UK National Security and Investment Bill

23 November 2020

Summary. The UK government has published long-awaited draft legislation increasing its ability to intervene in acquisitions of UK businesses to address national security concerns. The UK is following other European countries that have already strengthened their foreign investment review mechanisms, and is moving to something more comparable to CFIUS in the United States. The National Security and Investment Bill (the "Bill") will be the biggest change to the UK merger control regime since 2003 and comprehensively overhauls the current UK Foreign Direct Investment ("FDI") framework. The Bill is wide-ranging and is facing calls for greater clarity; in particular around the risks of politicisation of inbound UK M&A activity, uncertainty as to how the regime will apply, and bureaucratic delay for otherwise benign deals.

Background. The UK government does not currently have a separate FDI regime but can instead intervene in M&A deals only on the grounds of public interest (*i.e*., national security, financial stability, media plurality and, since June 2020, public health emergencies) and only if the UK or EU jurisdictional thresholds are already met.[1] The UK government has rarely used its powers and there have been only 12 public interest interventions on security concerns in the past 18 years, none of which were blocked.

The direction of travel has, however, for some time now been toward greater intervention to protect sensitive areas of the UK economy. Of the 12 cases cited, five were in the last three years (Gardner Aerospace/ Northern Aerospace (2018), Advent/ Cobham (2019), Connect Bidco/ Inmarsat (2019), Gardner Aerospace / Impcross (2019) and Aerostar/ Mettis (2019)) and although none were prohibited, two were abandoned in the face of Ministerial opposition.

The publication of the Bill has been a long time coming. The UK Government launched a national security infrastructure investment review in 2017. Following the publication of a White Paper in July 2018, the Bill was first announced in December 2019. In the interim, the UK government has introduced powers allowing it to intervene on public

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[1] Generally this is if the target has annual sales of more than £70 million in the UK or where the merged business would have a share of supply of more than 25% (subject to limited exceptions).

interest grounds in deals involving military products and technologies normally used for civilian purposes but which may have military applications, computing hardware, quantum technology and to combat public health emergencies such as coronavirus. However, this proposal ties it all together in a comprehensive package of reform.

The Proposed Regime. The proposed Bill is a far more wide-ranging reform of the existing UK FDI framework than had been anticipated. The Competition and Markets Authority ("CMA"), the body currently in charge of merger control, will no longer have a role in national security reviews. Instead, the responsibility will lie with the Secretary of State for Business, Energy and Industrial Strategy ("Secretary of State") who will be in charge of a new 100-person Investment Security Unit ("ISU"). All notifications required under the Bill will be made to the ISU. Once the Secretary of State has reviewed a transaction, they may make a final order preventing, remedying or mitigating a national security risk.

Under the proposed legislation, there would be a hybrid system of both mandatory and voluntary notifications:

- Mandatory Notification

  Transactions in 17 industry sectors considered to pose the greatest risk,[2] including computing hardware, data infrastructure, and transport, will be subject to a mandatory notification regime. The precise definitions of the sectors are currently the subject of an eight-week consultation period. Transactions in the sectors listed will be notifiable if they involve the acquisition of:

  - **15% or more** of the votes or shares in a qualifying entity (where the acquirer previously held less than 15%); or

  - **control** of a qualifying entity (defined as: *(i)* more than 25%, 50% or 75% of the votes or shares in a qualifying entity; or *(ii)* the acquisition of voting rights that enable or prevent the passage of any class of resolution governing the affairs of the entity).

  A qualifying entity is an entity which carries on activities in the UK or supplies goods or services to persons in the UK. The thresholds therefore apply to both direct and

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[2] Advanced Materials, Advanced Robotics, Artificial Intelligence, Civil Nuclear, Communications, Computing Hardware, Critical Suppliers to Government, Critical Suppliers to the Emergency Services, Cryptographic Authentication, Data Infrastructure, Defence, Energy, Engineering Biology, Military and Dual Use, Quantum Technologies, Satellite and Space Technologies, and Transport.

indirect acquisitions of UK entities, including where the UK entity is a subsidiary of the target group, as well as to foreign entities that supply goods or services to the UK.

- Voluntary Notification

  In addition to the mandatory regime, the Bill also sets out a voluntary notification system irrespective of which business the target is active in. Under the voluntary system, parties would be encouraged to notify the ISU of "trigger events" which may be of interest from a national security perspective, which in turn is based on the assumption that businesses will engage early with the government to seek clarification if their transaction could be of interest. Trigger events are acquisitions of control over a qualifying entity or assets. Control, for the purposes of the voluntary regime, is defined in the same way as set out above, but also includes acquiring "material influence" over a qualifying entity's policy.

  Importantly, for transactions that are not voluntarily notified by the parties, the Bill provides for a "call-in" mechanism whereby the UK government can review transactions up to five years post-completion.[3]

Key Features. Some of the key features of the Bill include:

- No Turnover, Asset or Market Share Thresholds

  Previously, the UK government could only intervene on the grounds of public interest if the merger control thresholds were met. However, under the Bill the UK government could intervene regardless of market share or sales and there is no requirement for the target to have UK assets or a domestic subsidiary. The potential for intervention has therefore been substantially widened, and so the Secretary of State could review company takeovers and share purchases as well as the acquisition of assets (including land or moveable property) and IP.

- Timelines

  The UK government has announced that "*investments will be screened much more quickly than the current regime*".[4] For mandatory notifications, the Secretary of State will have 30 business days to determine whether the proposed transaction needs to be formally "called-in". If a call-in notice is not issued within this time frame then

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[3] Note that this is reduced to 6 months if the UK Government is "aware" of the transaction, the test for which is still to be determined.

[4] https://www.gov.uk/government/news/new-powers-to-protect-uk-from-malicious-investment-and-strengthen-economic-resilience

the transaction is cleared and can be closed.

If a "call-in" notice is issued then the national security assessment must be completed within 30 business days, which can be extended by up to a further 45 working days. Additional extensions are also possible by agreement between the Secretary of State and the parties.

- Retrospective Application

  Once it has come into force, the Bill will apply to any transaction entered into from 12 November 2020, with such transactions open to review retrospectively for up to five years post-completion. If parties are involved in potentially relevant transactions after 12 November 2020, the UK government has invited them to share information to discuss the likelihood of the Secretary of State issuing a call-in notice once the Bill has been passed.

- Sanctions

  The Bill provides that where there is a failure to make a mandatory notification, any transaction that takes place without clearance will be declared void. The Bill also sets out civil and criminal sanctions for failing to notify, including a fine of the higher of £10 million or up to 5% of worldwide turnover and imprisonment for up to five years for directors.

Potential Impact. The UK government has confirmed that it will take a "*targeted, proportionate approach*" under the new regime and that "*most transactions will be cleared without any intervention*". However, the Impact Assessment accompanying the Bill estimates that up to 1,000 to 1,830 notifications per year will be subject to review. That is significantly higher than the number of merger notifications that the European Commission receives and is more than the number of cases reviewed by comparable FDI regimes, such as Germany. By comparison, the CMA averages around 60 merger cases a year. Therefore, regardless of the UK government's insistence on the proportionality of the regime, the new UK FDI rules will be an important consideration for any companies considering foreign investment into the UK in terms of timing, conditionality and feasibility.

The Bill will now be subject to debate and amendment in Parliament before being passed as law. However, due to the retrospective nature of the proposed regime, foreign investors in the UK will need to be fully aware of the proposed reforms before entering into transactions. We will only know the true extent and impact for foreign investment into the UK once the Bill has passed and reviews begin.

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Please do not hesitate to contact us with any questions.

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