

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 on-going transactions, because the 'call-in' power will apply retrospectively to any transaction that has not completed before 12 November 2020. While the 'call-in' power will of course not be exercisable until the Bill has been passed and commenced, parties may need to consider whether to engage with the Government to understand the risk of a retrospective 'call-in' after that date. The Government is aware of the uncertainty that this will create for commercial parties and will be setting up an email address and phone number that can be used for informal advice around the process. Officials have also indicated that it is not the Government's intention to have to use these retrospective powers, but there needed to be a protection against a 'rush' of harmful deals.

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 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 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, 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”. And the Government points out that most transactions will be cleared without any intervention (anticipating that it will receive over 1,000 notifications and call in up to around 95). But despite these claims, as we set out below, 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 where they involve the acquisition of 15% or more of the votes/shares in an entity, or 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 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.

Where a transaction is subject to mandatory notification, a 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”.

Voluntary notification and ‘call-in’ powers for the “wider economy”

Outside the mandatory notification regime, there will be the possibility 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, future and options are not exempt from scrutiny, although “the overwhelming majority of these are expected to pose no national security concerns”.

Specifically, the relevant trigger events are the acquisition of:

- more than 25%, 50% or 75% of votes or shares;
- “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 this route where they consider their deal may raise national security concerns, especially in light of the ‘call-in’ power described below. Indeed, the Government encourages 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.

Parties considering whether to make a voluntary notification should refer to the Government’s Statement of policy intent, a [draft](#) of which has been published alongside the Bill (and is subject to change before being finalised). It 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 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, there will be no turnover or share of supply thresholds below which transactions will fall outside the scope of the regime.

The Bill gives the Government the power to call in transactions which were not voluntarily notified to it, but may raise national security concerns. Once it 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). And, crucially, it applies from the day the Bill is laid before Parliament. This means that **deals where the trigger event occurs on or after 12 November 2020 will be at risk of being called in for up to five years**. The Government's reasoning behind this is to prevent potentially problematic transactions being rushed through before the regime takes full effect, thus creating an enforcement gap. The Government says it will offer informal advice to minimise the risk of disruption.

For deals not notified under the mandatory regime, it is possible to get retrospective validation.

A "slicker and quicker" process?

This is what the Government claims, at least. The key steps 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 (three or four pages) and not be overly burdensome for commercial parties to complete.

- The **ultimate decision-maker will be the Secretary of State** of 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 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 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.

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 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. 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 limited. They 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 in closed court.

Take the rules seriously or face the consequences

The Bill sets out sanctions for non-compliance with the regime. Fines of up to 5% of global turnover or £10 million (whichever is greater) can be imposed. 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

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’. And with that comes significant additional administrative burden and uncertainty for investors. The Government notes that there have been only 12 interventions on national security grounds since 2002. The White Paper predicted 200 notifications a year on the basis of a purely voluntary regime. The [Impact Assessment](#) for the Bill estimates an enormous 1,000-1,830 notifications each year. Of these, it expects 70-95 ‘call-ins’ for a detailed review, and around 10 remedies decisions. What remains to be seen is whether these predictions take into account the likely large numbers of ‘precautionary’ notifications made voluntarily, particularly in the infancy of the new regime – time will tell.

The Bill will now be debated in Parliament – the date for this has not yet been set but is likely to be in the next couple of weeks. More generally, the Government is keeping its cards close to its chest in terms of likely timetable for passage. But we expect it will be pushing for the Bill to be adopted 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.

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2020. This document is for general guidance only and does not constitute definitive advice. |