own initiative, even if the parties elected not to notify it, within four months from the time the material facts relating to the transaction are made public.

⁷ See footnote 3, paragraph 6.6.

⁸ See footnote 3, paragraph 4.14.



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