

Title: National Security and Infrastructure Investment Review: Impact Assessment IA No: BEIS008(C)-17-CCP RPC Reference No: Lead department or agency: Department for Business, Energy and Industrial Strategy Other departments or agencies:	Impact Assessment (IA)			
	Date: 21/09/2017			
	Stage: Consultation			
	Source of intervention: Domestic			
	Type of measure: Primary & Secondary legislation			
cniandmergersconsultation@beis.gov.uk				
Summary: Intervention and Options				RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANDCB in 2014)	One-In, Three-Out	Business Impact Target Status
TBC	TBC	TBC	In scope	Qualifying provision

What is the problem under consideration? Why is government intervention necessary?

Foreign ownership or control of certain key parts of national infrastructure and investment and other business transactions may lead to national security risks, namely an enhanced ability to undertake espionage; undertake disruptive or destructive actions; or to exploit an investment as inappropriate leverage in other negotiations. Government intervention is required to ensure the necessary legislative powers are in place to provide appropriate mitigations and reduce national security risks, both in the short and longer term.

What are the policy objectives and the intended effects?

The Government wants to ensure that it has clear and consistent means available to take necessary and proportionate steps to protect national security where required. In particular, ensuring adequate scrutiny of whether significant investment in our most critical of businesses – those which are essential to our country and society – raises any national security concerns, and that it is able to act in the extremely rare circumstances where this might be the case. The proposals are concerned only with national security, and are designed to be proportionate. There is a need for both a short-term and longer-term solution. In the short term, the Government wishes to take action now to close a gap in the current regime. In the longer term, the Government wishes to introduce more comprehensive reforms which ensure it is able to protect national security in the most effective and proportionate manner.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Options considered are:

- A. Do nothing in relation to investment in national infrastructure and our most critical businesses, services and assets
- B. Reform Government’s existing powers and introduce new powers for scrutinising investment for national security purposes (preferred option)

Within the preferred option B we are considering a number of options, to ensure that the reforms are a proportionate and effective way of managing foreign investment risks to national security.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: TBC				
Does implementation go beyond minimum EU requirements?			N/A	
Are any of these organisations in scope?			Micro Yes	Small Yes
			Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded:	
			Non-traded:	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible: Richard Harrington  Date: 21/9/2017

Summary: Analysis & Evidence

Policy Option B

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2018	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: TBC	High: TBC	Best Estimate: TBC

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	TBC		TBC	TBC
High	TBC		TBC	TBC
Best Estimate	TBC		TBC	TBC

Description and scale of key monetised costs by 'main affected groups'

The extent of the monetised costs and benefits to businesses, investors, and society will depend on the eventual decisions made about which reforms to introduce, upon which we are seeking stakeholder views, and further evidence we intend to gather in the Green Paper process and external research.

There could be additional costs to foreign investors if they had to notify the Government of their proposed investment into UK critical infrastructure and seek approval before the transaction could take effect, and to UK businesses falling within the scope of the new regime.

Government could also incur costs from administering and implementing reforms (i.e. staff costs, legal fees etc.), and there may be an impact on the Competition and Markets Authority and on the judicial and criminal justice system from additional appeals, sanctions or prosecutions. It is currently too early in the policy-making process to estimate these costs; these will depend on the final shape of reforms and any accompanying guidance.

In lieu of monetised estimates, and given our current stage of policy development, this Impact Assessment qualitatively assesses the direct costs and benefits from the high level policy, and highlights further work we intend to carry out to provide a monetised assessment at the final stage.

Other key non-monetised costs by 'main affected groups'

There might be a potential impact on inward Foreign Direct Investment (FDI) into the UK. The consultation will explore stakeholder views about this, particularly in light of the Government's commitment to a transparent, proportionate and wholly national-security focused regime. We are currently undertaking research on this and our final stage Impact Assessment will include key findings from that research. Final stage Impact Assessment(s) will also discuss any relevant indirect impacts and unintended consequence on businesses and other stakeholders should these become evident during our evidence gathering and stakeholder engagement as part of the consultation process.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	TBC		TBC	TBC
High	TBC		TBC	TBC
Best Estimate	TBC		TBC	TBC

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

The primary benefits from this regime arise from the Government's enhanced ability to identify and act upon risks to the UK's national security. Wider benefits of the regime are difficult to quantify; the proposals are likely to benefit society and the wider economy by providing clear information and reassurance to investors, consumers and businesses about the relevant rules; ensuring that UK economy is supported by well-functioning infrastructure and key services; and providing UK citizens with the greater confidence that Government can take steps to mitigate potential threats to safety and security.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

This Impact Assessment accompanies a Green Paper outlining potential reforms which are currently being explored. The Government intends to refine the detail of the proposals reflecting the Green Paper responses, and additional research which we have outlined in the body of this Impact Assessment. Therefore, at this stage it is not possible to accurately assess or quantify its impact.

BUSINESS ASSESSMENT (Option B)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: TBC	Benefits: TBC	Net: TBC	
			TBC

NATIONAL SECURITY & INFRASTRUCTURE INVESTMENT REVIEW
The UK review of the national security implications of foreign ownership or control
Impact Assessment – Evidence Base

Section 1: Strategic overview

The United Kingdom follows an economic model that thrives on openness to trade. This has served our country well over the years. However, such a model can only be effective if it comes with safeguards. Britain’s rightly-praised openness to foreign investment also needs to be accompanied by appropriate too little scrutiny of the potential national security impacts, as demonstrated by the Hinkley Point C decision last year. The vast majority of investment into the UK’s economy raises no national security concerns. However, we need 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. This is an issue already recognised by our international partners in their equivalent regimes.

The Government has therefore carefully reviewed the national security implications of ownership of certain key parts of national infrastructure, and considered further actions. It has launched a Green Paper “National Security and Infrastructure Investment Review” laying out proposals as to how it might reform how Government scrutinises investments for national security purposes.

The most immediate priority is to address the current gaps, which allow mergers in relation to smaller businesses in key parts of the economy to take place without Government able to intervene on national security grounds; and in relation to mergers where the proposed transaction does not lead to a change in the parties’ share of supply. Changes in technology since the Enterprise Act 2002 and the wider context mean that control of smaller businesses as well as larger businesses can now pose a national security risk. The Government proposes to bring forward secondary legislation shortly to deal with this issue.

Longer term, the Government intends to follow the example of other countries in this area, and make more substantive changes to how it scrutinises foreign investment in critical infrastructure.

The Green Paper sets out a number of different approaches including an expanded call-in power within a voluntary notification regime and a mandatory notification regime.

This Impact Assessment presents a discussion of the costs and benefits of the proposals laid out in this Green Paper. The analysis at this stage is proportionate to the stage of policy development. The Government seeks views from businesses and investors on how to make longer term, more substantive changes to its current powers and approach in order to protect UK's national security while retaining an open approach to trade and investment. In both the short- and long term the Government wishes to develop the detail of these proposals based on evidence received as part of this Green Paper process.

There will be two further, final stage Impact Assessments to accompany any legislation or policy changes if such legislation is introduced or implemented. At this stage, we envisage a separate final stage Impact Assessment on the immediate measures requiring secondary legislation; and a separate final stage Impact Assessment to accompany longer-term proposals.

Section 2: Problem under consideration

National security risks

The 2015 UK National Security Risk Assessment shows that the country faces greater and more complex threats compared to the last assessment published in 2010. Foreign intelligence agencies continue to engage in hostile activity against the UK and our interest. This includes human, technical and cyber operations at home and overseas to compromise the Government, diplomatic missions, Government-held information and critical national infrastructure; attempts to influence Government policy covertly; and operations to steal commercial secrets and disrupt the private sector.

The Government has a well-developed and well-co-ordinated approach to protecting our national security, including in the area of critical national infrastructure. The Government works with businesses to ensure that they have the necessary knowledge and tools to reduce risks. However, it lacks comprehensive statutory powers in relation to business ownership and control.

How control of businesses, particularly those operating critical national infrastructure, can raise national security concerns

In considering where national security risks relating to ownership or control are most likely to arise, the Government is most focused on critical national infrastructure; that is, where the loss or compromise of a service would give rise to a major detrimental impact on essential services, with severe economic or social consequences or loss of life.

These national security risks are, broadly, as follows:

- increased access (to businesses, physical assets, people, operations or data) and ability to undertake espionage;
- greater opportunity to undertake disruptive or destructive actions or an increase in the impact of such action; and

- the ability to exploit an investment to dictate or alter services or to utilise ownership or control as inappropriate leverage in other negotiations.

Hostile control of businesses which operate outside national infrastructure also raise national security concerns. The proliferation and growing importance of technology and advanced engineering know-how means that threats are not necessarily confined to large businesses with high turnover. For example, as technology has evolved, small businesses which undertake niche activities or produce specialised products in the military and dual-use sector increasingly hold information or items which carry significant national security risks.

In addition, many highly innovative businesses in the military and defence sector are thought to have operational advantages over their international competitors. The acquisition of UK businesses with this expertise and intellectual property can, therefore, raise legitimate and significant national security concerns for the country as a whole. Moreover, cyber security is now a real concern for almost every business and consumer. Advances in technology now mean that there are ubiquitous goods with the potential to be directed remotely should a hostile actor obtain access or control. This poses further challenges to the Government's ability to monitor and respond to emerging threats.

The risk of espionage may be intensified where a single investor has multiple areas of investment or ownership across a sector (or across sectors or supply chains). This cumulative investment could enable an organisation with malign intent to build a complex and detailed understanding of critical national infrastructure within a single sector, or indeed multiple sectors. Having these ownership stakes might also confer the ability to identify key vulnerabilities in the supply chain and engage in the theft of intellectual property.

National security risks could also arise from investments into locations which are in close physical proximity to a national infrastructure site. Known as 'proximity risk', the national security concern arises from the potential that the foreign investor's ownership or control of the adjoining site may be exploited to enable espionage or other activities.

Current powers

The Government is currently able to intervene in certain mergers or takeovers under the Enterprise Act 2002, but only where clear public interests are raised – either in relation to national security, media plurality or financial stability. These interventions are limited to mergers in scope of the Enterprise Act (specifically the merger must meet certain share of supply and/or turnover thresholds¹). An exception is made for certain mergers in relation to defence contractors² or media businesses, where the usual thresholds do not apply (the Special Public Interest Intervention Notice regime). This means that most mergers involving small and medium-sized businesses³ are outside the scope of the Act. In addition, investments in new projects such as new-build nuclear power stations are not covered by the Act until they begin

¹ For the CMA to assess a proposed merger and for the Secretary of State to intervene on public interest grounds, the acquired business must have an annual turnover of more than £70 million and / or the merger must result in the creation of, or increase in, a 25% or more combined share of sales or purchases in the UK (or in a substantial part of it), of goods or services of a particular description.

² However, not all businesses that design or produce military items are defence contractors or hold confidential defence material, so are not subject to the special public interest regime.

³ i.e. if they do not meet requirements described in footnote 1 above.

operation; nor is the acquisition of “bare assets” such as individual pieces of machinery or intellectual property as opposed to the acquisition of assets constituting a business. Further, there is no requirement on businesses to notify the Government of mergers where national security risks may arise. This potentially creates gaps in the Government’s knowledge and ability to scrutinise such mergers.

In addition, some sectors have specific regulatory powers, which are largely focused on how infrastructure is operated. The Green Paper (annex A) outlines some of the differences between the legislative and regulatory approaches which have been taken in different national infrastructure sectors. A consistent approach is not taken across the sectors. Currently, for example, some sectors are overseen by a regulator (e.g. Ofcom in telecommunications) and others such as defence are not. Even within the regulated sectors not all regulators have duties relating to national security. In addition, the sector-specific powers available to the Government or regulator to direct for national security purposes range from none (as in the case of chemicals) to an explicit Secretary of State power to give general or specific directions for the purposes of national security (in the case of telecommunications). The Government considers that the most pressing gaps relate to businesses who manufacture military and dual-use items, and certain advanced technologies where there may be risks to national security.

Overall, we find that the legislative powers the Government has at its disposal are currently **limited in places** – while the Enterprise Act 2002 powers enable the Government to intervene in mergers across the economy, interventions are, as described above, only permitted in mergers above certain turnover and share of supply thresholds. However, technological change means that thresholds designed at the turn of the century are no longer appropriate for the current economic, social or national security context; potential national security threats are not necessarily confined to large businesses with high UK turnover, for example.

Furthermore, in contrast to other countries’ regimes, our powers appear:

- (i) **inconsistent across markets and sectors** - this means that in some sectors the Government can rely only upon emergency or ‘backstop’ powers and that, as a result, some sectors or markets might be more adequately protected from potential security threats than others; and
- (ii) **may be too reliant on voluntary powers** – given the national security threats described in the Green Paper, the Government considers it may be insufficient to rely on business voluntarily notifying potential transactions involving foreign actors taking significant influence or control over key parts of our critical national infrastructure; and
- (iii) **potentially uncertain for businesses** – by solely relying on voluntary or ‘call-in’ powers, businesses cannot be certain in which transactions Government may, or may not, have national security interests.

In comparison, the approach taken by some of our partner countries shows a significant degree of consistency in the scope and the approach of their formal systems for scrutinising national security implications of foreign investment, particularly those into critical national infrastructure sectors. For example, a number of other governments require foreign investors to notify their intent and seek approval before finalising transactions which allow them to take control of significant infrastructure firms. The Green Paper compares the approaches taken by

governments in the United States, Australia, France and Canada⁴. These provide for a more comprehensive and timely scrutiny of such transactions compared with the UK's current regime.

The Government's view is that it should be able to act where necessary to protect national security. National security risks related to ownership can arise outside of regulated sectors; can arise in relation to new projects or developments; can arise in relation to both small and large businesses; and may not necessarily lead to an increase in the share of supply. The Government therefore sets out proposals for short- and long-term steps necessary to reform the existing regime to ensure that it is able to take action to protect national security where required.

Section 3: Rationale for intervention

National infrastructure and national security

The Government's rationale for intervention is based on the following:

- i. Ensuring that the Government has all the necessary legislative powers in place to protect **national security** in relation to our most critical of businesses. These businesses provide the services and assets that support and enable society and the economy to function on a day-to-day basis to maximise its potential, prosperity and growth in the long term. The Government needs to have sufficient legislative powers in place to monitor risks to certain key parts of national infrastructure and critical businesses and to be able to mitigate such risks and act upon them if necessary.
- ii. Ensuring that **legislation is proportionate** across sectors. Businesses need to be treated fairly and proportionately; the Government should aim its scrutiny at the areas where it knows national security risks are most likely to arise, balancing the need to know, and the ability to act against the potential burden on business.

Section 4: Policy objective

The Government wants to ensure that it has clear and consistent means available to take necessary and proportionate steps to protect national security where required, both in the short- and long term. This is why the Government is taking a staged approach that takes prompt action to deal with the most pressing issues and seeks views on how to make longer term, more substantial changes to its powers and approach.

In the short term, the Government wishes to amend the existing Enterprise Act through secondary legislation in order to address immediate gaps. The Government considers that the most pressing gaps relate to businesses in key parts of the military and dual-use and advanced technology sectors.

⁴ See Chapter 5 of the Green Paper for further discussion

In the longer term, the Government wishes to make a more comprehensive package of reforms which could include an expanded “call-in” power to allow the Government to act across a wider range of transactions where national security concerns arise than is currently the case; and/or a mandatory notification mechanism for certain transactions to ensure that critical national infrastructure is protected and to safeguard national security. While the design of the longer-term regime is in a very early stage of policy development and will be informed by the consultation, any new measures will be concerned only with national security, and will be designed to be focused and proportionate in their scope and application.

Together, these reforms aim to ensure that Government is made aware of all those transactions in areas where national security concerns are more predictable and pronounced; in particular, foreign investment into key parts of our national infrastructure; and granted sufficient power to intervene on occasions where national security issues are raised by other sorts of transactions.

Section 5: Options considered

National infrastructure and national security

On critical infrastructure and national security, the Government has identified two different options:

- A. Do nothing
- B. Reform Government’s existing powers and introduce new powers for scrutinising investment for national security purposes (preferred option)

As set out in the Green Paper document we are seeking views on our proposed outline model for a regime. Within the preferred option B we are considering further options on the detail, in particular:

- on an **expanded ‘call in’ power** for the Secretary of State to scrutinise transactions for national security reasons within a voluntary notification regime, including potentially new projects or assets; and/or
- businesses being subject to a **mandatory notification regime** where they undertake ‘essential functions’ in key parts of the economy, for example the civil nuclear and defence sectors. Mandatory notification could also be required for new projects that could reasonably be expected in future to provide essential functions and /or foreign investment in specific businesses or assets.

In all cases, the Government wishes to ensure that reforms would be proportionate and effective means of managing investment risks to national security.

A. Do nothing

In this option we rely on the current powers to intervene informed by expertise and intelligence held in Government departments and agencies. These current powers are outlined in the accompanying “National Security and Infrastructure Investment Review” Green Paper, which includes a summary of the current legal and regulatory powers across the 13 sectors that make up the country’s national infrastructure.

However, as identified earlier, there are gaps in the current set of powers. This will, therefore, not meet the policy objective ensuring that the Government has clear and consistent means available to take necessary steps to protect national security; in particular, ensuring adequate scrutiny of whether significant foreign investment in our most critical of businesses – those which are essential to our country and society – raise any national security concerns.

B. A new regime for scrutinising investment for national security purposes

The proposals are designed solely to ensure that the Government has clear and consistent means to take necessary and proportionate steps to protect national security where required, both in the short- and long term.

Short-term proposals

In the short term, as a matter of urgency, the Government intends to introduce secondary legislation to close the current gaps in the Enterprise Act 2002. The Government proposes to amend the turnover threshold and share of supply tests within the Enterprise Act 2002 to allow Government to intervene into smaller mergers within two sectors: (i) the dual-use and military sector, and (ii) parts of the advanced technology sector (such as multi-purpose computing hardware and quantum based technology) where new risks to national security have emerged since the introduction of the Act⁵.

This is because at present the Enterprise Act does not allow Government to intervene in mergers for national security reasons unless they relate to target businesses with a turnover of more than £70 million, or take the combined share of supply in the UK to 25% or more. As technology has changed and national security risks have become more complex, these have become less appropriate threshold for national security interests.

The Government proposes to take rapid action to amend this. In particular, for the two specified sectors, it proposes to reduce the threshold to cover small and medium-sized businesses (those with a turnover of greater than £1million) and to amend the share of supply test to remove the requirement for the merger to result in an *increase* in share of supply, whilst still keeping the 25% threshold. This is because, in some specified sectors, it is feasible for a small company to hold the rights to key technologies which are critical for defence or underpin the operation of key systems within the economy. It is also possible for a transaction of interest not to lead to an increase in the merger parties' combined share of supply in the UK, for example because the acquiring business is not already active in the relevant sector in the UK.

These changes will expand the scope of the Enterprise Act to smaller businesses in these two sectors; and mergers in the two sectors where there is no increase in the UK share of supply. This means that these transactions will also be subject to competition scrutiny by the CMA.

All other smaller businesses (other than those already covered by the special public interest regime) would remain outside the scope of the Act, as is currently the case.

⁵ See Section 6 for further description and discussion.

The Government seeks stakeholders' views on the precise forms of words to define sectors and technologies brought into scope by the proposals, as well as their views on the adequate and proportionate level of thresholds.

Long-term proposals

Longer term, the Government intends to undertake comprehensive reform to its powers. The Green Paper sets out a number of high level approaches which could form part of a new regime. These are not mutually exclusive – a package of complementary reforms could include some or all of the following in order to provide the most adequate balance to address national security risks:

- An **expanded version of the “call-in” power** within the Enterprise Act to allow Government to scrutinise a broader range of transactions for national security concerns within a voluntary notification regime, including new projects;
- A **mandatory notification regime** for foreign investment into the provision of a focused set of “essential functions” in key parts of the economy. Mandatory notification could also be required for foreign investment in key new projects and/or foreign investment in specific businesses or assets.

These two measures are discussed briefly below. However, the Government also seeks stakeholders' suggestions on any other measures which could form part of the overall reform and long-term regime.

An expanded version of the “call-in” power – voluntary notification regime

The Government would consider retaining a voluntary regime (similar to that which exists for mergers under the Enterprise Act 2002) but would want to expand the range of transactions into which it can intervene for national security reasons. In particular, it proposes that the Secretary of State would be able to make a special “national security intervention” where they reasonably believe that the national security risks are raised by the acquisition of significant influence or control over any UK business entity by any investor. This could be defined as obtaining certain percentage of a company's shares or votes (for example, 25% or more) or some other means of significant influence or control. *A mandatory notification regime*

As part of the mandatory regime, all foreign investors who are seeking to acquire significant influence or control over certain key businesses would need to secure the Government's approval before the transaction could take legal effect and would therefore be required to provide information on the investment according to an agreed timeframe.

Businesses would come into scope of the mandatory regime if:

- they undertake the essential functions which the Government views as crucial to ensuring the national security of the UK;
- where foreign ownership or control could pose a risk which there are no other reasonable means of adequately mitigating; and
- where existing licensing or regulatory regimes are insufficient to protect national security.

The Government proposes that mandatory notification would be proportionate only for certain parts of key sectors: namely energy, civil nuclear, defence, telecommunications, transport and the dual-use and military and advanced technology sectors described earlier. The regime could also extend to parts of the government and emergency services sectors.

A further step could be to extend these powers to new projects – in particular, developments and other business activities that are not yet functioning enterprises but can reasonably be expected to, in the future, become businesses whose activities may have national security interests.

There may also be merit in Government having the ability to specify particular businesses or assets where it wishes to scrutinise foreign investment in advance rather than a class of businesses. Such a power may be particularly useful in the case of businesses which supply critical services or goods to national infrastructure firms – by specifying individual businesses rather than an entire supply chain.

Section 6: Costs and benefits of each option

National infrastructure and national security

Option A: Do nothing scenario

Under 'do nothing' there would be no additional costs or benefits to business, individuals or society. We will continue to rely on the current monitoring framework and powers to intervene, and would not expect to meet the policy objective ensuring that the Government has clear and consistent means available to take necessary steps to protect national security. In particular, ensuring adequate scrutiny of whether investments or transactions raise any national security concerns.

Option B: Introduce a new regime for scrutinising foreign investment for national security purposes

This section examines the direct impacts of amending the thresholds in the Enterprise Act 2002 in the short term and the potential impacts of longer-term reforms in relation to investments and national security. The extent of the monetised costs and benefits to businesses, investors, and society will depend on the eventual decisions made about the detailed scope of the regime, upon which we are seeking stakeholder views, and further evidence we intend to gather in the Green Paper process and external research. In lieu of monetised estimates, and given our current stage of policy development, this Impact Assessment qualitatively assesses the direct costs and benefits from this policy, and highlights further work we intend to carry out to provide a monetised assessment at final stage, and on which the Green Paper seeks respondents' views. We then go on to qualitatively assess the indirect impacts of the policy including the impacts on the capital market, competition, and small suppliers.

Direct impacts as a result of amending the turnover threshold and/or share of supply test:

Our initial assessment, at this stage of policy development, indicates that the impact of lowering the threshold(s) on businesses would be minimal. The amendments to the Enterprise Act 2002 would refer only to two specific sectors of the economy, namely:

- (i) Military and dual-use technology** – the design or production of items which could have both military and civilian use and are therefore on the Strategic Export Control List; and
- (ii) Multi-purpose computing hardware and quantum-based technology** – these relate to specific activities and software where design, maintenance and support functions and manufacturing (in the case of quantum) raises national security concerns given either advancements in the technology, its ability to be directed or accessed remotely, and/or because Government or national infrastructure businesses rely on it to perform their functions.

Our initial analysis suggests that only a very small proportion of these businesses would be actually affected by the policy.

There are two ways in which businesses and investors could be affected by the policy: either because they were party to a merger or acquisition that the Secretary of State intervened into on the basis of national security concerns; and/or if the merger or acquisition leads to further investigation by the CMA for competition reasons.

We think that the total number of additional cases which are likely to engage competition concerns is likely to be very small. To put this into perspective, in 2016, the CMA undertook 57 phase 1 investigations⁶ where businesses were involved in mergers that were in (or likely to be in) scope of the Enterprise Act 2002 (EA02). Our presumption is that mergers and acquisitions of smaller businesses and mergers which do not increase the UK share of supply are unlikely, by definition, to raise competition concerns. Given this, and the fact that the current total number of cases is already low, it is likely that any amendments to the EA02 threshold(s), which would only be applicable to businesses in the two sectors outlined above, are likely to result in no or very few additional investigations undertaken unprompted by the CMA and hence only impact a small number of businesses. Businesses may, of course, choose to self-refer to the CMA. There would likely be additional costs if the CMA pursued a Phase 1 investigation on the basis of that self-referral. However, as above, the Government does not consider it likely that any mergers which are brought into scope of the Secretary of State's power as a result of the amendments will raise competition concerns. Nevertheless, if businesses choose to self-refer or the CMA launches an investigation, the businesses will incur additional administrative (including familiarisation) and legal costs to comply with the investigation and when they will need to pay a fee to the CMA. The Government will develop clear guidance to ensure any familiarisation costs to businesses in the affected sectors are minimal.

⁶ [Competition and Markets Authority's Annual Report and Accounts 2016 to 2017](#)

At this stage of policy development, we are not able to determine the total number of likely transactions per year in these two sectors that would be likely to raise national security concerns. In order to do so we would need to estimate the likely additional number of mergers in these two sectors which would be brought into scope of the Enterprise Act through the proposed changes; and we would need to make an assessment of how many were then likely to raise national security concerns. We are proposing to further gather and refine information through the consultation process. However, given that past public interest interventions for national security purposes have been extremely low (since the introduction of the Enterprise Act in 2002, the Government has only intervened seven times for the purposes of protecting national security) our view at this stage is that this is also likely to be small.

We are unable to estimate the scale of the costs given the current stage of policy development – the exact numbers of businesses in scope will depend on the chosen turnover and/or share of supply threshold level(s). We are seeking views on the detail of the changes in the Green Paper and will consult further with the CMA. We will carry out further work to develop the policy in light of the evidence received when the consultation closes. This will involve determining to which parts of the economy lower threshold(s) should apply and what these should be.

Although wider benefits of any changes to the threshold level(s) are difficult to quantify, the proposals are likely to benefit the society and wider economy by providing clear information and reassurance to investors, consumers and businesses about the relevant rules and ensuring that UK economy is supported by well-functioning infrastructure and key services where people have the necessary confidence that Government can take steps to mitigate potential threats to safety and security. The proposals will close gaps in the current regime and together with longer- term proposals will also support long-term business and investment planning given businesses and investors must have adequate clarity and confidence about the regulatory rules and systems with which they must work. We will explore this further during the Green Paper period.

Detailed analysis of the impacts of amending the EA02 turnover threshold(s) will be presented in the final stage Impact Assessment which will include discussion of all relevant types of costs on business, including familiarisation, and legal and administrative costs. It will also aim to include, subject to the available evidence, a more comprehensive assessment of the potential benefits of the policy. The final stage Impact Assessment will also include sensitivity analysis to assess impact and relative importance of various assumptions and data used in the preparation of the analysis.

Potential direct impacts of the longer-term proposals:

At this stage, it is necessarily very difficult to assess thoroughly any impacts of the longer-term regime as the design of the potential regime is in a very early stage of policy development and could include a combination of different measures. The final shape of the Government's long-term reforms is not yet sufficiently certain to enable thorough assessment of impacts on the key groups of affected stakeholders. The Green Paper highlights three high level approaches which could potentially form part of the new regime. The options are not mutually exclusive – that is to say, the final set of reforms may include some or all of the options. The Government also welcomes further suggestions for alternative measures. Nonetheless, in line with best practice,

we have attempted to provide a high level qualitative assessment of potential measures as they are currently suggested in the Green Paper.

Impact on businesses from a new 'call-in power'

The Government is considering retaining a form of a voluntary notification regime. This could mirror the powers currently available under the Enterprise Act 2002 for national security purposes, but remove the turnover and share of supply thresholds, and streamline the process for scrutiny of transactions. Businesses could choose to notify transactions or the Government could otherwise call in to scrutinise for national security purposes. The voluntary regime could allow the Government to act quickly and decisively when national security issues arise in unexpected areas.

The Secretary of State would be able to make a special “national security intervention” where they reasonably believe that national security risks are raised by a transaction, namely any acquisition of significant influence or control involving any parties (both domestic or foreign investors). In practice, to date, no public interest intervention for national security reasons has yet involved a domestic investor. The Government anticipates that, if introduced, this power would only rarely be used and hence the number of affected businesses would be very small.

If the transactions were scrutinised in the similar way as transactions notified under the mandatory regime, affected businesses would experience the same nature and type of costs as businesses automatically brought in scope under the mandatory regime (see next section on a new mandatory regime). Government and the justice system would also face costs similar to as if they were dealing with businesses under the mandatory regime.

We do not have any further information at this stage of early policy development to assess potential impacts as a result of the new call-in power (and the associated voluntary regime). The Green Paper seeks stakeholders' views whether and how the Government could best design the voluntary regime to maximise clarity to investors and businesses and to reduce the number of unnecessary notifications, ensuring the regime is proportionate.

We will use information and evidence gathered from the Green Paper consultation to provide more informative, qualitative assessment (and quantitative if we obtain robust data) of the voluntary regime and its impact on businesses, Government and wider economy.

A new mandatory notification regime for foreign investment into key parts of national infrastructure

Based on the essential functions outlined in the Green Paper, and expertise and intelligence held in the government departments with responsibility for these sectors, the Government currently estimates that fewer than 800 UK businesses would be automatically in scope of a new mandatory regime on the basis of the draft essential functions. We would expect the majority of these businesses to be those that are Government contractors or sub-contractors with facilities on List X.⁷ However, this is an indicative early estimate based on an initial

⁷ Companies working on UK Government contracts (or sub-contracts) must apply for 'List X' status for any facilities which hold very sensitive information that justifies heightened protective measures. This covers information at UK classifications of 'Secret' or above (or information provided by international partners and classified 'Confidential' or above), and ensures that such facilities meet minimum requirements set out in Cabinet Office guidance.

analysis, subject to change and dependent on final decisions on the scope of the regime and detail of the essential functions, both of which we are seeking views upon in the Green Paper.

In order to identify the number of relevant investments in businesses in scope of the regime we are currently undertaking research to conduct analysis on transactions relating to UK infrastructure businesses broadly representative of those we would expect to fall within the scope of the regime in the relevant sectors over the past five years. This includes a sensitivity analysis on the number of equity purchases above different thresholds (i.e. 10%, 25% etc.), and purchases of assets that in and of themselves would comprise an essential function. In this way we will better understand which aspects of the policy are most critical in driving costs to business, and reflect this information when taking a final view on which threshold would be appropriate.

The starting point for assessing the ownership of infrastructure businesses will be the financial database Orbis⁸, run by Bureau van Dijk⁹ (BvD). Orbis collates company-level data sourced from national registries (such as Companies House in the UK), research, and other sources such as company websites. Orbis covers over 200 million businesses worldwide – the majority of which are private, and more difficult to source data on compared to public companies. For the purposes of this analysis, relevant information within Orbis includes ownership details (name, domicile, percentage ownership), and high level financial data, which are available over time. Orbis was chosen, following appraisal of other financial data products, for its broad global coverage and detailed information about private businesses. However, whilst Orbis contains a vast amount of information, as with any data aggregator inconsistencies and inaccuracies can occur. To validate the analysis, our research cross-referenced the findings against other sources such as Thomson Reuters, the Office for National Statistics, the London Stock Exchange and published data from the economic regulators.

Forecasting patterns of ownership over the next 10 years

While the analysis of past trends provides a good indication on the number of future transactions that could be notified to any future mandatory regime, it is important to note that investments of this sort are difficult to predict year-on-year as they are (by their nature) high value but low frequency events. Indeed the number of inward merger and acquisition investments are thought to be sensitive to highly variable factors such as changes in relative economic growth, interest rates, exchange rates, tax rates and prices on the stock market.^{10, 11}

The below chart gives details of the value and number of acquisitions in the UK by foreign businesses, across the whole economy, between January 2006 and June 2017. During this period, the highest number of foreign acquisitions in the UK in any quarter was 86 (January to March 2008) and the lowest was 19 (January to March 2013). Even accounting for quarterly fluctuations the variability can still be stark: the highest number of foreign acquisitions in the UK during any 12 month period since January 2006 was 294 (April 2007 to March 2008) and the lowest was 109 (April 2014 to March 2015).

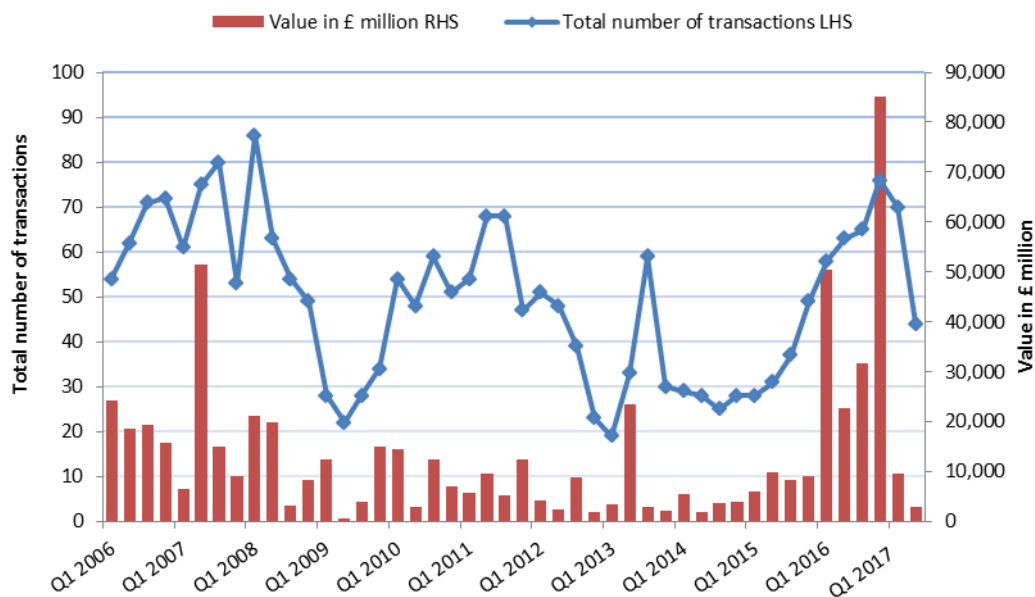
⁸ <http://www.bvdinfo.com/en-gb/our-products/company-information/international-products/orbis>

⁹ <http://www.bvdinfo.com/en-gb/home>

¹⁰ <https://www.ifama.org/resources/Documents/v6i4/Reed.pdf>

¹¹ <http://u.osu.edu/weisbach.2/files/2015/01/ELWJFfinalpdf-16sy82h.pdf>

Chart 1: Value and number of acquisitions in the UK by foreign businesses, 2006-2017



Source: Office for National Statistics¹²

As part of further research we will develop forecasts of future foreign investment activity in the businesses broadly representative of those we would expect to be automatically in scope of the regime, based on observed trends in the financial data and views expressed by investors during both structured interviews and as part of the consultation. For example, we could assume that the proportion of UK infrastructure that is owned by foreign investors will continue to grow at the same percentage point rate than it has done over the past five years, if this is consistent with results of the interviews.

We have also considered more complex approaches, such as econometric analysis, but do not consider them to be suitable for this review. We are not aware of any quantitative model that has accurately and consistently forecast the number of merger and acquisition transactions, and given time and resource constraints do not think it would be proportionate to develop one, which will in any case be subject to forecast error, for this Impact Assessment. Instead we believe that efforts should be focussed on understanding the drivers for the expected trends, and developing realistic high, low and best estimates on the number of future transactions based on these.

New projects

The Green Paper also seeks views about the merits of a mandatory regime being applied to new projects which it is reasonably expected would go on to provide an essential function. This would address the fact that the Enterprise Act 2002 only permits intervention into ongoing enterprises which, by definition, new projects will not be. If introduced, it is not intended that this regime would apply to every development in the UK – but only to those significant projects which are intended to provide an essential function in the future. Therefore, it is expected that there will be very few such projects captured each year, but given the current stage of policy

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<https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/mergersandacquisitions/bulletins/mergersandacquisitionsinvolvingukcompanies/apriltojune2017>

development in respect of the treatment of new project investments it is not currently possible to estimate the number likely to be captured.

Number of transactions likely to be notified to Government under the mandatory regime

Given the current stage of policy development, we are unable to reliably estimate the number of transactions likely to be notified to the regime. We will include detailed analysis on this based on the findings of our external research in the final stage Impact Assessment.

However, we would not expect the number of these transactions that fall into scope to be significant at this stage. Based on the essential functions outlined in the annex of the Green Paper, an initial analysis carried out on patterns of ownership in a sample of UK infrastructure businesses, and expertise and intelligence held in the government departments with responsibility for these sectors, the Government currently estimates that fewer than 100 transactions per year would be scrutinised by the regime.

Considering the use of the current powers under the Enterprise Act since its introduction in 2002, where Government has intervened seven times for purposes of protecting national security, we expect that only a small proportion of all transactions notified to Government under the mandatory regime would be subject to conditions or, in extremis, blocked outright. We would want to refine this figure through further consultation.

Costs to businesses in scope of the mandatory regime

We would anticipate that UK infrastructure businesses (or owners of assets or sites) falling within the scope of the mandatory regime will incur costs from familiarising themselves with the regulation and administrative / legal costs when notifying the Government about the transaction. They will also incur costs should the Government request information for national security purposes.

We are unable to estimate the scale of these costs given the current stage of policy development – our final assessment will depend on the final shape of the regime and any accompanying guidance. We are seeking views on the detail of the regime in the Green Paper and will use these to understand how different options will drive costs to business, and use this evidence to refine and finalise the regime. To supplement this we are planning meetings with stakeholders to test out the policy proposals and refine the cost estimates, during the consultation period. We would expect costs to ‘in scope’ businesses to be relatively small.

In addition there could be:

- **A direct cost to foreign investors** who, under any future mandatory notification regime, would have to notify the Government of their proposed investment and seek approval before the transaction could take effect. They may also incur additional costs should they choose to engage with the Government prior to formally notifying (if provision for this is made within the regime), or take out an insurance policy against the risk of the investment being blocked. Where sanctions are applied, investors may also incur legal costs or court fees.

It is currently too early in the policy making process to estimate these costs. Again, these would depend on whether the option of a mandatory regime was pursued, the final shape of this and any accompanying guidance. We are seeking views on the merits of this approach in the Green Paper and will use these to understand how different for options on the detail will drive costs to business and use this evidence to determine the way forward.

- **A direct cost to Government of administering and implementing any new mandatory regime** (i.e. staff and estates cost, legal fees etc.). If a mandatory regime was pursued, these costs would depend on its final scope and the estimated number of transactions we would expect to receive. We expect that, if this option was taken forward, our final stage Impact Assessment will set this out as we finalise the scope and detailed design and guidance for the regime, and develop our analysis on the number of expected transactions. We will also look at the administrative cost to other governments who currently have similar regimes in place.
- **A direct cost to the justice system** where the Government makes a decision in respect of an investment proposal which is then appealed, or where a sanction is applied in respect of non-compliance. The costs to the justice system will be dependent on the options that the Government pursues. For example, in the case of a mandatory regime, there would (by definition) need to be a sanction for non-compliance with the regime. The costs would depend on the scope of the mandatory regime, the number of transactions, and the compliance rate. All these data are not available at this stage, although we would expect (based on international experience) that the last of these would be high.

Final stage Impact Assessment(s) will also discuss any relevant indirect impacts and unintended consequence on businesses, third party suppliers and other stakeholders should these become evident during our evidence gathering and stakeholder engagement as part of the consultation process. For example, theoretically, there could be a potential impact on a company market value. There could be also some impacts on shareholders and third party suppliers. These impacts will depend on the detailed design of any future mandatory notification regime but might be difficult to quantify. If appropriate, the final stage Impact Assessment will discuss such impacts, including their nature (i.e. whether they would be deemed to be classified as direct or indirect) and magnitude of potential impacts.

Non-monetised impacts:

Benefits to national security

The principal benefit of the proposals will be to enhance the UK's ability to protect and safeguard its critical infrastructure from a range of threats. While it is often difficult to assign an exact monetary value to a national security benefit, an improved ability to protect national security will likely have positive long-term economic, social and reputational impacts. National security is the highest responsibility of any nation state.

The specific benefits of the proposed regime are to provide greater powers, set out in a more transparent and appropriate way to deal with national security concerns and to take reasonable steps as required mitigating these concerns. We will provide a more detailed analysis on the

benefits to national security at final stage once we have finalised our proposals following the Green Paper process.

Wider benefits to society

Although wider benefits of the regime are difficult to quantify, the proposals are likely to benefit the society and wider economy by providing clear information and reassurance to investors, consumers and businesses about the relevant rules and ensuring that UK economy is supported by well-functioning infrastructure and key services where people have the necessary confidence that Government can take steps to mitigate potential threats to safety and security.

We anticipate the regime will also support their long-term business and investment planning (and subsequent investment, innovation and growth) given businesses and investors must have adequate clarity and confidence about the regulatory rules and systems with which they must work. We will explore this further during the Green Paper period.

Impact on Foreign Direct Investment

These proposals are intended to help protect national security without disrupting or discouraging the vast majority of overseas investment, which the Government warmly welcomes. The Government is determined that the UK will remain an open and liberal international trading partner and a global champion of trade and investment. The UK's current performance in attracting foreign direct investment, and our plans to explore the potential relationship between regimes for scrutinising the national security implications of overseas investment and the flow of inward foreign direct investment, are summarised below.

The UK's current performance in attracting FDI

The UK is one of the world's top destinations for foreign direct investment (FDI). It has the third highest FDI stock in the world behind the US and China (see table 1). A 2016 ranking of countries by FDI as a proportion of Gross Domestic Product showed the UK at 46% – the fourth highest proportion in the world (table 2).

Table 1: FDI inward stock¹³ position in 2016 in top 10 countries

Ranking	Country	FDI (\$ trillions)
1	United States	6.4
2	China, including HK	1.6
3	United Kingdom	1.2
4	Singapore	1.1
5	Canada	1.0
6	Ireland	0.8
7	Netherlands	0.8
8	Switzerland	0.8
9	Germany	0.8
10	France	0.7

Source: 'Foreign direct investment', UNCTAD Data Center¹⁴

¹³ Inward stock refers to the total amount of FDI a country has received.

Table 2: Inward FDI stock as a percentage of GDP in 2016 in top 10 countries

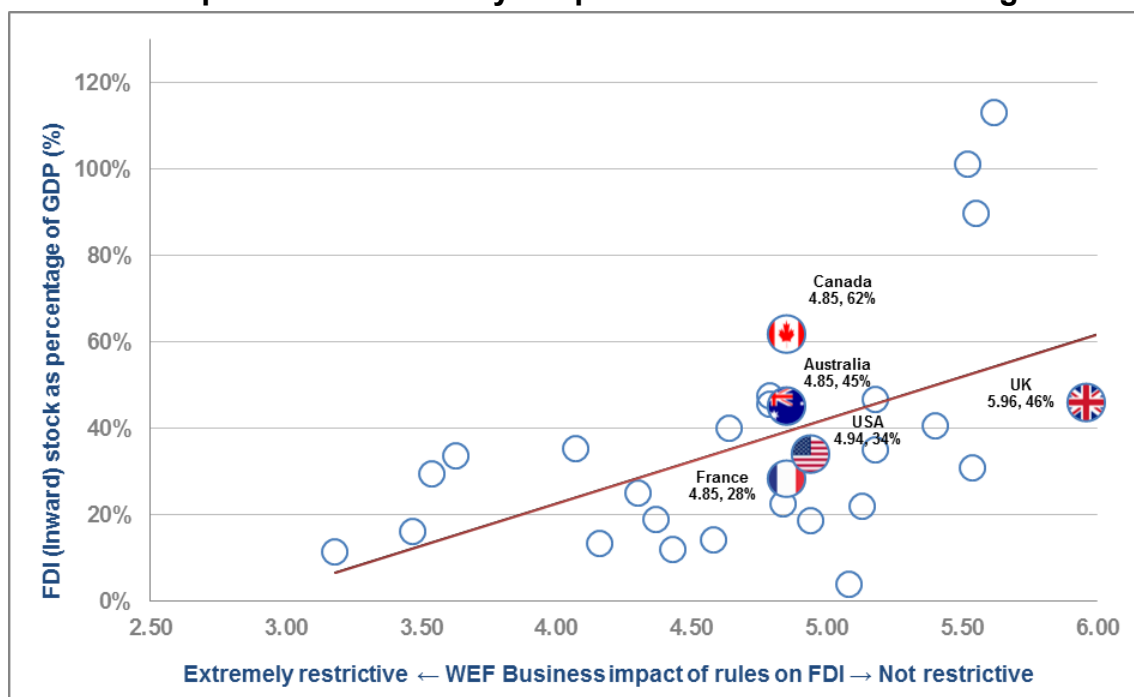
June	Country	FDI as % of GDP
1	Canada	62.2
2	South Africa	46.9
3	Mexico	46.6
4	United Kingdom	46.2
5	Australia	45.3
6	Brazil	35.3
7	United States	34.3
8	Saudi Arabia	33.6
9	Russian Federation	29.5
10	France	28.4

Source: UNCTAD Data Center¹⁵

The UK is also one of the largest outward investors in the world. UK outward FDI stock as a percentage of GDP stood at 56% in 2016, the third highest in the world.¹⁶ By 2016, the UK's stock of outward FDI was over \$1.4 trillion, behind only the United States in total value.

The reasons that drive FDI decisions are varied. The UK's policy environment is a key factor in making the country an attractive destination for foreign investors. The chart below compares the World Economic Forum's measure of how open a country's FDI rules are with that country's stock of FDI as a share of GDP. While there are multiple factors involved, there is a positive correlation between an economy's 'openness' and the foreign direct investment it attracts.

Chart 2: Relationship between a country's 'openness' and extent of foreign investment



Source: Data taken from WEF Competitiveness Rankings¹⁷ and UNCTAD¹⁸. Note: the chart covers the countries with the 30 largest Gross Domestic Products in 2016.

¹⁴ United Nations Conference on Trade and Development, 'Data Centre' (viewed on 7th September 2017)

¹⁵ United Nations Conference on Trade and Development (2016), 'Data Centre'

¹⁶ United Nations Conference on Trade and Development (2016), 'Data Centre'

Summary and potential impact of changes to FDI

The analysis suggests that the openness of merger regimes is one of a number of factors that determine a country's overall regulatory openness to FDI, which is of itself one factor amongst many that affects investor confidence and a country's ability to attract and retain foreign direct investment. Whilst the data does not allow us to provide a definitive assessment of either the strength or the nature of the relationship between a country's foreign investment rules and FDI, a positive business environment and access to the right skills and infrastructure both appear to rank more highly as factors that attract FDI to the UK. Other countries, with more restrictive foreign investment screening regimes, appear to continue to attract high levels of FDI.

While the regime is still being developed, and will be refined further following the Green Paper, our clear intention is to ensure a targeted scope with any new powers being proportionate, providing certainty and transparency, and ensuring the UK remains attractive to inward investment.

We will continue to explore the potential relationship between regimes for scrutinising the national security implications of overseas investment and the flow of inward foreign direct investment. We are seeking views in the Green Paper what impact, if any, stakeholders anticipate these proposals having on the capital market or UK infrastructure businesses' ability to raise financing. This is with a view to refining the regime to minimise any potential negative impact.

We are conducting independent research into the subject. Based on views expressed by investors during 20 structured interviews, the research explores to what extent national security based foreign investment rules are seen as a barrier for investors, how restrictive the current rules in place in other countries are seen, and how do they factor into an investor's decision making process. Initial findings from the research indicate that in general, a regime that is transparent, focused and proportionate is unlikely to have a detrimental impact on investment decisions.

We expect to include the findings of this research in our final stage Impact Assessment, and based on this provide a fuller assessment of the potential impact to inward flows of FDI to the UK. However, we would expect this assessment to be qualitative in nature. There are significant difficulties in forecasting the baseline level of inward FDI flows to the UK, as mentioned previously the number of inward merger and acquisition investments are thought to be sensitive to variable factors such as changes in relative economic growth, interest rates, exchange rates, tax rates and prices on the stock market.^{19,20} Equally, changes in the wider social and political environment may play a role, all of which are hard to anticipate with high reliability.

¹⁷ World Economic Forum (2016), [Business Impact of Rules on FDI](#)

¹⁸ United Nations Conference on Trade and Development (2016), '[Data Centre](#)'

¹⁹ <https://www.ifama.org/resources/Documents/v6i4/Reed.pdf>

²⁰ <http://u.osu.edu/weisbach.2/files/2015/01/ELWJFfinalpdf-16sy82h.pdf>

Section 8: Small and micro business assessment (SaMBA)

In terms of short-term proposals, our initial assessment, at this stage of policy development, indicates that the impact of lowering the threshold on businesses would be minimal. The short-term amendments propose to exclude micro businesses from the policy changes. However, depending on the turnover and/or share of supply thresholds decided upon, it is possible that small businesses, in two relatively small subsectors of the economy, could be brought into scope of the new threshold(s). However, the proposals would only give Ministers the necessary powers to act in case of suspected risks to national security; we believe therefore that these measures are proportionate.

It is too early to determine the exact impact of the long-term proposals as it will depend on the choice and design of particular options, measures and approaches. At this early stage of policy development, the Government estimates that if the Government were to adopt a mandatory regime along the lines outlined in the Green Paper, the number of businesses expected to be captured automatically by the regime would be fewer than 800, the majority of which would be businesses operating in the defence sector. If the call-in power was one of the measures in a wider package, at this stage of policy development the Government anticipates that the call-in power would only rarely be used and hence the number of affected businesses would be very small. The Government expects that a number of firms expected to be covered by the regime, particularly those operating in the defence sector, may be classified as either a small business²¹ or micro-business. We will investigate this further during the consultation period.

We have considered excluding all small firms from the scope of the regime, but feel that this would be inconsistent with the objectives of the policy. The rationale for these proposals is to protect the UK's national security, and the Government would not want to exempt any UK company from the scope of this regime where overseas ownership could be linked to an unacceptable risk to the UK's national security.

Moreover, even where small or micro businesses are included, the administrative cost to UK infrastructure businesses of complying with this regulation is expected to be minimal.

Section 9: Equality assessment

The Department for Business, Energy and Industrial Strategy (BEIS) is required to comply with the public sector duty (PSD) set out in the Equality Act 2010 ("the Act"). The PSD requires the Minister to have due regard to the need to advance equality of opportunity, hinder discrimination and foster good relations between those with and without certain protected characteristics. This due regard is taken to eliminate unlawful discrimination and to tackle prejudice and promote understanding. The characteristics that are protected by the Act are: age, disability, gender reassignment, marriage or civil partnership (in employment only),

²¹ A business with between nine and 49 employees (FTE).

pregnancy and maternity, race, religion or belief, sex and sexual orientation.²² As the proposals are aimed at UK businesses, and their prospective (mostly institutional) owners, we would not anticipate these proposals impacting upon people with a protected characteristic.

Section 10: Business Impact Target

These sets of proposals are expected to affect UK businesses in scope of the regime, and foreign investors operating in the UK. The proposals are therefore likely to be in scope of the business impact target and constitute new regulatory burdens for business (an IN).

The department will confirm the size of the business impacts in the final stage Impact Assessment.

Section 11: Rationale and evidence that justify the level of analysis used in the IA

The analysis at this stage is proportionate to the stage of policy development. This Impact Assessment accompanies a Green Paper outlining a proposed regime which is currently being developed. The Government intends to refine the detail of the proposals reflecting the Green Paper responses, and additional research which we have outlined in the body of this Impact Assessment. Therefore at this stage it is not possible to accurately assess or quantify its impact. Instead we would expect to provide a fuller Impact Assessment if or when any legislation is introduced following the Green Paper.

²² <https://www.gov.uk/discrimination-your-rights/types-of-discrimination>