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THE UK'S NATIONAL SECURITY AND INVESTMENT BILL: KEY POINTS AND IMPLICATIONS

The UK Government has published its National Security and Investment Bill. The draft legislation will create a new, standalone screening regime, allowing the Government to review acquisitions of certain interests in legal entities, assets and intellectual property and to prohibit such transactions, or impose remedies on them, if it identifies national security concerns.

Mandatory filing obligations will apply to qualifying transactions in 17 sensitive sectors, with all other transactions subject to a voluntary filing regime and possibilities for the Government to review unnotified transactions up to five years after they have closed. Once the legislation has passed, the Government will also be able to retrospectively review any transactions that closed on or after 12 November 2020.

Key issues

- Which transactions will be reviewable on national security grounds, and which of those will be subject to mandatory filing obligations?
- When are investments in non-UK companies and assets affected?
- What are the procedures for interventions and clearances, and what will be made public about those interventions?
- How will deals currently in progress be affected?
- What factors will guide the Government's national security assessments?
- How will the regime interact with the merger control and other regimes?
- When is the Bill expected to be enacted?
- How many filings and interventions are anticipated under the new regime?

WIDE NEW POWERS

The Government already has powers to intervene in transactions on national security grounds under the Enterprise Act 2002, but those powers can only be exercised in relation to acquisitions of certain interests in a company or assets that amount to a business, and then only if certain turnover or market share thresholds are met. In addition, the current regime imposes no mandatory filing obligations. Investors can choose to proceed with an investment without first seeking the Government's blessing, in which case they take the risk that the Government may intervene subsequently and impose remedies to address any national security concerns.

The new regime will greatly expand the scope of transactions that can be reviewed by the Government and will introduce mandatory filing obligations for some deals. The expanded scope of the regime has been driven by the Government's experience that "at times investors have found novel means to try to obfuscate our current regime; for example by structuring a deal in such a way that it is difficult to identify the ultimate owner of the investment by funnelling investment through a UK or ally investment fund or by buying or licencing certain intellectual property, rather than investing in or acquiring the whole company directly". The Government has also explained that its decision to impose mandatory filing requirements (which was not foreseen in its initial proposals for legislation) has been driven in part by a concern that the coronavirus pandemic has left some businesses in sensitive sectors more susceptible to "rapid and potentially concerning takeovers".

Types of transactions caught

The regime will apply to any investment that results in the investor having, directly or indirectly:

- votes or shares of the target legal entity that exceed a threshold of 25%, 50% or 75%;
- voting rights that enable or prevent the passage of any class of resolution governing the affairs of the target (seemingly by reference to the classes of resolution that could be vetoed or determined with a 25%, 50% or 75% interest under the Companies Act 2006); or
- material influence over the target's policy, which the Government intends to be interpreted consistently with the test for material influence under the UK's merger control regime.

For transactions that are subject to a mandatory filing (see below), the trigger events in the first two bullet points above will apply, but the third (material influence) will be replaced by a threshold of 15% of the target's shares or voting rights.

For investments in assets, the triggers are the acquisition of a right or interest that allows the investor to use the asset, to direct or control how the asset is used, or to do so to a greater extent than before the transaction.

Unlike the existing regime, the investment need not be in a business. Investments in bare assets - such as land, tangible moveable property and certain intellectual property (**IP**, being any "idea, information, or technique with industrial, commercial or other economic value") – are covered. Moreover, no quantitative jurisdictional thresholds are foreseen, so even the smallest of deals could be scrutinised.

The Government has published a "statement of policy intent" which states that, while loans, conditional acquisitions, futures, and options are not exempt from scrutiny, they are expected to give rise to concerns only in rare circumstances, and that 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).

Mandatory and voluntary filings

While the Government will be able to review any of the caught transactions described above, a sub-set of them will be subject to mandatory filing obligations. These are investments in legal entities with certain activities in any of the following 17 sectors: civil nuclear; communications; data infrastructure; defence; energy; transport; artificial intelligence; autonomous robotics; computing hardware; cryptographic authentication; advanced materials; quantum technologies; engineering biology; critical suppliers to government; critical suppliers to the emergency services; military or dual-use technologies; and satellite and space technologies. Investments in assets in these sectors (as opposed to legal entities) are not subject to mandatory filing obligations.

The Government has issued a consultation on the detailed definitions that will determine which parts of these sectors are covered by filing obligations, the closing date of which is 6 January 2021. The Government will also have the ability to update these definitions through secondary legislation in the future, and to exempt certain acquisitions based on the characteristics of the investor.

Investors will be prohibited from closing prior to clearance a transaction that is subject to mandatory filing. Penalties for breach will be imprisonment of up to 5 years for individuals and/or fines of up to 5% of the group worldwide turnover of the investor, or £10 million (whichever is higher), and transactions that close in breach of the prohibition will be legally void.

For transactions that are caught by the new regime but which are not subject to mandatory filing, the Government will have powers to intervene and impose remedies up to five years after the deal has closed, or six months if the relevant Government Minister is made aware of the transaction. However, investors will be able to obtain legal certainty that no remedies (or no unacceptable remedies) will be imposed by submitting a voluntary filing. In addition, investors will be able to seek informal non-binding guidance from the Government prior to making a mandatory or voluntary filing. Details of what must be included in filings are to be set out in secondary legislation.

When a filing is made, whether mandatory or voluntary, the Government will have a binding deadline of 30 working days (subject to extension in certain circumstances) to decide whether to "call in" the transaction for a detailed national security assessment. There will be an additional review period of 30-75 working days for transactions that are called in (again, subject to extension in certain circumstances).

Application to deals currently in progress

After the legislation enters into force, the Government will have retroactive powers to review any qualifying transaction that closes between 12 November (the day after the publication of the Bill) and the date on which the legislation enters into force. Parties to potentially-affected transactions can consult with the Government to get advice on what to expect, although it is not clear whether this would extend to a non-binding indication that the transaction will not be called in for review once the regime is in place. In the period running up to the entry into force of the new regime, the Government will continue to be able to review transactions under the existing regime, provided they meet the applicable thresholds.

Deals that close after the entry into force of the new regime will, if they meet the relevant criteria, become subject to mandatory filing requirements. This could delay closing and cause complications where regulatory conditions precedent to closing have already been agreed. We understand that the Government is prepared to work with affected parties to minimise delays by shortening the clearance process as much as possible, once a notification has been made, but no formal exemptions from the filing obligation are envisaged at this stage.

National security assessments

The Government has decided that the Secretary of State for Business, Energy and Industrial Strategy (**SoS**) will continue in the role as decision maker for national security reviews, acting in a quasi-judicial capacity. They will be supported by a dedicated "Investment Security Unit", which will be the point of contact for businesses seeking guidance or making filings.

The SoS will take decisions on the basis of all the relevant evidence, including evidence gathered through the use of extensive information gathering powers that will be available to the SoS, as well as evidence provided to the SoS by other Ministers, Departments and Agencies.

The SoS will be able to prohibit a transaction or impose remedies if they consider that a qualifying transaction is likely, on balance of probabilities, to give rise to national security concerns. In making this assessment, the SoS will be guided by its "statement of policy intent", which will also form a useful reference point for businesses to understand the risk of proceeding with a transaction and to decide whether to make a voluntary filing. The statement explains that the assessment will consider three types of risk:

- the target risk: targets with activities subject to mandatory filing obligations will be most likely to be called in for a detailed review, as well as transactions involving assets that are used for those activities. Investments in the 17 sectors listed above, but which are not subject to mandatory filing will also be at risk (albeit lower risk) of being called in, as will investments in any of the national infrastructure sectors defined by the Centre for the Protection of National Infrastructure, non-critical suppliers to Government and the Emergency Services and land that is in a sensitive location. Investments in all other areas of the economy are only expected to be called in on an exceptional basis;
- the trigger event risk: the type and level of control being acquired and how this could be used in practice. The focus here will be on the potential for disruptive or destructive actions, espionage and inappropriate leverage over the UK; and
- the acquirer risk: the extent to which the acquirer raises national security concerns. This will be assessed on a case-by-case basis, by reference to the track record of the investor, their other investments within a sector or core area, relevant criminal offences and known affiliations. In this respect, national security risks will be most likely to arise when acquirers are hostile to the UK's national security, or when they are affiliated with hostile states or organisations (although the Government has not indicated which states it considers to be hostile). However, state-owned entities, sovereign wealth funds and other entities affiliated with foreign states are not regarded as being inherently more likely to pose a national security risk, and the Government recognises that these organisations may have full operational independence in pursuing long-term investment strategies with the object of economic return, raising no national security risks.

The acquirer risk will be considered alongside the target risk and the trigger event risk. For example, the Government has indicated that it recognises that pension funds may be long-term investors in entities that operate in the UK's national infrastructure, but will not often seek to interfere in their processes even if they have the capability to do so.

If a risk to national security is considered likely to arise, the SoS will have wide powers to impose remedies that are necessary and proportionate to prevent, remedy or mitigate that risk, including behavioural obligations or prohibitions, divestments or even (as a last resort) the complete unwinding of the transaction. This last possibility could have significant practical and financial consequences, particularly if the seller has already applied the proceeds of sale, e.g. to pay off debt, make investments or pay dividends. Moreover, parties to transactions that are not notified could suffer these consequences up to five years after closing, which is likely to create strong incentives to make voluntary filings for even relatively innocuous transactions.

Substantive decisions of the SoS will be appealable to the courts on the judicial review standard. Such appeals will be subject to a shorter deadline (28 days) than normal, and may be heard in closed proceedings to protect information that is sensitive from a national security perspective .

Foreign transactions

The Government's powers will extend not only to investments in UK companies and assets, but also to investments in foreign companies that carry on 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 the supply of goods or services to UK customers. As currently worded, it is unclear whether the Bill is intended to catch assets that are owned by parties with no UK activities or supplies. For example, if a Russian factory supplies goods to a Germany company with UK activities, is that factory used "in connection with" the German company's activities? If so, owners or buyers of that factory may be unable to foresee the potential application of the UK regime, as they may not know where German company sells its end products.

However, foreign transactions falling within one of the sensitive sectors will only be subject to mandatory filing obligations if they satisfy a tighter test for a UK nexus, which will be defined in secondary legislation.

Publicity and information sharing

Following investor feedback on its original proposals, the Government no longer intends to routinely publish decisions to call in a transaction, or decisions to unconditionally clear transactions that have been called in, and will instead only do so where it is appropriate, e.g. where a party is required to notify the market of price-sensitive information. However, the Government will publish information about cases in which it decides, after a detailed assessment, to prohibit the transaction or to impose remedies.

As regards information sharing, the Government envisages entering into memoranda of understanding with various UK regulators, and will also have powers under the new legislation to disclose information that it receives under the new regime to overseas public authorities for the purpose of protecting national security or for the purpose of any criminal investigation or proceedings, or civil proceedings under the new regime.

Interaction with the merger control regime

Unlike the existing regime, the new regime will be separate from the merger control regime and the Competition and Markets Authority (**CMA**) will not have a role in the process, other than sharing with the Government any information that it reasonably requires to carry out national security reviews. Transactions may therefore be subject to both a merger control review and a national security review, in parallel. The SoS will, however, be able to prevent the CMA from imposing competition remedies that run contrary to national security interests, or to override such remedies.

Public interests other than national security – such as media plurality, financial stability and combatting public health emergencies – will continue to be considered as part of the merger control clearance process, as they are at present.

Timing

While timing of the Bill's passage through Parliament is uncertain, it is expected to be enacted during the current Parliamentary session (so before Spring 2021), but after the consultation on the sectors that are to be subject to mandatory filing, which closes on 6 January.

Implications

The Government's impact assessment envisages that there are likely to be between 1,000 and 1,830 filings every year under the new regime. Out of the these, the Government anticipates that around 70-95 would be called in for a detailed assessment (so around 5-10% of all transactions notified) and only about 10 would be subject to remedies (1% or less).

The anticipated volume of filings is huge. To put it into context, around 60 transactions are 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 regime for screening mergers for national security concerns catches only one or two a year. Under the previously-proposed fully voluntary regime, the Government had estimated around 200 filings, so it seems that most of the envisaged filings under the new regime are expected to fall into the mandatory category. Accordingly, while ostensibly motivated in part by the coronavirus pandemic, mandatory filing obligations will have a substantial impact on M&A in the UK for many years after the pandemic subsides.

It is also possible that the Government may have underestimated the number of voluntary filings that will be made, given the wide scope of transactions caught by the regime, the lack of any thresholds, the potentially onerous consequences of a decision not to notify (including, in exceptional cases, an order to unwind a transaction up to five years after closing) and the highly subjective and vague criteria for assessing whether national security risks may arise. Consequently, the new regime is likely to cause significant additional costs and uncertainties for many transactions affecting the UK; not just mergers, acquisitions and joint ventures, but also certain financing arrangements, licensing or transfer of IP and real estate deals.

The Government emphasises that it intends for the UK to remain open to foreign investment and that its legislation has been designed with the sole aim of addressing legitimate national security concerns. It commissioned research to better understand the potential impact of the regime on foreign investment in the UK, which found that national security regimes do not appear to play a major role in informing the investment decision-making process, provided that the regime is clear and predictable. However, that research also found that investors perceive regimes that make "political" decisions to be a significant barrier to investment. The concept of national security contains a lot of room to hide political decisions, so it may be some time before it is apparent whether the new regime falls into this category.

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