ALERT MEMORANDUM

UK Proposes A Mandatory, Pre-Closing National Security Regime

13 November 2020

On November 11, the UK Government proposed a new national security screening regime that would allow the Government to intervene in "*potentially hostile*" foreign investments that threatened UK national security while "*ensuring the UK remains a global champion of free trade and an attractive place to invest.*"[1] If approved by Parliament, the National Security and Investment Bill would introduce a mandatory and suspensory CFIUS-like regime with the following principal features:

- Transactions in defined sectors would require notification to, and pre-closing approval from, a new Investment Security Unit. Transactions that closed without clearance would be void.
- A Government minister would be the decision-maker, assessing the risk to national security and the need for and scope of any remedies.
- Sectors expected to fall within the mandatory notification regime include advanced technologies (artificial intelligence, quantum computing, robotics, and computing hardware); critical suppliers to Government; satellite and space; and critical national infrastructure (military, defence, energy, and communications).
- The power to intervene would extend to acquisitions of intellectual property and assets, as well as investments in businesses.
- Sanctions for non-compliance would include fines of up to 5% of worldwide turnover and imprisonment for directors.
- The Government could retrospectively "call in" transactions raising national security concerns that occur as of 12 November.

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We expect the new regime will come into force in the first half of 2021, assuming it receives Parliamentary approval. Given its broad scope and retrospective application, foreign investors considering transactions that may raise national security issues should already consider engaging with the Government and taking account of the new regime in deal negotiations and transactional documents.

[1] Department for Business, Energy & Industrial Strategy, "New powers to protect UK from malicious investment and strengthen economic resilience" (November 11, 2020).

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National Security and Investment Bill: Principal Provisions

Scope

- Notification would be **mandatory** for certain transactions in pre-defined sectors. The scope of mandatory filing requirements would be determined in regulations after public consultation.
- The regime would apply to acquisitions of control or influence over **UK entities or assets** by foreign or UK buyers.
- Transactions that require mandatory notification would be **void** if closed before approval.
- Other transactions could be **notified voluntarily** or **"called in"** by the Government up to five years after closing (or six months after closing is made known). There would be no safe harbour for small transactions.
- Transactions closed on or after November 12, 2020 but before the Bill is enacted could be called in **retrospectively**.

Assessment and Remedies

- The Government would have **30 working days** after receiving a notification to decide whether to open a full review.
- The decision whether to call in a transaction would take into account "**risk factors**" relating to the nature of the target, the transaction, and the acquirer (similar to a review by CFIUS).
- A full review would last a further **30 working days**, extendable by another **45 working days**, and further by agreement.
- The Government would be able to issue **requests for information and witness summons**, with non-compliance punishable by **imprisonment and/or fines**.
- The Government would have the power to **block transactions and impose remedies**, including obligations to maintain strategic capabilities or assets in the UK and to safeguard sensitive information.

Background

Current regime. The UK has no standalone regime that vets foreign investments in UK companies. Transactions may be subject to merger control, where political involvement is limited and, in the overwhelming majority of cases, decisions are taken on competition grounds by an independent agency, the Competition & Markets Authority ("CMA").

The Government can, however, intervene in respect of mergers that raise narrowly-defined "public interest considerations," namely national security, plurality of the media, stability of the UK financial system, and (since June 2020) the ability to combat public health emergencies.[2]

Calls for a new regime. The limitations of the existing public interest regime have been exposed in recent years as concerns about foreign investments in UK companies have grown. Acquisitions by Chinese companies in particular have been at the forefront of these concerns, including in respect of investment in the Hinkley Point nuclear power station and Huawei's involvement in the UK's 5G network.

In 2018 and 2020, the Government lowered the thresholds to review transactions in certain high-risk sectors, adding a new ground for intervention during public health emergencies in June 2020. In September 2020, the Government effectively prohibited the acquisition of Impcross Limited, a UK-

[2] Certain mergers that do not meet the UK thresholds may also be investigated on public interest (but not competition) grounds. They are currently limited to mergers involving "government contractors" holding confidential information relating to defence and certain mergers in the newspaper and broadcasting sectors.

based aerospace component manufacturer, by Chinese-owned Gardner Aerospace.

The UK has not been alone in considering a standalone regime to vet foreign investment. In the past 12 months, the United States, France, and Germany all reinforced their existing FDI regimes, while the EU introduced a new FDI Regulation to facilitate information sharing between EU Member States.

National Security and Investment Bill

The Bill proposes an entirely new regime for reviewing transactions on national security grounds, independent of the existing merger regime. As explained by the Business Secretary, Alok Sharma, "*hostile actors should be in no doubt – there is no back door into the UK* ... [the Government will] *continue to welcome job-creating investment to our shores, while shutting out those who could threaten the safety of the British people*."

The Bill is subject to change as it completes the legislative process to enactment. In addition, the extent of the mandatory notification requirement would be subject to secondary legislation that is being consulted on. This means the modalities and scope of any new regime will not become clear for several months. The principal features of the new regime proposed in the Bill are as follows:

Hybrid regime. The foundation of the new regime is that certain transactions would need to be notified to the Government pre-closing and other transactions would not need to be notified but could be called in for review (with or without a voluntary filing), possibly up to five years after closing. This is similar to the Australian foreign investment regime, for example, where a range of transactions are reviewable but only a subset must be reported to the FIRB.

Qualifying transactions. Transactions to which the regime would apply are described as "*trigger events*" and would occur when a person gains control of either a "*qualifying entity*" or a "*qualifying asset*."[3] A qualifying entity would, broadly speaking, be any entity other than a natural person that carries on business in the UK.[4] In this sense, the meaning of "*entity*" is similar to the meaning of "*enterprise*" within UK merger control. A qualifying asset is either land, tangible moveable property, or "*ideas, information or techniques which have industrial, commercial or other economic value*" (*i.e.*, intellectual property).[5]

This extends the scope for review well beyond the existing regime, under which transactions must qualify as mergers to be liable for public interest review. This requires two enterprises to "*cease to be distinct*,"[6] and would not typically capture the transfer of land, physical assets, or intellectual property. Under the regime proposed by the Bill, however, these transactions could be caught.

Control. Acquiring control of a qualifying entity would mean acquiring:

- More than 25%, 50% or 75% of shares or voting rights;
- Sole control or veto rights over its affairs;
- Voting rights that enable or prevent the passage of any class of resolution governing the entity's affairs; or
- Material influence over the policy of the entity.[7]

For a qualifying asset, a person would gain control if they acquired a right or interest in, or in relation to, the asset and were able to use or direct or control how it was used, or do so to a greater extent than prior to the acquisition.

[3] Bill, s 5.

[4] Bill, ss 7(2)–(3).

[5] Bill, s 7(4)(c). The Bill provides the following examples: (1) trade secrets, (2) databases, (3) source code, (4) algorithms, (5) formulae, (6) designs, (7) plans, drawings, and specifications, and (8) software.

[6] Enterprise Act 2002, s 23.

[7] Bill, s 8. This is the same concept of "material influence" used in jurisdictional tests for the existing merger regime; see the Government's Consultation Response published alongside the Bill, para. 59.

Mandatory pre-closing review. Only certain trigger events ("*notifiable acquisitions*") would be subject to mandatory notification.[8] The Government has identified 17 sensitive sectors where transactions could require mandatory notification.[9] As noted above, the Government is consulting on how these sectors should be defined in secondary legislation (which would also mean that the Government would have greater flexibility to amend the definitions in future).

The 17 sectors provisionally identified are far broader than the sensitive sectors where lower merger control thresholds apply and where national security review is currently undertaken. The Government does not, however, anticipate that all transactions within these 17 sectors would be reportable.

Notifiable acquisitions would need to be reported to the Government before they were completed.[10] Failure to do so would be a criminal offence and any acquisition implemented without approval would be void.[11] Other trigger events would not require notification, but could be notified to the Government on a voluntary basis.[12] Notifications would be made to a new Investment Security Unit, under the remit of the Business Secretary. The Government would have 30 working days to screen notifications, after which it would have to "*call in*" the transaction for review or decide to take no further action.[13]

***Ex officio* review.** The Government could also "*call in*" for review trigger events that had not been notified within six months of becoming aware of them, and in any event within five years of the trigger event.[14] By way of comparison, in Germany the equivalent period is five years, and in the United States and Australia there is no limitation period at all.

To call in a trigger event, the Government would need to have a "*reasonable suspicion*" that a trigger event had taken place or was in contemplation, and that it had given or might give rise to a risk to national security.[15] The scope of the "call-in" power would not be limited to specific economic sectors.

The Statement of Policy Intent published alongside the Bill describes how the Government expects to use the call-in power, as well as the three risk factors that the Government expects to consider when deciding whether to do so:

— ***Target risk***: The entity or asset subject to the trigger event could be used to undermine UK national security;

— ***Trigger event risk***: The underlying acquisition of control would give rise to practical concerns that could be used to undermine national security; and

— ***Acquirer risk***: The identity of the acquirer would give rise to national security concerns. A range of factors would be considered to determine this risk on a case-by-case basis.[16]

Assessment. Where a trigger event is called in—either after notification or *ex officio*—the Government would have 30 working days, extendable by a further 45 working days, to conduct their assessment.[17] This period could be extended by agreement.

In conducting this assessment, the Government would have similar powers to those available to the CMA in

[8] Bill, s 14.

[9] Civil nuclear, communications, data infrastructure, defence, energy, transport, artificial intelligence, autonomous robotics, computing hardware, cryptographic authentication, advanced materials, quantum technologies, engineering biology, critical government suppliers, critical emergency service suppliers, military or dual-use technologies, and satellite and space technologies.

[10] Bill, s 14.

[11] Bill, ss 13(1) and 32. Under ss 15–17, however, the Government may retrospectively approve the acquisition.

[12] Bill, s 18(2).

[13] Bill, ss 14(8)–(9) and 18(8)–(9). The public consultation accompanying the Bill anticipates, however, that this period should be 15 working days for simple cases and 30 working days for complex ones.

[14] Bill, s 2(2).

[15] Bill, s 1(1).

[16] Bill, s 3.

[17] Bill, s 23.

merger control. The Government could issue requests for information and compel the attendance of witnesses.[18] Failure to comply, or the provision of false or misleading information, would be a criminal offence, punishable by imprisonment and/or a fine,[19] or by administrative fines imposed by the Government.[20]

Decisions and remedies. The assessment period would end either with unconditional approval or a final order that remedied the risk to national security (including by prohibiting or unwinding the transaction).[21] Decisions would be taken by the Business Secretary, though in practice other Government departments would have significant input (*e.g.*, the Ministry of Defence in relation to defence-sector transactions). Decisions would be subject to judicial review.

The terms of a final order could be broad, but would need to be "*necessary and proportionate*" to remedy the identified national security risk.[22] The Government's consultation response accompanying the Bill indicates that it would require similar remedies to those imposed in public interest cases under the current regime, such as the maintenance of strategic capabilities in the UK, the protection of intellectual property, and the obligation to maintain security-cleared British citizens on company boards.

Sanctions. The new regime would include strict sanctions for non-compliance with the mandatory notification requirement or other statutory requirements, including civil penalties of up to 5% of a company's global turnover or £10 million (whichever is higher) and criminal sanctions of up to five years' imprisonment.[23]

Commencement. Trigger events taking place in the period between 12 November 2020 and the commencement date (when the Bill comes into force) could be called-in, provided that:

— Where the Government was aware of the trigger event **prior** to commencement, the transaction was called in within six months of commencement; or

— Where the Government only became aware of the trigger event **on or after** commencement, the transaction was called in within five years of the trigger event, as long as the call-in notice was given within six months of the Government's becoming aware of the event.

If a transaction were called in for review under the existing regime for public interest intervention before the Bill is enacted, the new rules would not apply. To the extent that the Government could intervene but has not done so at the time the Bill is enacted, it is possible the transaction could be reviewed under either the new or old regime.[24]

Comparison with CFIUS

It is clear that the new UK regime has been inspired in large part by the U.S. CFIUS regime, and recent experience in the United States may therefore help to inform expectations as to how to navigate the new UK regime. There are, however, a few important differences between the proposal included in the Bill and the CFIUS regime, including:

— The CFIUS regime is narrower in that it applies only to investments by foreign persons (which can include, for example, a U.S. subsidiary of a non-U.S. company).

— The CFIUS mandatory notification requirements relating to critical infrastructure and sensitive data U.S. businesses only apply to foreign government investors, whereas the UK regime is not confined to foreign governments or even foreign persons.

— CFIUS generally does not have jurisdiction over a foreign person acquiring intellectual property (unless, of course, the intellectual property is part of a U.S. business). Instead, the U.S. export control laws would kick in and potentially restrict

[18] Bill, ss 19–21.

[19] Bill, ss 34, 39(2), and 40–41.

[20] Bill, s 43.

[21] Bill, s 26.

[22] Bill, s 26(3)(b).

[23] Bill, ss 39 and 41.

[24] Bill, s 62.

the ability of the intellectual property to be transferred to the foreign person. The UK regime is broader in this respect.

Issues & Implications

Many of the details of the regime remain to be determined, including the extent of the mandatory filing obligation. A number of issues and implications are already apparent.

— Many transactions will face parallel review under the merger rules and the new National Security and Investment regime, adding complexity and cost. Further, the scope of the proposed regime is so broad as to capture transactions that would not fall within the scope of the merger rules or otherwise require regulatory approval.

— Given the consequences of failing to comply with a mandatory filing obligation (including transactions being declared void), it will be essential for the Government to define the categories of transaction that require notification clearly and objectively.

— Any uncertainty in the requirements to make mandatory filings will likely result in companies making voluntary filings on a fail-safe basis. Similarly, the possibility for transactions to be unwound retrospectively is likely to result in voluntary notifications.

— The Government refers to the possibility for informal guidance, but it is not clear whether this would relate only to specific transactions or could also help foreign investors (including sovereign wealth funds) to understand more generally how they would be viewed under "acquirer risk."

— While the new regime is intended to address "national security" considerations, that term is (intentionally) not defined in any meaningful way. There is therefore the potential for Governments to use the new regime to intervene in transactions for a variety of reasons that do not relate to national security in the strict sense.

— The Government estimates that mandatory filings alone will result in up to 1,800 notifications per year. (By contrast, only 12 transactions have been reviewed on national security grounds since the current regime was introduced in 2003.) The number could be materially higher taking into account voluntary filings, many of which will not give rise to any material national security considerations.

— The Bill sets ambitious timeframes for review. Unless the Government dedicates sufficient administrative resources to deal with the volume of notifications that are likely to arise, the regime could have a material impact on transaction timing.

— The Bill and accompanying documents do not address the interaction of the new regime with the strict timetable requirements of the Takeover Code. By way of example, it is uncertain whether the Takeover Panel would allow a bidder to rely on a condition precedent relating to national security approval. Nor is it clear whether a bidder would be able to begin the national security review process before formally launching its public bid.

— Finally, the potential for the Government to review transactions that close before the Bill comes into force raises challenging questions for parties to transactions that are already in progress and may already have signed. Similarly, parties to new transactions that will not complete until after the Bill comes into force will have to consider whether a mandatory filing is required before closing and will not be in a positon to do so until the Government clarifies details of the mandatory filing obligation – and the date from which that obligation will apply – in secondary legislation.

Conclusion

The Bill is likely to be revised by Parliament and certain of its provisions will be implemented by secondary legislation following a public consultation. We nevertheless expect that a new regime closely reflecting the principal provisions of the Bill will come into force in the first half of 2021.

The screening regime envisaged by the Bill would represent the most significant change in the UK's regulatory environment for investments in UK companies since the Government ceded the power to approve mergers under the Enterprise Act 2002. The

proposed system would add a new layer of mandatory review, imposing non-trivial costs on investments in UK companies. The possibility to investigate qualifying transactions retroactively could create uncertainty in respect of closed transactions that could, in the worst case, be forced to unwind.

As noted at the outset, given its broad scope and retrospective application, foreign investors considering UK investments that may raise national security issues should consider engaging with the Government and taking account of the regime in deal negotiations and transactional documents, in particular in respect of deal feasibility, transaction timetables, and contractual conditionality.

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