ALLEN & OVERY

National Security and Investment Bill: a new frontier for scrutiny of investment in the UK

On 11 November 2020 the UK Government published its ground-breaking National Security and Investment Bill (**Bill**). The Bill will drastically expand the Government's powers to scrutinise investment on national security grounds, through a requirement for mandatory notification of transactions in 17 identified sensitive sectors backed by a 'call-in' power applying to an extremely wide range of transactions across all sectors of the economy, with no turnover or market share thresholds (the target need only carry on activities or supply customers in the UK).

The Bill has immediate implications for ongoing transactions, because the 'call-in' power will apply retrospectively to any transaction that has not completed before 12 November 2020. Although this retrospective 'call-in' power cannot be exercised until the Bill has been enacted, the parties may need to consider whether to engage with the Government to understand the risk of a retrospective 'call-in'. In this context the Government has said that, in advance of the legislation being implemented, it welcomes informal representations about transactions which could be in scope of the new regime and that, following such informal contact, it may provide advice to assist in business planning. While the Government does not commit to provide comfort on a transaction where informal contact is made in this period, making it aware of the transaction means its ability to call it in retrospectively will be reduced from five years to six months from commencement of the relevant part of the Act. The Government has also said that it does not expect many transactions to be affected by this retrospective 'call-in' power.

The Government has been considering these changes for a number of years, amid increasing political concern over potential national security risks posed by foreign ownership of strategic or sensitive UK businesses/assets (see our alert on the 2018 White Paper). While the current rules – where national security sits as one of the public interest grounds under the (voluntary) UK merger control regime – have been used to intervene in a number of high-profile deals in recent months (eg Advent/Cobham, Connect Bidco/Inmarsat and Gardner Aerospace/Impcross), the Government has decided that these do not go far enough, even with tweaks to lower jurisdictional thresholds in certain key areas which were made in 2018 and earlier this year.

It is therefore proposing a new stand-alone (in most cases) mandatory suspensory national security screening mechanism with strong powers of enforcement, which could apply even to non-UK entities if they carry on activities in the UK or supply goods or services in the UK and could also catch deals where UK subsidiaries are not the direct targets. The Government is clear that these powers will be used only to address national security concerns – but with "national security" intentionally left undefined in the Bill, it will have significant flexibility to intervene in transactions.

The mandatory suspensory nature of the proposed new mechanism is a substantial departure from the voluntary UK merger control regime, and will apply to transactions involving entities operating in defined parts of the economy (backed by a 'call-in' power applying in all sectors). The scope of the notification obligation is not yet fully settled and will be set out in secondary legislation following a consultation running until 6 January 2021, but the Government envisages that it will apply to transactions involving entities operating in 17 "core" sensitive sectors of the economy. Officials have indicated that they want to define these areas as clearly as possible. However, there is an obvious risk of uncertainty around the precise definition of these sensitive sectors.

The Bill does not signal that the Government is closed to foreign investment. In fact, the intention is quite the opposite. In announcing the Bill, the Government notes that the new laws are "proportionate", and will ensure that the "UK remains a global champion of free trade and an attractive place to invest". The Bill applies to all investments, whether by domestic or foreign acquirers. Indeed, the proposed new regime comes just two days after Prime Minister Boris Johnson announced a new Office for Investment – a unit designed to attract high value and strategic foreign investment opportunities in the UK "which align with key government priorities". The Government has also stated that it expects most transactions will be cleared without any intervention (anticipating that it could receive over 2,000 'early engagements', resulting in potentially 1,800 or more notifications, up to 95 of which will be 'called in' for a review and 10 made subject to remedies). As we set out below, however, the far-reaching scope of the new regime and the resulting administrative burden and transaction risk will inevitably have a significant impact on acquirers looking to invest in the UK.

Mandatory notification for transactions in "sensitive" sectors

Under the proposed regime, transactions in 17 specified "sensitive" sectors will require mandatory notification by the acquirer where they involve the acquisition of:

- 15% or more of the votes/shares in an entity (note that this threshold was removed from the final Act – see our update alert);
- an increase in a holding of votes/shares in an entity to more than 25%, more than 50% or to 75% or above; or
- voting rights that allow the acquirer to enable or prevent the passage of any class of resolution governing the affairs of the entity (this is potentially far-reaching).

The relevant sectors are expected to be: civil nuclear, communications, defence, data infrastructure, energy, transport, AI, autonomous robotics, computing hardware, cryptographic authentication, advanced materials, quantum technologies, engineering biology, military or dual-use technologies, satellite and space technologies and critical suppliers to the Government and emergency services.

The Government is consulting until 6 January on the exact definitions for the type of entity within each sector that could come under the mandatory regime. These will ultimately be set out in secondary legislation and the Government will have the power, via secondary legislation, to amend the list as it sees fit in future. It is to be hoped that the Government follows through with its pledge to "clearly and tightly define" the scope of the relevant sectors and to keep the definitions under review.

At present, the Government does not intend to require mandatory notification of asset acquisitions in the sensitive sectors (which will instead be subject to the 'call-in' powers described below), but it will have the power to do so in the future. However, where assets are closely related to "core activities" (primarily within the sensitive areas), their acquisition is more likely to be called in than other assets.

The Government also does not intend to require notification of lending to companies in these sectors, but there may be circumstances where the enforcement of corresponding security will require mandatory notification. Although the Government's expectation is that the Secretary of State will intervene rarely in respect of loans, namely when an actual acquisition of control takes place, lenders will need to assess upfront, as well as prior to enforcement, the implications of the regime for their security package. For example, the timeframe for enforcement of share security may be impacted, and an intervention may result in unexpected remedies. The make-up of the lender group may well be critical to the outcome. As discussed below, the Government could in principle also intervene using its call-in powers in certain other circumstances relating to the financing arrangements an entity has in place.

Where a transaction is subject to mandatory notification, an implicit suspension obligation will prevent completion until clearance. The deal will have no legal effect until clearance is obtained.

All of this goes further than the purely voluntary system put forward in the White Paper – the Government notes that after consideration, these earlier proposals would "not do enough to prevent the few determined hostile actors from evading scrutiny and acquiring critical businesses or assets under the radar". Given the potentially extremely serious sanctions that apply for failure to notify (see below), it is to be hoped that the Government will provide additional clarification on the scope of the notification obligation in due course.

Voluntary notification

Outside the mandatory notification regime, there will be the possibility for a seller, acquirer or the entity concerned to voluntarily notify transactions which qualify as "trigger events". This could cover a wide range of transactions, including asset acquisitions – land, tangible moveable property and "ideas, information or techniques which have industrial, commercial or other economic value" (ie intellectual property).

The Government notes that loans, conditional acquisitions, futures and options are not exempt from scrutiny, although "the overwhelming majority of these are expected to pose no national security concerns", whether in the sensitive sectors or otherwise. The Government has indicated that the Secretary of State generally only expects to intervene when an actual acquisition of control will take place – for example, at the point when a lender seizes collateral. However, in certain transactions parties may need to consider whether financing arrangements, combined with the make-up of (and any changes to) the lender group, could be a trigger event outside that context (ie as a separate issue to security enforcement). This will depend on the scope of the lenders' control/influence over their borrower or its assets, with the nature of the borrower's activities influencing the risk of any potential trigger event being called in. This may need particular consideration, for example, in projects in the sensitive sectors.

Specifically, the relevant trigger events are the acquisition of:

- an increase in a holding of votes/shares to more than 25%, more than 50% or to 75% or above;
- "material influence" over the policy of an entity – this aligns with the UK merger control regime, and we expect it to be interpreted in a consistent manner;
- voting rights that enable/prevent the passage of any class of resolution governing the affairs of an entity; or

- a right or an interest in an asset giving the ability to use the asset or direct/control how the asset is used (or to enable it to be used, or its use directed/controlled to a greater extent than prior to the transaction).

For reasons of legal certainty, parties may decide to take the voluntary notification route where they consider their deal may raise national security concerns, especially in light of the 'call-in' power described below. Parties considering doing so should refer to the Government's Statement of policy intent (**Statement**), a draft of which has been published alongside the Bill (and is subject to change before being finalised). Indeed, the Statement encourages voluntary notifications as well as early discussions (on a confidential basis – notifications are only made public if the Government exercises its power to call a deal in for review).

Under the voluntary process, completion could in theory take place before clearance, or even before notification. But as with the UK merger rules, the Government will have the power to impose interim orders to halt or reverse any integration and, in anticipated transactions, to order that completion does not take place.

The Statement gives guidance on the types of transactions which may raise national security concerns. In short, it sets out that three potential risks will be considered:

- Target risk – the Statement notes that national security risks are more likely to arise in certain "core areas" of the economy (primarily the sectors where mandatory notification is required). The nature of the target is also a relevant factor, eg land which is, or is near to, a sensitive site such as critical national infrastructure or government buildings.
- Trigger event risk – the potential of the underlying acquisition to undermine national security, for example by enabling the acquirer to corrupt processes or systems, or engage in espionage or exert inappropriate leverage.
- Acquirer risk – the extent to which the acquirer itself raises national security concerns, considering, for example who ultimately controls the acquiring entity and their track record. The Statement notes that national security risks are most likely to arise when acquirers are hostile to the UK, or where they owe allegiance to hostile states or organisations. But – notably – the Statement is clear that state-owned entities and sovereign wealth funds are not regarded as inherently more likely to pose a risk.

Unlike the UK merger control regime (and unlike the vast majority of transactions that would fall under the UK's existing national security screening regime), there will be no turnover or share of supply thresholds below which transactions will fall outside the scope of the regime.

'Call-in' powers for the "wider economy"

The Bill gives the Government the power to call in transactions which were not voluntarily notified to it, but which may raise national security concerns. Crucially, these powers also extend to events occurring before the Bill is enacted:

- **Events after commencement:** Once the Government becomes aware of a trigger event it will have six months to call it in, subject to an overall five year limitation period from the trigger event occurring. This power is significant, although not out of line with other regimes (eg those in France and Germany).
- **Events before commencement**: As highlighted, the 'call-in' power also applies to trigger events which occur **on or after 12 November 2020** (the day the Bill was laid before Parliament). These will be **at risk of being called in for up to five years from commencement of the applicable part of the Act** (not from

their date of occurrence). After commencement, once the Government becomes aware of a trigger event which happened in that period, it will have six months to call it in, in line with events occurring after commencement.

The Government has said that it does not expect many transactions to be affected by this retrospective 'call-in' power, but its reasoning behind this approach is to prevent potentially problematic transactions being rushed through before the regime takes full effect, thus creating an enforcement gap. In this context the Government has said that, in advance of the legislation being implemented, it welcomes informal representations about transactions which could be in scope of the new regime and that following such informal contact, it "may" provide advice to assist in business planning.

While the Government does not commit to provide comfort on transactions that are the subject of informal contact in this period, its ability to call in such transactions retrospectively will be **reduced to six months from commencement of the applicable part of the Act** (notably, not from when it became aware of the event).

For deals under the mandatory regime which have not been notified (and are therefore void), it is possible to obtain retrospective validation.

A "slicker and quicker" process?

The Government claims, at least, that the new regime will provide a clear process for businesses and investors and be less cumbersome than the existing approach. The key elements of the process are as follows:

- Notifications will be made via an online portal to a new **Investment Security Unit**, which will sit within the Department for Business, Energy and Industrial Strategy (**BEIS**). This is good news – there were concerns when the proposals were initially considered that the review may be conducted by a patchwork of government departments. Having a single unit to carry out the reviews and (as the Government points out) coordinate cross-government activity to identify, assess and respond to national security risks should ensure a certain level of consistency and certainty.
- The Government's intention is that the **review form will be relatively short** and not be overly burdensome for commercial parties to complete. This is welcome, but until final regulations are published on the precise form and content of notifications, it remains to be seen whether this intention will be realised in practice. An early indication may be seen in the draft list of questions recently published for consultation by the Government (available here), which suggests that the Government wants to obtain quite comprehensive information about the structure of the target and acquirer groups, up to the level of the ultimate beneficial owner, including information on the shareholdings or equivalent of all persons holding voting rights in the acquirer and, strikingly, a breakdown by nationality of its investors, as well as confirmation whether any government (other than the UK) has a direct role in the operation or decision-making of the acquirer. The list of questions appears to be a relatively early draft, positioned as "examples of the types of questions we expect to put into the notification requirements", and invites feedback on their ease of completion and relevance. One area where clarification could usefully be provided is their application to fund structures, where provision of information regarding non-controlling financial investors (such as limited partners) may prove onerous and unnecessary. It would be preferable for standard notification questions to focus on the entity that controls the fund (within the usual meaning in a merger control context), with requests for more

extensive information limited to cases with a clear national security nexus.

- The **ultimate decision-maker will be the Secretary of State** for BEIS. Decisions will be of a quasi-judicial nature and the Government stresses that it is "particularly important that the decision-maker acts independently and is not subject to improper influence". Parallels can be drawn with the existing UK public interest (which includes national security) regime where the relevant Secretary of State undertakes a similar role.
- The Secretary of State will have a maximum of **30 working days** to decide whether to clear a transaction or to call it in for a more detailed review. The Government notes that most transactions will be cleared at this stage, and often more quickly than the 30-day period. This is a clear improvement on the timing for review under the current rules.
- If the Secretary of State reasonably suspects that there is – or could be – a risk to national security, they will conduct a **detailed review**. They will have **up to another 30 working days** to do this, extendable by 45 working days in exceptional circumstances. Any further extension can be agreed with the acquirer.
- The Government has wide powers to request information in order to inform its assessment, including through interviews. These powers extend to requiring information from acquirers outside the UK. To avoid parties running down the time periods by delaying responses, the clock stops when such requests are made, so the overall timeframe may extend.

Remedies or even prohibition on the cards

In order to address any national security concerns found, the Government can impose remedies and even prohibit transactions. Possible remedies include limits on the level of shareholding that can be acquired, restricting access to commercial information, and controlling access to certain sites or works. They could be extensive. It is important to point out, though, that the Bill specifically provides that, under the new regime, transactions can only be assessed on national security grounds. The Government cannot, therefore, use the new powers to intervene for broader economic or public interests (albeit – as discussed in more detail below – deals may be scrutinised in parallel under the UK's existing merger control regime for their impact on competition and/or other specified public interest considerations such as media plurality and financial stability). Indeed, the current Government has resisted calls from the opposition party to introduce a wider public interest review regime.

The opportunities for parties to make representations during the review process appear to be relatively limited, although before a final order the Secretary of State is required to consider any representations made. Parties- can request that any remedy or prohibition order is reviewed, but only after it is issued as final. The Secretary of State will only consider varying any such order if there has been a material change in circumstances. Parties can, however, challenge decisions in the courts – given their sensitive nature, any appeals may need to be held partly in closed court.

Take the rules seriously or face the consequences

The Bill sets out civil and criminal sanctions for non-compliance with the regime. Fines of up to 5% of global turnover or £10 million (whichever is greater) can be imposed on the acquirer. Individuals face imprisonment of up to five years. And transactions subject to the mandatory notification requirement will be void if they take place without clearance. We expect the Government to take non-compliance seriously, and to actively make use of these sanctions.

Interaction with the UK merger control regime

Once the Bill is formally passed into legislation, the national security screening mechanism will fall outside the scope of the UK merger control regime. The Government has been keen to emphasise that the competition review and the national security review will be entirely separate processes, albeit there are powers to allow for the Government to receive information provided by parties to the Competition and Markets Authority (**CMA**). This means that, in practice, a transaction may undergo parallel reviews – on both competition grounds (by the CMA) and national security grounds (by the Government). In order to address concerns over potentially inconsistent outcomes, the Bill gives the Secretary of State the power to direct the CMA to take, or not take, action under the merger control regime in relation to the transaction. This effectively means that the national security issues can 'trump' competition concerns. The CMA will retain the power, however, to review deals on other public interest grounds such as financial stability and media plurality.

Conclusion and next steps

As the Government points out, the "UK is not alone in making such changes to its regime". Jurisdictions across the globe, including the U.S. and Australia, have strengthened or are strengthening existing (or introducing new) foreign investment control mechanisms in an attempt to protect strategic domestic companies/assets from foreign takeovers. The Covid-19 pandemic has accelerated the push for greater intervention. But the Bill does stand out – it is not just a tweak to existing rules but it establishes an entirely new regime with real 'teeth'.

What remains to be seen is whether the already enormous numbers of early engagements and notifications predicted in the Impact Assessment accurately take into account the likely large numbers of 'precautionary' notifications made voluntarily, particularly in the infancy of the new regime. Time will also tell if the government resources allocated to the screening regime will be sufficient to cope.

The Bill is now progressing through Parliament (the Public Bills Committee Report to the House of Commons is due by 15 December 2020). The Government is keeping its cards close to its chest in terms of overall timetable for passage, but we expect it will be pushing for the Bill to be enacted as soon as possible in 2021.

We are closely tracking progress of the Bill and will be providing further updates on developments.

Please get in touch with your usual Allen & Overy contact if you would like to discuss the implications of the new regime for your business.