

UK Government Introduces New Regime for Screening Foreign Direct Investment

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The UK government's long-awaited National Security and Investment Bill (the Bill), which paves the way to significant changes in the UK's regime for screening foreign investment, was laid before Parliament on 11 November 2020.¹

While the text of the proposed legislation will require detailed analysis, it is already clear that the regime will provide for a very different approach to screening national security and foreign investment in the UK than has existed to date. The Bill gives the UK Secretary of State powers to call in acquisitions of interests in entities above certain thresholds or of assets (so-called "trigger events") where the Secretary of State reasonably suspects there is, or could be, a risk to national security. Unlike the present arrangements under the Enterprise Act 2002, the new regime will be divorced from merger control.

The regime would capture acquisitions of assets and intellectual property as well as of minority shareholdings. The revenue and share of supply thresholds under the Enterprise Act 2002 will cease to apply so that the UK government will be able to intervene in any transaction that potentially threatens national security. Notably, whilst notification is generally voluntary, in a significant departure from the regime proposed in the White Paper published by the UK government in 2018, a mandatory notification regime is proposed for transactions in core sectors that pose the greatest risks from a national security perspective, such as advanced technology, defence, aerospace, transport, energy, data infrastructure, engineering biology, critical government suppliers, nuclear and communications.

The Bill builds on a 2017 Green Paper, the White Paper published and consulted on in 2018, and reforms to the Enterprise Act 2002 in 2018 and 2020, which made government intervention easier in transactions affecting particularly sensitive sectors, such as military and civilian dual use and advanced technologies, and extended the UK government's powers to intervene in transactions that might affect the UK's capability to deal with a public health emergency. (See our *2019 Insights* article "[Foreign Investment Control Reforms in Europe](#)" and our June 24, 2020, client alert, "[UK Amends Enterprise Act 2002 To Protect Businesses Critical To Addressing Public Health Emergencies, Extends Powers To Protect Companies and Technologies](#)".) The COVID-19 pandemic has brought concerns about the UK's ability to address challenges to national security into sharper relief and emphasized the need to ensure that the UK government can intervene in any deal across the economy that raises national security risks.

During the consultation process on the White Paper, the government anticipated around 200 notifications per year would be made under the new proposals (which compares to around 50-60 per year for UK merger control purposes). There has been some scepticism as to whether this significantly underestimated the number of notifications that would be made, at least in the early years of the regime, given its potential breadth, the uncertainty as to how the UK government would implement it and the potential sanctions for infringement. In addition, concerns had been raised over whether the government would be able to process a large number of notifications in a timely manner. In today's announcement, the UK government made clear that it recognizes the importance of the regime operating effectively and predictably from day one and has stated that work is ongoing across government to ensure that sufficient resources are in place to handle and

¹ Press Release: "[New Powers To Protect UK From Malicious Investment and Strengthen Economic Resilience](#)" (11 November 2020).

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process cases in accordance with the statutory timescales. The UK government anticipates 1,000-1,830 notifications per year under its revised estimates, of which 70-95 would be “called in” for detailed national security assessment and around 10 would result in remedies.

Background

The goal of the proposed legislation is to modernize the UK government’s powers to investigate and intervene in potentially hostile foreign direct investment, updating and replacing the government’s current powers under the Enterprise Act 2002 and bringing them into line with national security regimes introduced by comparable jurisdictions without damaging the UK’s reputation as an attractive place to invest. In particular, the UK government has noted that:

- Earlier this year, the US introduced mandatory notification requirements for transactions concerning specified types of businesses as part of a broader programme of reform;
- Australia has introduced legislation requiring foreign investors to seek approval to acquire a direct interest in sensitive national security businesses; and
- Several other major recipients of inward investment, including France and Italy, have regimes making transactions in certain sectors that have not had prior approval void.

Accordingly, the Bill is intended to strengthen the UK’s ability to investigate and intervene in mergers, acquisitions and other types of deals that could threaten national security. Government statements note that the Bill will mean that “no deal which could threaten the safety of the British people goes unchecked, and will ensure vulnerable businesses are not successfully targeted by potential investors seeking to cause them harm.”

However, notably, in light of ongoing discussions around industry policy in the UK, particularly following the economic impact of COVID-19, the UK government states that it will not be able to use these new powers to intervene in transactions for “broader economic reasons”. The legislation will establish a clear test that must be met for the government to call in a transaction for a national security assessment: The Secretary of State must have a reasonable suspicion that a risk to national security may arise as a result of the transaction. Given the intense political pressures that governments are often subject to in controversial cross-border acquisitions of British businesses for a range of reasons, including concerns about their impact on UK jobs and the loss of marquee British brands, the rigour with which politicians will be able to adhere to this standard in practice may be open to question.

Statement of Policy Intent

The UK government also published a draft statement of policy intent today, which describes how the Secretary of State expects to use the call-in power in the Bill to review transactions and the three risk factors (the target risk, the trigger event risk and the acquirer risk) that the Secretary of State expects to consider when deciding whether to use it. The Bill requires the Secretary of State to have regard to this statement of policy intent when exercising the call-in power and to review it every five years.

In determining whether to exercise the power to call in transactions, the Secretary of State will consider:

- The target risk: the nature of the target and whether it is in an area of the economy where risks are more likely to arise;
- The trigger event risk: the type and level of control being acquired and how this could be used in practice; and
- The acquirer risk: the extent to which the acquirer raises national security concerns.

Scope of Proposed Regime

Mandatory Notification for Certain Sectors

The notification of certain transactions considered most likely to give rise to national security risks will be mandatory. The obligation will be on the acquirer to notify, with significant penalties for completing a transaction without clearance. This marks a significant departure from the proposals that were initially put forward in the White Paper in 2018 and also adopts a different approach to the UK merger control regime, which is currently voluntary.

The mandatory notification requirements will apply to transactions affecting a limited number of sensitive sectors:

- Civil nuclear
- Communications
- Data infrastructure
- Defence
- Energy
- Transport
- Artificial intelligence
- Autonomous robotics
- Computing hardware
- Cryptographic authentication
- Advanced materials

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- Quantum technologies
- Engineering biology
- Critical suppliers to the government
- Critical suppliers to emergency services
- Military or dual-use technologies
- Satellite and space technologies

The UK government today launched a consultation on which sectors, and which activities in of each sector, should be included within the scope of the mandatory regime set out in the Bill.

Where there is no mandatory requirement to notify, the Bill will create a voluntary notification system to encourage notifications from parties that consider that a trigger event they are involved in may raise national security concerns. This applies to all economic sectors.

Review To Cover Acquisitions of Assets and Intellectual Property as Well as Companies

The UK government's screening powers will extend beyond the acquisition of interests in companies to cover acquisitions of sensitive assets (such as land and tangible moveable property) and intellectual property — *i.e.*, any idea, information or technique with industrial, commercial or other economic value. The Secretary of State expects to intervene very rarely in asset transactions, although where assets are integral to the activities of an entity that is involved in “core” areas of the economy, or where land is in a sensitive location, their acquisition is more likely to be called in. Examples include the acquisition of design and associated rights to technology with military application or of land that is, or is proximate to, a sensitive site such as critical national infrastructure sites, military facilities or government buildings. Assets bought by consumers, such as computer software, mobile phones and GPS will not be covered.

Acquisitions of minority shareholdings will also be caught, except where the shareholding is less than 15% and does not give rise to “material influence over the policy of the entity”. Also excluded are transactions representing an increase of an existing shareholding within specific bands (for example, an increase of a shareholding between 25% and 50%, between 51% and 75%, and between 76% and 100%). The definition of “material

influence over the policy of the entity” will be key, and it seems likely parallels will be drawn with the concept of material influence under the UK's merger control regime, which also captures certain acquisitions of minority shareholdings.

Regime To Focus on Particular Target and Acquirer Risks

According to the draft statement of policy intent, the Secretary of State will consider on a case-by-case basis the risk to national security based on whether the transaction could enable:

- Disruptive or destructive actions: the ability to corrupt processes or systems;
- Espionage: the ability to have unauthorised access to sensitive information; or
- Inappropriate leverage: the ability to exploit an investment to influence the UK.

The new regime will apply to investors from any country, but the government stresses that it will remain targeted and proportionate. According to the draft statement of policy intent, the factors that will be considered by the Secretary of State when considering whether to exercise the call in power will include:

- Those in ultimate control of the acquiring entity;
- The track record of those people in relation to other acquisitions or holdings;
- Whether the acquirer is in control of other entities within the sector or owns significant holdings within a “core” area of the economy, as this will tend to increase their leverage; and
- Any relevant criminal offences or known affiliations of any parties directly involved in the transaction.

The new regime will not regard state-owned entities, sovereign wealth funds or other entities affiliated with foreign states as being inherently more likely to pose a national security risk, and the Secretary of State recognizes that these organisations may have full operational independence in pursuing long-term investment strategies with the object of economic return, raising no national security concerns. As such, when considering the acquirer risk, the Secretary of State will consider the entity's affiliations to hostile parties rather than the existence of a relationship with foreign states in principle, or their nationality.

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A More Streamlined Assessment

Under the Bill, investors and businesses will notify a dedicated government unit (the Investment Security Unit) that will sit within the Department for Business, Energy and Industrial Strategy. It can be expected that — as with the current public interest regime — relevant stakeholders (such as the Ministry of Defence) would also be involved in any review. The Investment Security Unit will coordinate cross-government activity to identify, assess and respond to national security risks arising through market activity.

The proposals indicate that once a complete notification is made, there will be an assessment period of 30 working days for the Secretary of State to decide whether to call in a transaction to further scrutinize it for national security concerns. If the UK government decides that there may be a national security concern with a transaction, there will be a detailed review. The government has up to 30 working days to conduct this detailed assessment, which can be extended by a further 45 working days. If more time is needed, the UK government will discuss a possible extension with the relevant businesses and investors. This contrasts with the current public interest regime, where the relevant minister sets individual timelines by case.

The UK government will have wide information-gathering powers and can require that businesses and investors involved in a trigger event provide any information relevant to the transaction. In addition, the UK government may request any information, at any time, from any person if it is necessary to inform an assessment of the national security risks of a transaction.

It is suggested that most transactions will require no intervention and can proceed in the knowledge that the UK government will not revisit a transaction once cleared unless inaccurate information was provided.

UK Government To Have Wide Remedial Powers

The UK government will have the power to scrutinize, impose conditions on or, as a last resort, block a deal in any sector where there is a risk to national security.

- Potential conditions that may be imposed on deals posing a risk to national security include altering the amount of shares an investor is allowed to acquire, restricting access to commercial information and controlling access to certain operational sites or works.

- Criminal and civil sanctions for noncompliance will include fines of up to the greater of 5% of worldwide turnover or £10m, and five years' imprisonment.
- Transactions covered by a mandatory notification requirement that take place without clearance will be legally void.

The UK government will also have a five-year retrospective power to call in transactions that it did not receive notification of that may raise national security concerns. The Secretary of State will be able to call in a trigger event that has taken place up to six months after the Secretary of State became aware of it (for example, by way of media coverage of the deal), so long as it is done within five years of the trigger event occurring. These powers will not apply to transactions that took place prior to the Bill's introduction to Parliament, so businesses and investors have certainty about historical deals.

However, in respect of trigger events occurring between 12 November 2020 and the day before the Bill becomes law, a call-in notice may not be given more than six months after the date on which the Bill is enacted if the Secretary of State became aware of the trigger event before that date. For trigger events occurring during this period of which the Secretary of State became aware after the Bill is enacted, a call-in notice may not be given more than six months after the Secretary of State became aware of the relevant trigger event and may not be given more than five years after the date on which the Bill is enacted.

The five-year time limit will not apply where the acquisition was subject to mandatory notification.

Under the Bill, the Secretary of State will need to reasonably consider that it is necessary and proportionate to impose a final remedy. Further, the new regime will be subject to judicial oversight, so parties involved in transactions will have the right to challenge decisions in the courts.

The UK government has taken into account concerns that were raised during the consultation process on the White Paper in 2018 relating to commercial and reputational implications of publication of government decisions to call in trigger events. Instead, the UK government will only routinely publish information at the final decision stage and usually only in relation to trigger events where final remedies (including blocking orders) are imposed.

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Key Takeaways

The detail of the Bill will need to be scrutinized and debated in Parliament before it passes into law. The Bill raises a number of questions that will require consideration. For example, the legal implications of a transaction that has already been completed being rendered void could well be complicated and far-reaching for the parties involved. However, it is notable that in introducing the Bill, the UK government stressed the importance of foreign direct investment to the UK economy and that the new regime will be targeted and proportionate such that the UK will remain an attractive place to invest. The regime will clearly capture a wider range of transactions than have been reviewed under current public interest intervention powers to date. However, the UK government considers that the Bill provides for a more streamlined, predictable and transparent review process than is currently the case and anticipates that most transactions will be cleared without any intervention.

The new regime will be a significant factor for overseas investors to consider in planning investments in the UK. Advance planning on how to address any potential national security concerns the transactions may raise, their impact on the timing and structure of transactions, and how and when to interact with the government, other parties to a transaction and other relevant constituencies, will become increasingly important to getting deals done successfully. It will be particularly important for those planning larger, more complex and cross-border transactions to consider the implications of the new regime alongside foreign investment screening processes in other jurisdictions and merger control requirements. All in all, the new regime contemplated by the Bill represents a very significant departure from the past as far as inward investment into the UK is concerned.