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Foreign, Commonwealth  
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9 November 2020

Dear Tom,

### **Inquiry into Foreign Asset Stripping and Control of UK Technology Companies**

Thank you for your letter of 15 October on the recent amendments to the turnover test and share of supply test for company takeovers provided for in regulations under the Enterprise Act 2002. Your inquiry into foreign asset stripping and control of UK technology companies by hostile actors is both important and timely, and we look forward to the Foreign Affairs Committee's report.

We are currently preparing a National Security and Investment Bill for introduction shortly. We would welcome a discussion with you on its provisions and in more detail than it is possible to cover in a letter at this stage.

You raised several questions in your letter and we have taken each of them in turn below.

*Pages 14-15 of the guidance on changes to the public interest considerations in merger cases, published under the of Enterprise Act 2002, state that:*

*“if the merger were structured such that the division designing quantum sensors was not subject to the new acquirer’s material influence or control (i.e. it was retained under the existing ownership and control), then Government intervention in the merger (on national security grounds) involving the other divisions would only be permitted if it met the existing tests, such as the enterprise being taken over having UK turnover in excess of £70 million.”*

*It is difficult to imagine a situation in which a party would not have substantial influence, even if not material control, over a division of a business of which it owned all other divisions. This raises the following questions:*

a. *How does the Government plan to account for influence outside that which comes with direct ownership of a division, to ensure that the guidance is not unduly permissive or allows avoidance of the regulations on a technicality?*

b. Why does the original threshold of greater than £70 million still apply in this case?

c. *It is possible that foreign powers may gain influence over relevant UK businesses through means other than direct ownership and control; for example, through supply chain dependencies or the acquisition of “bare” IP rights or intellectual property assets. How will the Government mitigate against these risks?*

If the sale included a division designing quantum sensors, this would likely fall under the reduced thresholds specified in the Enterprise Act amendments. We would carefully consider the level of influence that the transaction gave over the division in question, and if it emerged that the transaction did give the acquirer material influence over the division, this could be deemed a “relevant merger situation” under that legislation.

As you suggest, direct ownership of a particular company is not the only factor that can cause national security concerns – for example, influence over suppliers or customers, or access to intellectual property may also do so. Under the Enterprise Act the Government is still able to intervene in a relevant merger situation if the target enterprise has a UK turnover in excess of £70 million or if the merger led to an increase in share of supply of goods or services in the UK to 25% or more. In specific circumstances that fall outside of the general merger regime, the Government can also intervene under the Enterprise Act special public interest merger situation (for example for a transaction involving a relevant Government contractor in defence industry).

The upcoming National Security and Investment Bill will expand the Government’s powers further, giving the Government the ability to intervene in transactions that may harm national security regardless of share of supply or turnover. As part of this, it will ensure that hostile parties cannot circumvent the law by acquiring an asset that has national security implications, such as intellectual property, rather than acquiring the business itself.

*Page 15 of the guidance, which explains the ways in which strategic export control lists (SECLs) are formed, states:*

*“The lists are derived, in large part, from various international commitments related to the non-proliferation of conventional arms and of weapons of mass destruction, as well as from concerns around national security and human rights. However, there are items on the control lists in which Government has*

*no national security interests. Therefore, not all businesses which produce or design items subject to export control are subject to the amended thresholds.” The fact that certain items on this list are not considered relevant to national security is potentially concerning. This raises the following question:*

*a. What are these items, and for what reason did the Government conclude that they are not of concern to the UK’s national security?*

The legislation does not capture certain items related to torture, capital punishment, or other cruel, inhuman or degrading treatment or punishment. This is not to suggest that the scope of the UK’s national security interest is unconcerned with human rights, but rather that these amendments focus specifically on national security risks arising from foreign investment, rather than wider objectives of supporting human rights which are considered through export control legislation.

*Page 27 of the guidance states that:*

*“the turnover test of the Enterprise Act... still excludes the acquiring of micro-businesses from the scope of the revised thresholds, ensuring that the Government take as proportionate and focused approach as possible to delivering its policy intention.”*

*Many of the UK’s competitive technologies are being produced by small businesses or tech start-ups which do not yet generate revenue. There may therefore be a risk that, by excluding them from these regulations, they are vulnerable to acquisition by hostile foreign actors. This raises the following questions:*

*a. What is the reason for having a fixed turnover threshold of £1 million?*

*b. What assessment has the Government made of the likelihood of cutting-edge technologies of significant national security value to the UK – which are highly desirable to international competitors – being produced by smaller companies with an annual turnover of less than £1 million?*

The Government carefully considered this threshold and concluded that £1 million would be the appropriate level of turnover to capture those businesses that, although small, may have a critical role in matters that may affect national security, while excluding acquisitions involving micro-businesses that were unlikely to generate such concerns.

However, the recent Enterprise Act amendments are only intended to be a short-term solution. The impact of acquisitions in micro-businesses is something the Government is carefully considering as part of the National Security and Investment Bill.

*Page 28 of the guidance states:*

*“The provisions do not apply retrospectively. The Government cannot rely on the new provisions to intervene in mergers where the parties ceased to be distinct before the relevant order came into force.”*

*That raises the following questions:*

*a. What protective measures are, or will be, in place in the event that a UK-owned company with existing foreign ownership begins to develop critical technologies in relevant areas of the economy covered by the legislation?*

The Government’s view is that it would create a disproportionate level of uncertainty for businesses if the Government could use the Enterprise Act to reopen decisions that have already been approved through the Act’s processes. You are right, however, that companies can and do develop into new sectors or applications, and the Government has a range of tools available to continue safeguarding our national security, including, using our extensive engagement with key sectors, carefully managing critical supply chains for Government, utilising our export control powers, and providing advice on keeping secure to companies in particular sectors.

*b. What are the possibilities for review in instances where there is no change of control, to protect against technology transfer that may undermine the UK’s security interests?*

For transactions that have been assessed under the Enterprise Act, if necessary we can put in place detailed assurance frameworks to ensure the parties involved comply with any remedies – including around technology transfer.

The upcoming National Security and Investment Bill will give the Government greater scope to intervene in transactions involving assets (including intellectual property).

*Page 9 sets out a relevant merger situation as defined in the 2002 Enterprise Act and the 2018 regulations, stating:*

*“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...[or] or the target must have a share of supply of 25% or more of relevant goods or services in the UK, i.e. goods or services connected with their activities in the three defined areas of the economy.”*

*The guidance only addresses acquisitions of a relevant target business by foreign entities within a single merger situation. However, there is a possibility of small investments in a target company by multiple entities from the same country, who may act in concert to exert collective influence or control over a UK company. This raises the following question:*

*a. Are the associated persons provisions of the Enterprise Act and the information gathering powers of relevant authorities sufficient for identifying and addressing state-sponsored investment, or situations where the authorities lack information as to the ultimate investors and the corporate governance rights?*

The provisions of the Enterprise Act, including the associated persons provision and the provision on obtaining control by stages, allow different companies which have the same ultimate owner, or are controlled by people associated with one another to be captured by the public interest regime in specified circumstances. To establish this and other key facts, the Competition and Markets Authority has the power to gather information and to request evidence from a witness.

However, the National Security and Investment Bill will strengthen the Government's powers to gather information for national security assessments. The Bill will also enable the Government to investigate and, if necessary, intervene in a much wider range of transactions than is currently possible, helping us to address different ways for actors to gain ownership or control.

*Page 34 of the guidance states:*

*“the Secretary of State may make orders imposing conditions or, if they consider no remedies can adequately address the public interest concerns, they can block the deal entirely.”*

*It is possible that in some instances, the target company may have only one prospective buyer and that they are foreign. In the event that the Government views it necessary to block the transaction on national security grounds, this could result in the collapse of the company and the possible loss of critical IP. This raises the following question:*

*a. What steps will be taken to ensure that UK businesses and their IP are protected in such circumstances?*

The Government will carefully balance different considerations, including the impact of particular mitigations, when deciding how best to respond to investment-related national security concerns. As you suggest, in some circumstances blocking a transaction outright may not be proportionate or necessary, and it may be better for national security to allow a sale to go ahead with other mitigations put in place (such as reassessing Government supply chains or imposing conditions on the sale) – although these decisions would depend on the individual case.

You are also right to draw attention to the risk from the potential loss of critical intellectual property. We intend to take greater powers in the forthcoming Bill to safeguard not only against harmful investment in companies, but also transactions involving intellectual property and other assets.

*On artificial intelligence, page 21 of the guidance says:*

*“The Government intends to cover all businesses that produce, develop and design AI technologies, including components and service providers and all relevant intellectual property, where these products are reasonably expected to be used in systems critical for national security.”*

*This raises the following questions:*

*a. How will the Government ensure that the relevant Departments have appropriate mechanisms in place to manage a workload of this scale?*

*b. By what processes will you determine that a product can be ‘reasonably expected’ to be used in systems critical for national security?*

*c. How do you plan to use horizon scanning and other means to reduce the chance of seemingly innocuous technologies being used in unexpected/unforeseen ways?*

You may be aware that we already have an Office for Artificial Intelligence, a joint unit between DCMS and BEIS. They work very closely with the Artificial Intelligence Council and businesses within the sector. You may be aware that the Government has a sector deal with the AI sector and through that deal works closely with businesses and academia to develop the sector. It is through these various initiatives that we can understand the breakthrough areas of technology and study their potential uses. Furthermore, we have already put more resource into departments responsible for national security risks and investment screening, future resource is also being considered in the spending review.

*Page 23 of the guidance states that:*

*“The Government does not intend to intervene in mergers or takeovers where enterprises whose goods and services that utilise AI which are generally available to the public and for use by the consumer, for example, virtual AI assistants that are capable of undertaking certain actions by voice commands. Other examples of widely available functions include traffic routing, SPAM removal, social networking applications, facial recognition for security and shopping recommendations.”*

*This raises the following questions:*

*a. How will the Government mitigate the national security risks arising from foreign access to AI for facial recognition for security, given its surveillance applications? What is the rationale for excluding AI for such applications?*

*b. How will the Government safeguard against the exploitation of UK's citizen's data for potentially malicious purposes, when accessed through AI for functions such as social networking, traffic routing and shopping recommendations?*

*c. How are 'social networking applications' defined?*

The legislation does not prevent the Government from intervening in transactions involving artificial intelligence companies if the transaction creates national security concerns. However, the guidance alongside this legislation explains that in the case of a company providing capabilities that are already generally available, the Government is less likely to judge that this transaction would give rise to national security concerns. If the Government has concerns about exploitation of UK citizens' data, the Information Commissioner's Office can also investigate and penalise harmful practices.

Social networking applications are not formally defined in this legislation, but instead were given as an example of where Artificial Intelligence may be used, and we intended this to refer to internet based social media sites that are regularly accessed by the public.

*Page 26 sets out the criteria for relevant enterprises that fall within the subsection of advanced materials. The definition of advanced materials set out in this section does not include advanced materials with superior or unprecedented properties such as weight-to-strength ratios, durability or flexibility. This raises the following questions:*

*a. What is the rationale for excluding such materials?*

These amendments to the Enterprise Act were intended to mitigate risks in the short term ahead of more comprehensive powers in the forthcoming National Security and Investment Bill, which will enable the Government to intervene in a much wider range of transactions if necessary.

*Page 26 states that relevant enterprises include those whose activities (as described on page 25) pertain to:*

*"Any manufacturing processes that are involved in the solid state formation of alloys in or into crude or semi-fabricated forms, or powders for additive manufacturing, where "additive manufacturing" means a process of joining materials to make parts from three-dimensional model data."*

*This raises the following question:*

*a. Does the term ‘manufacturing processes’ apply exclusively to production processes, or also to advanced modelling and design?*

The meaning of “manufacturing processes” will depend on the circumstances of the production of any particular material. However, the definition of a “relevant enterprise” includes developing or producing advanced materials; owning, creating or supplying intellectual property relating to the functional capability of advanced materials; and research into advanced material, which is likely to apply to an entity concerned with the modelling or design of an advanced material.

*Chapter Three of the guidance clearly sets out the relevant enterprises to which the amended thresholds apply; namely, the sectors and constituent technology areas defined as critical for UK national security. However, the rapid pace of innovation in both technologies and concepts requires flexibility and adaptation. This raises the following questions:*

*a. How frequently does the Government intend to review that the legislation is sufficiently adaptable to keep pace with innovation, not only in terms of new technologies and advances in manufacturing, but also in the way that existing consumer technologies (not currently included in the guidelines) can be exploited and used in new ways to undermine UK national security?*

As we have set out above, these amendments to the Enterprise Act were intended to mitigate risks in the short term ahead of more comprehensive powers in the forthcoming National Security and Investment Bill. It is right that Parliament will have the opportunity to scrutinise these fundamental and long-term reforms to the UK’s approach to investment screening. The forthcoming Bill will enable the Government to assess transactions across the economy if they give rise to national security concerns. As you would expect with legislation of this nature, we will keep these measures under constant review.

*b. What evidence-gathering took place to inform the amendments to the Enterprise Act? How were the perceived gaps in the existing regime (artificial intelligence, cryptographic authentication and advanced materials) identified?*

We developed these amendments through collaborative work across Government, including input from the Intelligence Agencies, the Home Office, the Ministry of Defence, and lead Departments for the affected sectors. This was also informed by investment patterns in the UK, and we conducted careful analysis of the impact of these technologies should they fall into the wrong hands.

These sectors were also highlighted in the 2018 Draft Statement of Policy Intent for the National Security and Investment Bill, and the Government is carefully considering our treatment of these sectors in the forthcoming Bill.

*Can you give an indication of when the National Security and Investment Bill will be introduced?*

The National Security and Investment Bill will be introduced when Parliamentary time allows.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Alok Sharma'.

**THE RT HON ALOK SHARMA MP**  
Secretary of State for Business, Energy & Industrial Strategy

A handwritten signature in blue ink, appearing to read 'Dominic Raab'.

**THE RT HON DOMINIC RAAB MP**  
Secretary of State for Foreign, Commonwealth, and Development Affairs



## Foreign Affairs Committee

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15 October 2020

Dear Secretaries of State

1. I am writing to you regarding the recent amendments to the turnover test and share of supply test for company takeovers provided for in regulations under the Enterprise Act 2002. As part of our inquiry into foreign asset stripping and control of UK technology companies by hostile actors, the Committee is assessing current and future legislation in this area. With this in mind, I would be grateful if you could provide responses to the points and questions raised below.

### **Influence**

2. Pages 14-15 of the guidance on changes to the public interest considerations in merger cases, published under the of Enterprise Act 2002, state that:

*if the merger were structured such that the division designing quantum sensors was not subject to the new acquirer's material influence or control (i.e. it was retained under the existing ownership and control), then Government intervention in the merger (on national security grounds) involving the other divisions would only be permitted if it met the existing tests, such as the enterprise being taken over having UK turnover in excess of £70 million.*

It is difficult to imagine a situation in which a party would not have substantial influence, even if not material control, over a division of a business of which it owned all other divisions. This raises the following questions:

- a. How does the Government plan to account for influence outside that which comes with direct ownership of a division, to ensure that the guidance is not unduly permissive or allows avoidance of the regulations on a technicality?
- b. Why does the original threshold of greater than £70 million still apply in this case?
- c. It is possible that foreign powers may gain influence over relevant UK businesses through means other than direct ownership and control; for example, through supply chain dependencies or the acquisition of "bare" IP rights or intellectual property assets. How will the Government mitigate against these risks?

### **Export control lists**

3. Page 15 of the guidance, which explains the ways in which strategic export control lists (SECLs) are formed, states:

*The lists are derived, in large part, from various international commitments related to the non-proliferation of conventional arms and of weapons of mass destruction, as well as from concerns around national security and human rights. However, there are items on the control lists in which Government has no national security interests. Therefore, not all businesses which produce or design items subject to export control are subject to the amended thresholds.*

The fact that certain items on this list are not considered relevant to national security is potentially concerning. This raises the following question:

- a. What are these items, and for what reason did the Government conclude that they are not of concern to the UK's national security?

### **The turnover test**

4. Page 27 of the guidance states that:

*the turnover test of the Enterprise Act... still excludes the acquiring of micro-businesses from the scope of the revised thresholds, ensuring that the Government take as proportionate and focused approach as possible to delivering its policy intention.*

Many of the UK's competitive technologies are being produced by small businesses or tech start-ups which do not yet generate revenue. There may therefore be a risk that, by excluding them from these regulations, they are vulnerable to acquisition by hostile foreign actors. This raises the following questions:

- a. What is the reason for having a fixed turnover threshold of £1 million?
- b. What assessment has the Government made of the likelihood of cutting-edge technologies of significant national security value to the UK – which are highly desirable to international competitors – being produced by smaller companies with an annual turnover of less than £1 million?

### **When the provisions take effect**

5. Page 28 of the guidance states:

*The provisions do not apply retrospectively. The Government cannot rely on the new provisions to intervene in mergers where the parties ceased to be distinct before the relevant order came into force.*

That raises the following questions:

- a. What protective measures are, or will be, in place in the event that a UK-owned company with existing foreign ownership begins to develop critical technologies in relevant areas of the economy covered by the legislation?
- b. What are the possibilities for review in instances where there is no change of control, to protect against technology transfer that may undermine the UK's security interests?

### **Share of ownership and single entities**

6. Page 9 sets out a relevant merger situation as defined in the 2002 Enterprise Act and the 2018 regulations, stating:

*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...[or] the target must have a share of supply of 25% or more of relevant goods*

*or services in the UK, i.e. goods or services connected with their activities in the three defined areas of the economy.*

The guidance only addresses acquisitions of a relevant target business by foreign entities within a single merger situation. However, there is a possibility of small investments in a target company by multiple entities from the same country, who may act in concert to exert collective influence or control over a UK company. This raises the following question:

- a. Are the associated persons provisions of the Enterprise Act and the information gathering powers of relevant authorities sufficient for identifying and addressing state-sponsored investment, or situations where the authorities lack information as to the ultimate investors and the corporate governance rights?

## **Mitigation measures**

7. Page 34 of the guidance states:

*the Secretary of State may make orders imposing conditions or, if they consider no remedies can adequately address the public interest concerns, they can block the deal entirely.*

It is possible that in some instances, the target company may have only one prospective buyer and that they are foreign. In the event that the Government views it necessary to block the transaction on national security grounds, this could result in the collapse of the company and the possible loss of critical IP. This raises the following question:

- a. What steps will be taken to ensure that UK businesses and their IP are protected in such circumstances?

## **Artificial intelligence**

8. On artificial intelligence, page 21 of the guidance says:

*The Government intends to cover all businesses that produce, develop and design AI technologies, including components and service providers and all relevant intellectual property, where these products are reasonably expected to be used in systems critical for national security.*

This raises the following questions:

- a. How will the Government ensure that the relevant Departments have appropriate mechanisms in place to manage a workload of this scale?
- b. By what processes will you determine that a product can be 'reasonably expected' to be used in systems critical for national security?
- c. How do you plan to use horizon scanning and other means to reduce the chance of seemingly innocuous technologies being used in unexpected/unforeseen ways?

9. Page 23 of the guidance states that:

*The Government does not intend to intervene in mergers or takeovers where enterprises whose goods and services that utilise AI which are generally available to the public and for use by the consumer, for example, virtual AI assistants that are capable of undertaking certain actions by voice commands. Other examples of widely available functions include traffic routing, SPAM removal, social networking applications, facial recognition for security and shopping recommendations.*

This raises the following questions:

- a. How will the Government mitigate the national security risks arising from foreign access to AI for facial recognition for security, given its surveillance applications? What is the rationale for excluding AI for such applications?
- b. How will the Government safeguard against the exploitation of UK's citizen's data for potentially malicious purposes, when accessed through AI for functions such as social networking, traffic routing and shopping recommendations?
- c. How are 'social networking applications' defined?

### **Advanced materials**

10. Page 26 sets out the criteria for relevant enterprises that fall within the subsection of advanced materials. The definition of advanced materials set out in this section does not include advanced materials with superior or unprecedented properties such as weight-to-strength ratios, durability or flexibility. This raises the following questions:

- a. What is the rationale for excluding such materials?

11. Page 26 states that relevant enterprises include those whose activities (as described on page 25) pertain to:

*Any manufacturing processes that are involved in the solid state formation of alloys in or into crude or semi-fabricated forms, or powders for additive manufacturing, where "additive manufacturing" means a process of joining materials to make parts from three-dimensional model data.*

This raises the following question:

- a. Does the term 'manufacturing processes' apply exclusively to production processes, or also to advanced modelling and design?

### **Sectors with relevance to national security**

12. Chapter Three of the guidance clearly sets out the relevant enterprises to which the amended thresholds apply; namely, the sectors and constituent technology areas defined as critical for UK national security. However, the rapid pace of innovation in both technologies and concepts requires flexibility and adaptation. This raises the following questions:

- a. How frequently does the Government intend to review that the legislation is sufficiently adaptable to keep pace with innovation, not only in terms of new technologies and advances in manufacturing, but also in the way that existing consumer technologies (not currently included in the guidelines) can be exploited and used in new ways to undermine UK national security?
- b. What evidence-gathering took place to inform the amendments to the Enterprise Act? How were the perceived gaps in the existing regime (artificial intelligence, cryptographic authentication and advanced materials) identified?

### **National Security and Investment Bill**

13. Can you give an indication of when the National Security and Investment Bill will be introduced?

14. It would be helpful to have a response to this letter by 26 October, which we will use as evidence in our current inquiry.

Best wishes

A handwritten signature in black ink, appearing to read "Tom Tugendhat". The signature is fluid and cursive, with the first name "Tom" and last name "Tugendhat" clearly distinguishable.

**TOM TUGENDHAT**