Client Alert | Mergers & Acquisitions

UK Foreign Investment Review of Mergers

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Traditionally, the UK has been open to foreign investment and the UK Government has had no general power to review foreign investments or take into account industrial policy in merger reviews. However, in the recently volatile political climate a series of announcements have been made of plans to expand the UK Government's power to intervene in takeovers, including in the context of the decision to proceed with the Hinkley Point C nuclear project to be constructed by France's EDF and China's General Nuclear. Despite continuing political uncertainty, the indications are that plans are being drawn up and change may be on the way. From the announcements so far it remains to be seen what impact these may have on implementing M&A transactions. White & Case's M&A, National Security and CFIUS and Antitrust practices are monitoring this area closely and will update you with further analysis once proposals are published.

The Existing Rules

Current regime under the Enterprise Act 2002

Under the Enterprise Act, the Government's power to intervene in takeovers is limited to certain specified "exceptional public interest" grounds. These are national security; media quality, plurality and standards; and stability of the UK financial system.

National security

Until recently, the national security ground had only been invoked in mergers involving defence companies. However, this year a public interest review was initiated on national security grounds of a company outside the defence industry for the first time.

Media

Media quality, plurality and standards includes sufficient plurality of persons with control of media enterprises. Earlier this year, the Culture Secretary initiated a public interest review of Twenty-First Century Fox's proposed acquisition of the shares in Sky that it does not already own on the basis of plurality of persons with control of media enterprises and commitment to broadcasting standards. This is still to be determined.

Financial stability

The Secretary of State can introduce additional grounds of exceptional public interest, subject to approval by Parliament. The stability of the UK financial system was added as an exceptional public interest ground in 2008 to allow the Secretary of State to intervene in the takeover of HBOS by Lloyds TSB. That merger was not referred for a detailed competition review, on the basis that the stability of the UK financial system outweighed the risk that the merger would be anti-competitive. In this instance the deal went ahead on public interest grounds.

Sector regulators may also be involved in mergers involving regulated industries, and bespoke statutory rules apply in some cases (such as in the water and media sectors).

Manufacturing undertakings

At present, under the Industry Act 1975 the Secretary of State can prohibit control of an "important manufacturing undertaking" passing to a non-UK resident where this would be contrary to the UK's interests. This power has never been used and, in any event, would require approval by both Houses of Parliament.

Golden shares

The Government has also held golden shares in small numbers of companies, primarily in the defence and infrastructure sectors. Usually a golden share is a single share carrying special veto rights held by a government minister whose consent is needed for matters such as material disposals and share issues. Under European law, golden shares are generally prohibited and are only allowed on clear public security and public policy grounds as they could more generally be viewed as undermining EU rules on free movement of capital within the European Community and the right of establishment of nationals of other member states. It has never been tested whether the same could be said of a use of the Government's powers under the Industry Act. The use of golden shares in the UK may be deregulated following Brexit.

UK Takeover Code

Finally, under the regime in the Takeover Code on post-offer undertakings and statements of intention introduced in the wake of Kraft's 2010 takeover of Cadbury, bidders can choose to make public commitments or intention statements designed to address public interest concerns. These can address particular courses of action that bidders commit or intend to take or not take over a particular period of time after the end of an offer period. Post-offer undertakings are binding for the time period specified in the undertakings. Interestingly, the approach on International Airline Group's takeover of Aer Lingus[1], which was governed by Irish law and the Irish Takeover Code, was that the Minister of Finance of Ireland retained a golden share in Aer Lingus entitling him to veto any action by Aer Lingus inconsistent with legally binding undertakings given by IAG as to operation of airline slots and maintaining the company headquarters in Ireland.

Plans for reform

In September 2016, BEIS announced Government plans to reform its approach to ownership and control of critical infrastructure to ensure that scrutiny is made of the implications of foreign ownership. The announcement was made in the context of the decision to proceed with the Hinkley Point C nuclear power project to be constructed by EDF of France and General Nuclear of China. The stated aim is to bring Britain's policy framework into line with other major economies, highlighting that, whilst the UK will remain one of the most open economies in the world, foreign direct investment must work in the country's best interests. This seems in keeping with a developing trend in other jurisdictions towards tighter review of proposed takeovers. Germany has recently introduced stricter rules on foreign acquisitions, strengthening its review rights, broadening the notification requirements and extending the time limits for review. Germany, France and Italy also proposed to the European Commission that foreign investments should only be permitted if reciprocity exists and that a protection mechanism should be established for investments by state-owned investors. Subsequently, on 13 September 2017 the European Commission announced a draft proposed EU regulation establishing a framework for the review of foreign direct investments into the EU based on criteria of security and public order, although this does not pursue a reciprocity test.

[1] White & Case LLP acted on this transaction.

The Conservative Party's subsequent manifesto for the June 2017 general election confirmed its intention to update the rules on mergers and takeovers. It indicated that this will involve requiring: bidders to be clear about their intentions from the outset of the bid process; that all promises and undertakings made in the course of takeover bids can be legally enforced afterwards; and that the Government can require a bid to be paused to allow greater scrutiny. The manifesto also reaffirmed the plan to protect critical national infrastructure, with a view to ensuring that foreign ownership does not undermine British security or essential services, citing a limited range of sectors such as telecoms, defence and energy.

Following the outcome of the general election, the Queen's speech on 21 June 2017 only contained a scaled-back proposal to ensure that critical national infrastructure is protected to safeguard national security. However, the background notes to the speech repeat the driver of ensuring that foreign ownership of companies controlling important infrastructure does not undermine security or essential services, albeit this time without citing any particular sectors (thereby potentially leaving this open to broad interpretation), whilst emphasising that scrutiny of foreign investment will only be for the purpose of protecting national security. "Critical infrastructure" has traditionally been interpreted in the UK to include assets that are vital to the continued delivery and integrity of essential services on which the UK relies, the loss or compromise of which would result in severe economic or social consequences or loss of life. Sectors holding critical infrastructure include energy, water, transport, communications, emergency services, healthcare and financial services.

Despite the current political uncertainty, Government aides and BEIS have indicated that the manifesto plan on takeovers will be moved forward and that plans are being drawn up.

From the announcements so far it is unclear what shape the proposals will take and what impact they could have on implementing M&A transactions if adopted. It remains to be seen whether a CFIUS-style model will be put forward. In the US, this allows acquisitions by foreign persons which could threaten national security to be investigated and blocked or unwound. Voluntary CFIUS notifications are subject to a 30-day review and, potentially, a 45-day second-stage investigation, with scrutiny placed on critical infrastructure (which is widely defined). More generally, concerns are sometimes raised that some jurisdictions may try to invoke national security grounds as a basis for more broadly restricting foreign investment. Having said that, the UK will not want to deter the foreign investment necessary for modernisation of infrastructure. The background notes to the Queen's speech made clear the Government's view that it is important that the UK remains an open and liberal international trading partner and a global champion of free trade and investment.

The above update is written in anticipation of publication of proposed new rules. We are monitoring this area closely in conjunction with our National Security and CFIUS and Antitrust practices.

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