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THE UK'S PROPOSED NEW NATIONAL SECURITY INVESTMENT SCREENING REGIME: STANDALONE, MANDATORY, AND BROAD IN SCOPE

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THE UK'S PROPOSED NEW NATIONAL SECURITY INVESTMENT SCREENING REGIME: STANDALONE, MANDATORY, AND BROAD IN SCOPE

The proposed regime is a huge departure for the United Kingdom, since it introduces mandatory filings for certain investments raising a national security concern, while it also gives the UK government extensive call-in powers for a period of up to five years for completed transactions, and it has retrospective application for transactions closing on or after 12 November 2020 but before the Bill is enacted.

I. SUMMARY AND KEY TAKEAWAYS

On 11 November 2020, the draft National Security and Investment Bill (the Bill) was laid before the UK Parliament. Assuming the new regime is ratified by Parliament in its current form, it represents a marked departure for the UK since it proposes to:

- introduce mandatory pre-closing filings to a new Investment Security Unit within the UK Government's Department for Business, Energy and Industrial Strategy (with a prohibition on closing until clearance is received) for certain investments, including non-controlling investments and asset acquisitions, in 17 sectors related to UK national security;
- enable the Secretary of State to "call-in" transactions raising national security concerns where the relevant sector does not give rise to a mandatory filing (including completed transactions for a period up to five years from closing), while parties can also make voluntary pre-closing notifications;
- introduce a screening regime whereby, following a filing, the Secretary of State will have up to 30 working days to decide whether to call in a transaction to scrutinise it for national security concerns - if he/she decides to scrutinise a transaction, the Secretary of State will then have 30 working days to conduct a detailed national security assessment, which may be extended by an additional 45 working days (or more);
- remove the existing link between the national security screening regime and the UK merger control regime;
- apply the new national security regime to investors from any country (including the UK) as well as investments in foreign targets by foreign purchasers; and
- give the Secretary of State the ability to review transactions that complete on or after 12 November 2020 but before the Bill is adopted as an Act for up to five years following the date of the Act coming into force.

The UK government says that it anticipates 1,000–1,830 notifications per year under the new regime, but estimates that only about 70 to 95 transactions would be called in for a detailed national security assessment and that only around 10 would result in remedies. However, it is expected that the new regime will give rise to a much higher number of filings, not least since parties to a non-mandatory filing transaction may seek greater deal certainty by making a voluntary notification given the retrospective powers of the Secretary of State to review, impose conditions, and potentially unwind, completed transactions for a maximum period of up to five years following completion (or six months from the date the Secretary of State becomes aware of the transaction).

The legislative timetable for the passage of the Bill by Parliament has not yet been published but it is currently expected that the Bill will be enacted within the next six months. In the meantime, there is considerable debate and controversy regarding the Bill particularly as regards (i) the ability to block transactions involving companies considered vital to the UK national interest, the so called "crown jewels"; and (ii) investor concerns regarding the chilling effect that this may have on investment in the UK, particularly given the number of potential notifications falling within the new regime and the retrospective powers of the Secretary of State to review completed transactions. The UK business community has also expressed a concern that the new regime could be exploited by the UK government to block deals for political ends, further deterring investment in the UK.

Parties planning and/or executing transactions on or after **12 November 2020** need to consider in advance (i) whether any potential UK national security issues may arise under the new regime; (ii) how best to address any such issues - including liaising with the UK Government and other stakeholders; and (iii) any impact on deal structure and timetable. Parties contemplating completing a transaction that may give rise to UK national security concerns before the Bill is enacted (especially if it falls within one of the 17 sectors being considered for the mandatory notification regime) may wish to seek legal advice and consider engaging informally with the UK Government as their transaction may be called in for a national security review once the Bill is passed. Doing so would ensure that the Secretary of State must exercise his/her call-in powers within six months from the date the Act comes into force, thereby providing greater deal certainty.

II. PROPOSED REGIME

Key features of the Bill include the following:

i. **Mandatory notification** – unlike the current regime,[1] the Bill provides for **mandatory** notification of certain transactions in the most sensitive national security areas of the economy. The obligation to notify such transactions is on the purchaser. The UK government has identified 17 sectors that may be captured by the mandatory filing requirement, and it is currently consulting on which ones should be subject to the mandatory regime (see below at (ix) *Relevant sectors for the mandatory notification obligation).* Transactions subject to a mandatory notification requirements must not be completed prior to UK government clearance. Unlike with voluntary filings (discussed at (iii) below), the Secretary of State's power to call in for a national security

[1] Currently there is no bespoke national security regime, but acquisitions may be reviewed further to the UK's merger filing regime under the Enterprise Act 2002. Under the current regime, subject to limited exceptions, the Secretary of State may only intervene in a transaction on national security grounds where the transaction meets the relevant merger control thresholds (e.g. via a Public Interest Intervention Notice under section 42 of the Enterprise Act 2002). The normal UK merger control thresholds are: (i) that the target has GBP 70 million or more in UK turnover; or (ii) that the transaction results on the creation of or increase in a 25% or more combined share of supply or purchases of goods or services of a particular description in the UK (or a substantial part thereof) (section 23(1)(2) Enterprise Act 2002)). As a stop-gap measure, until the Bill is enacted, the UK government lowered these thresholds for certain sectors considered particularly sensitive (namely artificial intelligence; cryptographic authentication; advanced materials; military or dual-use items; aspects of computing hardware; and quantum technology) (section 23A of the Enterprise Act 2002). The lower merger control filing thresholds for transactions in those sectors are (i) GBP 1 million in UK target turnover; or (ii) the target having a share of supply or purchases in the relevant sector of 25% or more in the UK (or a substantial part thereof) (with no required increment) (section 23(b)(ii) and section 23(2A) Enterprise Act 2002). Once the Bill is enacted, these lower UK merger control thresholds for these "sensitive sectors" will no longer apply. Under the current merger control regime, while the CMA and the Secretary of State have the power to intervene in transactions that appear to meet the relevant UK merger control filing thresholds, as a starting point it is not mandatory for the parties to notify the transaction to the CMA. Furthermore, the timeframe for the Secretary of State's review of a transaction following a Public Interest Intervention Notice is not set in statute but is determined on a case-by-case basis. Under the new regime the timeframe for a review will be defined in statute (see (xi) *Review periods* below).

review unnotified transactions subject to the mandatory filing requirement will not be limited to five years from completion (see (vi) *Five-year retrospective "call-in" powers* below). Moreover, if parties complete a transaction prior to receiving clearance, their transaction will be void.

ii. **Mandatory notifications capture minority and non-controlling investments** – the mandatory filing obligation will apply to the following changes in control, including the acquisition of **15%** or more of the relevant shares or voting rights, as well as certain **asset** acquisitions:

   a. acquisitions of shares or voting rights from a position of less than 15% to 15% or more;
   b. acquisitions of shares or voting rights from 25% or less to more than 25%, from 50% or less to more than 50%, or from 75% or less to more than 75%;[2]
   c. the acquisition of voting rights that enable or prevent[3] the passage of any class of resolution governing the affairs of the qualifying entity; or
   d. the acquisition of a right or interest in, or in relation to, a qualifying asset providing the ability to (i) use the asset, or use it to a greater extent than prior to the acquisition; or (ii) direct or control how the asset is used, or direct or control how the asset is used to a greater extent than prior to the acquisition.

iii. **Voluntary notifications** – where the transaction in question does not involve a sector listed for mandatory notification, the Bill also provides for voluntary notification by parties who consider that their transaction may raise national security concerns. In such instances, there is no suspensory obligation. Accordingly, unless the Secretary of State orders otherwise, parties may continue to progress their voluntarily notified transaction during the assessment period.

In addition to the types of change in control listed at (ii)b - d above, acquisitions may also be voluntarily notified if they give rise to "material influence" in the qualifying entity. The concept of "material influence" appears to be borrowed from the current UK merger control regime, which is interpreted very broadly in practice. It can be based on an assessment of factors including the distribution and holders of the remaining shares, patterns of attendance and voting at recent shareholders' meetings, the existence of any special voting or veto rights, and any other special provisions in the entity's constitution and may even exist in shareholdings of **under 15%**.

The Bill defines the changes in control over a qualifying entity or asset set out at (ii)b - d above, as well as the acquisition of material influence over a qualifying entity, as "**Trigger Events**". Even though the Bill sometimes refers to the exercise of "control", some of the Trigger Events fall short of the meaning of control for accounting purposes and include minority and non-controlling investments.

iv. **The regime will apply to both UK and foreign investors** – the proposed regime is not a direct foreign investments (FDI) regime, as it will apply to both UK and foreign investors. However, the affiliations of the investor may be relevant for the purposes of the substantive national security review, and indeed for the exercise of the call-in power with regard to transactions not giving rise to the mandatory filing obligation.

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[2] Transactions that are out of scope of the Bill would include e.g.: (i) transactions involving an existing holding of over 25% moving to a new level of 26-50%; (ii) transactions involving an existing holding in an entity of over 50% moving to a new level of 51-75%; and (iii) transactions involving an existing holding in an entity of 75% or more, moving to a new level of 76-100%.

[3] I.e. veto rights.

v. **Extraterritorial application** – the regime may also apply to investments in foreign targets by foreign purchasers, where the relevant criteria are satisfied.

vi. **Five-year retrospective "call-in" powers** – the Bill gives the Secretary of State the power to "call in" Trigger Events with respect to investments that do not give rise to the mandatory filing obligation where the Secretary of State reasonably suspects that there is or could be a resulting national security risk. The Secretary of State will only be able to do so if the types of change of control envisaged for a voluntary filing are satisfied. Accordingly, he or she may not call in a transaction involving an acquisition of under 25% of the votes or shares in a qualifying entity, unless the transaction involves the acquisition of material influence over the qualifying entity.

The Bill would grant the Secretary of State the power to call in for national security assessment completed transactions within six months of becoming aware of the Trigger Event taking place, as long as this is done within a five-year period from completion.

With respect to transactions subject to mandatory notification that close without clearance, the Bill states that the call-in power of the Secretary of State is not limited by the five year limitation period, since such transactions will be considered void (see (xiv) *Civil and criminal penalties for non-compliance* below).

As regards transactions that closed on or after 12 November 2020 but before the Bill is passed, the Secretary of State will be able to exercise his or her call-in power once the Act comes into effect (see III. *Immediate implications of the Bill* below). Parties currently contemplating a transaction that may give rise to UK national security concerns (especially if it falls within one of the 17 sectors being considered for the mandatory notification regime) may therefore wish to consider engaging informally with the UK Government as their transaction may be called in for a national security review once the Bill is passed (see III. *Immediate Implications of the Bill - Informal discussions* below).

Once called in, the Secretary of State will carry out a full assessment of the potential national security risks, and will have the power to order remedies, block a transaction or even order unwinding for completed transactions.

In deciding whether to exercise the call-in power, the Secretary of State will consider the following risks:

a. **the target risk** – the nature of the target and whether it is active in an area of the economy where the UK Government considers national security risks are more likely to arise.

b. **the trigger event risk** – the type and level of control being acquired and how this could be used in practice.

c. **the acquirer risk** – the extent to which the acquirer raises national security concerns.

vii. **No minimum applicable thresholds** – unlike the UK merger filing regime, the mandatory and voluntary filing regime envisaged by the Bill does not include minimum turnover and/or share of supply thresholds.

viii. **Assets in scope** – the Bill also applies to certain transactions involving land, tangible moveable property and intellectual property (including any idea, information or technique with industrial,

commercial or other economic value). Assets bought by consumers, such as computer software, mobile phones and GPS are out of scope.

ix. **Relevant sectors for the mandatory filing obligation** – the UK government is currently consulting on which sectors and which parts of each sector should be included within the mandatory notification regime.[4] The consultation is discussed in further detail below at IV *Next Steps*. The UK government expects some transactions falling within the following sectors to be subject to mandatory notification:

	Proposed Sector for Mandatory Notification Under the Bill
1.	Civil nuclear
2.	Communications
3.	Data infrastructure
4.	Defence
5.	Energy
6.	Transport
7.	Artificial intelligence
8.	Autonomous robotics
9.	Computing hardware
10.	Cryptographic authentication
11.	Advanced materials
12.	Quantum technologies
13.	Engineering biology
14.	Critical suppliers to the government
15.	Critical suppliers to emergency services
16.	Military or dual-use technologies
17.	Satellite and space technologies

x. **The Investment Security Unit** – this body will be the relevant regulator for the purposes of the Bill, and it will consider the national security implications of a relevant transaction. It will sit within the UK Government Department for Business, Energy and Industrial Strategy and will provide a single point of contact for businesses wishing to understand the Bill and notify the UK government about transactions. The Investment Security Unit will also coordinate cross-government activity to identify, assess and respond to national security risks arising through market activity. Any UK competition law assessment of the transaction would be conducted by the CMA in parallel further to the existing merger filing regime under the Enterprise Act 2002.

[4] The consultation closes on 6 January 2021.

xi. **Review periods** – following a notification, the Secretary of State will have up to 30 working days to decide whether to call in a transaction for a review of any national security concerns. If he/she decides to scrutinise a transaction, the Secretary of State will then have 30 working days to conduct a detailed national security assessment, which may be extended by an additional 45 working days. If more time is needed, the Secretary of State will discuss a possible further extension with the relevant parties. The UK Government currently anticipates that transactions will often be reviewed in a shorter time period.

xii. **Information gathering powers** – the Secretary of State may request any information at any time from any person if it is necessary to inform the assessment of a transaction's national security risk. If the parties to the transaction provide false or misleading information in their notification or in response to an information request, the Secretary of State has the power to reopen the case (as well as impose penalties).

xiii. **Remedies** – if the Secretary of State considers it necessary he or she may impose conditions to clearance including, for example, altering the amount of shares an investor may acquire, restricting access to commercial information, or controlling access to certain operational sites or works. The Secretary of State may also block the investment and, with regard to a completed transaction, require its unwinding.

xiv. **Civil and criminal penalties** – penalties for completing an acquisition subject to mandatory notification without clearance include fines for the acquirer of up to 5% of its worldwide turnover or GBP 10 million (whichever is the greater). Failure to comply with an interim or final order from the Secretary of State also carries such fines. Transactions subject to mandatory notification that take place without clearance will be legally void. In addition, there will be criminal penalties for an acquirer closing a transaction subject to mandatory notification prior to receiving clearance or for any person failing to comply with an interim or final order from the Secretary of State, including up to five years imprisonment. Individuals will also be liable for director disqualification orders.

III. IMMEDIATE IMPLICATIONS OF THE BILL

Retrospective Application

In relation to a Trigger Event that takes place between 12 November 2020 but before the Act is adopted, the Secretary of State will have the power to call it in for a national security review once the Act comes into force.

- If the Secretary of State becomes aware of the Trigger Event before the Act is adopted, the Secretary of State will have up to six months after the Act comes into force to call in the completed transaction.

- If the Secretary of State becomes aware of the Trigger Event either on the date of adoption or after adoption of the Act, the Secretary of State may call in the completed transaction within six months of becoming aware of it, up to five years after the date of the Act coming into force.

This means that effectively the Secretary of State may have the ability to review transactions that complete on or after 12 November 2020 but before the Act is adopted for up to five years following the Act coming into force.
Once the mandatory filing sectors are determined, any transactions that would have been notifiable had they completed after the Bill is enacted, may be voluntarily notified by the parties after the Act comes into force.

Informal Discussions

In advance of the Bill being adopted, the UK government welcomes informal representations from businesses regarding contemplated transactions which may be within the scope of the new regime. It may be advisable to engage in such discussions particularly if the transaction may have important UK national security implications or falls within one of the 17 sectors identified as potentially coming within the mandatory filing obligation (listed at (ix) *Relevant sectors for the mandatory notification obligation* above). By contacting the UK Government, businesses may get advice on what to expect once the regime is adopted to assist in business planning. From a practical perspective, the parties will have put the Secretary of State on notice, so that he or she must exercise his/her call-in powers within six months from the date the Act comes into force. The UK Government encourages parties to refer to the Bill and the Statutory Statement of Policy Intent, to assess whether their transaction may fall within the scope of the new regime. However, given the uncertainties introduced by the proposed regime and the Secretary of State's wide powers, it would be advisable to seek legal advice and to contact the UK Government to get more clarity.

IV. NEXT STEPS

The UK government is currently consulting on which sectors and which parts of each sector should be included within the mandatory regime of the Bill under secondary legislation. The consultation sets out the UK government's proposed definitions for the types of entity within each sector that could be subject to the Bill's mandatory regime. The full UK government consultation is available here and is open for responses until 6 January 2021.

The legislative timetable for the passage of the Bill by Parliament has not yet been published but it is currently expected that it will be passed within the next six months. The House of Commons' first reading took place on 11 November 2020 and the second reading took place on 17 November 2020. The House of Commons Committee Stage is scheduled for 24 November 2020.

V. BACKGROUND

Although in principle the Bill applies to investors from any country, including the UK, it is expected to have a material impact on foreign investments. The Bill is the latest and most comprehensive in a series of reforms aimed at putting in place a UK FDI screening regime. For further background please see our previous LawFlashes including: *Potential UK Reforms could Increase Screening of Certain Foreign Takeovers*; *New Powers for UK Government in Transactions Impacting Public Health Emergencies and National Security*; *New UK Powers in Transactions Impacting National Security*; and *UK Withdraws Draft Legislation On EU FDI Information Sharing Regime*.

The Bill is part of a wider global trend towards greater scrutiny of FDI, especially in the light of the coronavirus (COVID-19) pandemic. For further background on these developments see our previous LawFlashes, including: *COVID-19: Control of Foreign Direct Investments in France*; *Germany to Tighten National Foreign Direct Investment Screening Regime in Light Of COVID-19*; and *COVID-19: EU Commission Issues Guidelines to Protect Against Predatory Buyers*.

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