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The UK introduces audacious new National Security and Investment Bill

On 11 November 2020, the UK Government introduced the much-anticipated National Security and Investment Bill (the "**NSIB**").[1] It creates a new standalone screening regime expanding on the Government's existing powers to scrutinise foreign investment on national security grounds under the current public interest regime (provided for in the Enterprise Act 2002 ("**EA2002**")). [2]

Indeed, the NSIB represents nothing short of a complete overhaul of the present framework whereby mandatory filing obligations will apply to qualifying transactions in 17 sensitive sectors. Other transactions will be subject to a voluntary filing regime and the possibility that the Government will "call-in" and review unnotified transactions up to five years after they have closed. Once this legislation is passed, which is anticipated in the first half of 2021,[3] the Government will also be able to retrospectively review any transactions that closed on or after 12 November 2020. There will also be significant civil and criminal sanctions for non-compliance.

The Government's Impact Assessment estimates that the new regime will likely result in 1,000 – 1,830 transactions being notified per year. This is a significant number given that only 12 transactions have been reviewed previously on national security grounds under the current public interest regime. It is also far higher than the number of annual reviews seen under similar schemes in other European countries.[4]

The new regime will inevitably place significant cost, administrative burden and transaction risk on investors from any country looking to invest in the UK.[5]

Key features of the new regime are set out below.

Mandatory and suspensory notification system

A transaction will be *mandatorily* notifiable under the NSIB if it concerns the acquisition of a certain shareholding in a UK entity active in one of 17 different sectors considered to pose the greatest risk. Government approval will be necessary prior to closing, otherwise the transaction will be void. Notification must be made by the acquirer.

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[1] The NSIB can be viewed at: https://publications.parliament.uk/pa/bills/cbill/58-01/0210/20210.pdf

[2] The Government currently has powers to intervene in transactions on national security/public interest grounds under the EA2002, but those powers are only exercised in relation to acquisitions of certain strictly defined interests (i.e. national security, financial stability, media plurality, public health emergencies) in a company or assets that amount to a business, and only if certain turnover or market share thresholds are met. Since the introduction of the current regime, the Government has also twice reduced the thresholds for intervention for transactions involving businesses in sensitive sectors: for the military and dual-use, multi-purpose computing hardware sectors in 2018 and for the advanced materials, AI and cryptographic sectors in June 2020. In July 2020, the Government then introduced emergency reforms to the EA2002 in response to COVID-19 so that Government could review transactions involving UK companies involved in mitigating or combating public health emergencies (e.g. food supply chain, healthcare and IT supply). Crucially, the current regime does not impose any mandatory filing obligation. Parties can choose to proceed with the investment without first seeking the Government's approval, though they take the risk in doing so of the Government intervening and imposing remedies to address any national security concerns.

[3] The NSIB has begun its journey through Parliament and is currently at the Committee stage in the Commons. It is anticipated that the NSIB will be passed by mid-2021 but, owing to delays in the parliamentary process primarily due to COVID-19, it remains uncertain as to when exactly the NSIB will become law.

[4] As a frame of reference, around 60 transactions are currently reviewed each year under the UK's merger control regime (although that may be closer to 100 after the end of the Brexit transition period) and the existing public interest regime only captures one or two on grounds of national security.

[5] The Government's powers will extend not only to direct investments in UK companies and assets, but also to indirect investments in foreign companies that carry activities in the UK or supply goods or services to UK customers, as well as foreign assets or IP that are used in connection with UK activities or supply of goods or services to UK customers.

In considering whether a mandatory notification is necessary:

- The 17 sensitive sectors include: (i) critical national infrastructure (e.g. civil nuclear, communications, data infrastructure, defence, energy and transport); (ii) advanced technologies (e.g. artificial intelligence, autonomous robotics, computing hardware, cryptographic authentication, advanced materials, quantum technologies and engineering biology); (iii) critical suppliers to Government and emergency services; (iv) military or dual-use technologies; and (v) satellite and space technologies. The Government is currently consulting on the proposed sector definitions to determine which parts of these sectors will be subject to notification. This remains to be finalised and the consultation will run for 8 weeks until 6 January 2021. [6]
- Transactions in these sectors will fall within the scope of the NSIB where: (i) an existing shareholding (or voting rights) is increased to above 15% in a UK entity; (ii) an acquisition is made of more than 25%, 50% or 75% of the votes and/or shares of a UK entity; or (iii) it allows the acquirer to enable or prevent the passage of any class of resolution governing the affairs of the UK entity.
- Asset acquisitions will not require mandatory notification but may fall within the scope of the voluntary regime (see below).

It is clear, therefore, that these thresholds will catch a great number of transactions. Indeed, the relative size (i.e. turnover) and market share of the parties will have no bearing whatsoever on the mandatory notification requirement (or indeed on the voluntary notification system – see below).

Voluntary notification and "call-in" system

The NSIB also envisages a voluntary notification system for those transactions which fall outside of the 17 key sectors (i.e. those identified as being subject to mandatory notification). Parties will be encouraged to notify "trigger events" (see section on National Security Grounds below) which they consider may be of interest from a national security perspective. Notifications may be submitted by the acquirer, the seller or the relevant entity.

Importantly, the voluntary notification regime:

- Will apply to any investment which results in the investor having directly or indirectly: (i) votes or shares of more than 25%, 50% or 75% in the UK entity; (ii) voting rights that enable or prevent the passage of any class of resolution governing the affairs of the UK entity; or (iii) material influence over the UK entity's policy (which shall be interpreted in line with the test for material influence under the UK's merger control regime).[7]
- Includes asset acquisitions (including investments in "bare assets") within its scope. Acquisitions of a right or interest in an asset (including land, physical property and intellectual property) [8] which give the acquirer the ability to use that asset – or to direct/control how the asset is used (including to a greater extent than before the transaction) – are in scope.[9] By contrast, the Government has already indicated that transactions concerning consumer technology are expected to be out of scope (e.g. assets bought by consumers such as personal computer software, mobile phones, GPS).

[6] Department for Business Energy and Industrial Strategy. *National Security and Investment: Sectors in Scope of the Mandatory Regime – Consultation on secondary legislation to define the sectors subject to mandatory notification in the National Security and Investment Bill*. November 2020. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935774/nsi-consultation.pdf

[7] These thresholds are similar to the ones that apply to mandatory notifications, albeit the threshold of 15% of the UK entity's share or voting rights is replaced by the material influence threshold.

[8] Section 7(4) of the National Security and Investment Bill. Available at: https://publications.parliament.uk/pa/bills/cbill/58-01/0210/20210.pdf
Examples of "ideas, information or techniques which have industrial, commercial or other economic value" (which essentially refers to intellectual property) are set out in section 7(5) of the NSIB as involving: (i) trade secrets; (ii) databases; (iii) source code; (iv) algorithms; (v) formulae; (vi) designs; (vii) plans, drawing and specifications; and (viii) software.

[9] However, it is important to emphasise that assets do not fall within the mandatory notification regime.

Where a transaction caught by the new regime is not subject to a mandatory filing and the parties in question decide not to voluntarily notify the transaction, it is important to know that the Government will have powers to "call-in" the transaction in order to assess if the transaction raises any national security concerns:

- Indeed, once the regime comes into force (i.e. when it receives Royal Assent), the Secretary of State for Business Energy and Industrial Strategy ("**BEIS**") will have a window of 6 months to decide whether or not to "call-in" a transaction from the date they become aware that it has taken place, subject to a total 5-year limitation period.
- Importantly, from commencement this power will become effective as of 12 November 2020 and any transactions that close on or after this date are at risk of being subject to retrospective review under the NSIB, regardless of the fact that the NSIB has yet to be approved by both Houses of Parliament.

The Government will issue secondary legislation setting out how the "call-in" notice powers will be issued in order to give guidance to parties whose transactions fall outside of the mandatory notification regime.

This "call-in" aspect of the NSIB in particular will have enormous implications for parties. It would seem prudent, therefore, for parties to err on the side of caution when it comes to self-assessment, where more clarity and certainty will be available if a voluntary reference is made and approval subsequently given; as opposed to taking a chance that the deal will not be "called in", the uncertainty of which will hover over any such transaction for 5 years until the limitation period passes.

National security grounds?

When undertaking a national security assessment and deciding whether to "call-in" a transaction, the Government must have a reasonable suspicion that the transaction gives rise to a national security risk. The Government will be guided by its "statement of policy intent", which identifies various trigger events, i.e. types of risk. This document will also be a useful reference point for businesses trying to understand the risk of a transaction and whether or not to make a voluntary filing. The "statement of policy intent" provides that the Government will have regard to:

I. The target risk – (i.e. the nature of the target and whether it is in an area of the economy where the Government considers risks more likely to arise. Targets with activities subject to a mandatory filing obligation will be most likely to be called in for review);

II. The "trigger event" risk – (i.e. the type and level of control being acquired and how this could be used in practice to undermine national security, such as for destructive actions, espionage and inappropriate leverage over the UK); and/or

III. The acquirer risk – (i.e. the extent to which the acquirer raises national security concerns, due (e.g.) to its affiliation with hostile states or organisations. This will be assessed on a case by case basis according to the track record of the acquirer, their other investments and any relevant criminal offences).[10]

Notifications

Once the new regime is implemented, notifications will be made to a new Investment and Security Group ("**ISG**") (comprising of around 100 persons) which will sit within the BEIS. The ultimate decision maker will be the Secretary of State for BEIS. As such, the Competition & Markets Authority ("**CMA**") will not be responsible for reviews under the NSIB and the regime will be entirely separate to the UK's merger control regime (which will remain under the CMA's jurisdiction).

The Government has indicated that review periods will be relatively short, but it is not yet clear what information will need to be provided by parties pending publication of secondary legislation/guidance. The Government has also confirmed that it will take a *"targeted, proportionate approach"* and that *"most transactions will be cleared without intervention"*.

[10] The Department for Business Energy and Industrial Strategy. *National Security and Investment Bill – Statement of policy intent*. 20 November 2020. Available at: https://www.gov.uk/government/publications/national-security-and-investment-bill-2020/statement-of-policy-intent

The Secretary of State will only "call-in" a transaction for review where there is a reasonable suspicion that it may give rise to a national security risk. Further, the Government has said that any prohibition of transactions will continue to be a power of last resort. Saliently, the NSIB also provides that a transaction may only be assessed on national security grounds and not for reasons of broader economic interest.

A new appeals mechanism will be introduced by the Government, with decisions subject to either judicial review or a bespoke appeals procedure. Note also that the Government is intending to enter into memoranda of understanding with various UK regulators as regards information sharing. It will also have powers to disclose information to overseas public authorities for the purpose of protecting national security or criminal investigation / proceedings or civil proceedings.

Timing

For both mandatory and voluntary notifications, the Government will conduct an initial screening process of up to 30 working days before deciding whether to issue a "call-in" notice on the basis that it suspects a risk to national security. If a "call-in" notice is not issued within this timeframe, then the transaction is deemed to be cleared and can be closed.

Where a "call-in" notice is issued, the Government will have a further 30 working days to determine whether or not to clear the transaction, impose remedies or refer the matter for a more in-depth review, where the latter will involve a further period of up to 45 working days before any decision is made.[11] The in-depth review may also be extended by mutual agreement in writing between the parties and the Secretary of State.[12]

Broad powers

As is the case under the existing UK public interest regime, the Government (under the NSIB) will have broadly similar powers to the CMA under the merger control rules. For instance, the Secretary of State will be able to issue requests for information ("**RFIs**") at every stage of the process (which will include powers to require individuals to provide evidence in person) and impose hold separate and other initial enforcement orders to prevent pre-emptive actions. The Government will also have the ability to clear, impose conditions on (i.e. remedies) or unwind/block deals where there is an unacceptable risk to national security. Where conditions are imposed, the Government is seeking powers, for instance, to limit the number of shares investors can acquire, ring-fence sensitive information and/or technology as well as require investors to maintain strategic capabilities/security of supply in the UK.

Penalties for failure to notify

The NSIB sets out civil and criminal sanctions for non-compliance with the regime. Fines of up to 5% of annual global turnover or £10 million (whichever is the higher) can be imposed on acquirers.[13] Moreover, there are criminal sanctions involved for individuals who complete a transaction without obtaining approval of up to 5 years imprisonment. Transactions subject to mandatory notification requirement will also be void if they take place without clearance.

Parallel regimes

Once the NSIB is passed, the national security provisions in the current public interest regime will no longer apply. However, the other public interest considerations (media, plurality, public health and financial stability) will continue to be part of the current regime and run alongside the new national security regime together with the CMA's review of mergers on competition grounds. The NSIB gives the Secretary of State the power to direct the CMA to take (or not to take) action under the merger control regime in relation to a transaction. As such, it will be able to intervene, for instance, where competition remedies run contrary to national security interests if this is considered necessary or proportionate.

Final comments - impact?

The NSIB represents a seismic overhaul of the present legislative framework concerning the scrutiny of FDI in the UK. The Government is at

[11] Section 23(3)(a)-(b) of the NSIB.
[12] Section 23(3)(c) of the NSIB.
[13] Section 41 of the NSIB.

pains to stress that it wants to continue encouraging foreign investment and lauds the benefits in job creation and economic stimulation that FDI has so far achieved in the UK. This new envisaged FDI regime seeks to strike the balance between the desire to continue encouraging foreign investment and the need to shore up protections around key national sectors and industries, a move that has no doubt been accelerated by COVID-19.

However, in its present form it will inevitably create new strategic considerations and regulatory hurdles for investors in the UK. There will be a significant amount of additional costs, burdens and complexities (e.g. timing, conditionality, feasibility) for parties considering investing in the UK – not just in respect of mergers, acquisitions and joint ventures, but also certain financing arrangements,[14] licensing or transfer of IP and real estate deals. As a result, going forward parties should:

1. Once the regime comes into force, assess early on whether the transaction falls within scope for mandatory filing obligations or else is at risk of being "called-in" (and involves a voluntary notification). If necessary, contact the ISG for informal advice before making a filing.
2. In particular, for any potentially relevant transactions entered into from 12 November 2020 which are unlikely to close by the time the NSIB is passed, consider approaching the Government. The Government has invited parties to share information to discuss the likelihood of the Secretary of State issuing a "call-in" notice once the NSIB is passed.
3. Remember to also consider the new NSIB regime alongside other foreign investment review and merger control requirements – rules which will apply in parallel. Indeed, for transactions concerning listed companies, the new regime may need to be navigated alongside the Takeover Code.[15]
4. Ensure that deal documents include the appropriate conditionality, risk allocation measures and long-stop date for a potential notification and review period. Importantly, the new regime will have a significant impact on deal timetables and certainty, so its impact should be considered swiftly.
5. Should the transaction likely raise national security issues, engage with the Government early on regarding potential solutions to resolve the concerns. Early engagement is important to securing a favourable outcome.

It remains to be seen how much effect the NSIB will have on investment appetite in the UK – the true extent will only be known once the NSIB is passed and reviews begin. In particular, it will be interesting to see whether the rules will be sufficiently clear for the parties involved given the NSIB has not actually defined the concept of "national security risk". Similarly, time will tell whether there will be a degree of risk of "policitisation" of inbound M&A activity and even whether there will be an unnecessary delay to deals that in fact raise no real national security concerns.

[14] The Government has indicated that while loans, conditional acquisitions, futures and options are not exempt from scrutiny, they are expected to give rise to concerns in rare circumstances. If the Government does intervene, it expects to do so only when an actual acquisition of control takes place (e.g. a lender seizing collateral) in one of the 17 sensitive sectors

[15] As regards public takeovers, the Government has noted that it will work closely with the Takeover Panel to ensure that the new regime interacts "effectively and efficiently" with the Takeover Code. See Department for Business Energy and Industrial Strategy. *National Security and Investment White Paper*. November 2020. Para 197. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935335/nsi-government-response.pdf

Contact us

If you would like to know about any of the issues raised in this briefing, our Competition Team would be happy to speak to you.

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