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The UK's new NSI regime takes shape – Part I

by **Becket McGrath**

As the National Security and Investment Bill (NSI Bill) nears the end of its passage through Parliament, further details of the regime are becoming clearer. Nevertheless, fundamental questions over how the regime will operate in practice remain. Consideration of the long pre-history of the Bill, and examination of how other new investment screening regimes are bedding in, may shed some light.

The entry into force of the Enterprise Act 2002 marked the abandonment of the UK's long-standing approach to merger control, which was based on ministerial decision-making and a general public interest standard for all cases, in favour of an explicitly competition-based test applied by independent authorities. Necessitated by this shift, the Enterprise Act introduced a residual power for ministers to intervene in transactions that raised public interest concerns over and above competition issues, with any competition review being undertaken in parallel by the Competition and Markets Authority.

While the Enterprise Act's list of public interest concerns permitting intervention was initially limited to national security, the list was rapidly extended to include media plurality and, in response to the financial crisis, financial stability. More recently, the list was extended further to allow intervention where a transaction threatens to have an adverse impact on the country's ability to combat public health emergencies. While interventions under these provisions have been relatively rare,[1] the regime has generally proved to be an effective means to balance potentially conflicting public policy objectives in a flexible and reasonably transparent way. The new regime to be implemented under the NSI Bill will replace the Enterprise Act's public interest regime as far as the review of transactions for national security issues is concerned.

Although the Enterprise Act regime was generally viewed as effective, the seismic political impact of the June 2016 Brexit referendum result, and the subsequent arrival of Theresa May as Prime Minister, led to a marked shift away from the Cameron government's extremely open approach to foreign (and especially Chinese) investment in the UK, in favour of a more cautious and even protectionist stance.

The difficulty of maintaining such a stance while outwardly continuing to welcome foreign investment was demonstrated in September 2016 when, following a protracted and politically charged process, the government finally granted permission for Chinese energy company China General Nuclear to invest in a new nuclear power station at Hinkley Point, on condition that the government would also implement "significant new safeguards". These included that the government would tighten controls of companies involved in the civil nuclear sector and initiate a review of the UK's "approach to the ownership and control of critical infrastructure to ensure that the full implications of foreign ownership are scrutinised for the purposes of national security".

That review led to the government publishing its National Security and Infrastructure Investment Green Paper in October 2017.[2] The Green Paper observed that, while the vast majority of investments in the UK raise no national security concerns, the government "need[s] to be alert to the risk that having ownership or control of critical businesses or infrastructure could provide opportunities to undertake espionage, sabotage or exert inappropriate leverage". Responding to concerns that the existing Enterprise Act national security regime was unable to capture all potentially problematic transactions, the Green Paper proposed short term revisions to the regime to expand the Act's jurisdictional reach, together with longer term proposals to extend the government's "call in" power. These longer term proposals would enable the government to intervene in a wider range of transactions, including asset sales, and would include a new "mandatory notification regime for foreign investment into the provision of a focused set of 'essential functions' in key parts of the economy".

Notwithstanding the likely significant impact of such changes, these proposals were presented as simply a "periodic refinement and improvement of the regime". The Green Paper was explicit that "scrutiny does not mean making any part of the UK's economy off-limits to foreign investment. The proposals are concerned only with national

security, and are designed to be focused and proportionate in their scope and application". On the other hand, it indicated that "Foreign nationality is considered a risk factor when making assessments about the threat to national security posed by an individual or group of individuals" since "foreign nationals may feel an allegiance or loyalty to their home nation or in the case of dual nationals, their 'other' nationality. This loyalty may motivate them to undertake hostile 'insider' activity ...".[3] In a further shift of emphasis, contrasting the proposed changes with what were at that time new proposals for an EU mechanism for screening foreign direct investment (FDI)[4] the Green Paper emphasised that, while "screening to prevent threats such as espionage, sabotage and leverage merit special treatment ... this should not be conflated with screening to control market access for protectionist reasons. The UK is committed to free trade and investment, which must remain a priority for both a successful UK and European economy".

The government subsequently consulted on the long-term legislative changes in July 2018, by means of a White Paper.[5] This restated the primary objective to "protect national security from hostile actors using ownership of, or influence over, businesses and assets to harm the country" by creating "clear and focused powers within a predictable and transparent process". Unlike the Green Paper, however, the White Paper proposed that there would be no mandatory notification requirement, with parties simply being encouraged voluntarily to notify investments "that may raise national security concerns". Applying such a regime, the White Paper noted that the government anticipated around 200 notifications each year, of which about half would be cleared after an initial screen and half would be called in for further scrutiny.

The short-term changes were implemented in two stages, in July 2018 and July 2020. These introduced new lower jurisdictional thresholds for acquisitions of businesses involved in military and dual use technology, quantum technology and computer hardware (from July 2018) and artificial intelligence, advanced materials and cryptographic authentication (from July 2020). Although this period saw an increased intervention rate compared with previous years,[6] the fact that the regime continued to be based on discretionary intervention by ministers, together with a continued focus on transactions in the defence sector, avoided dramatic changes.

Practitioners had to wait more than three years for the full details of the new "long-term" national security regime, with the publication of the NSI Bill on its introduction to Parliament on 11 November 2020. Although the changes had been long heralded, the details of the regime still came as somewhat of a shock.

The expanded call-in power introduced by the NSI Bill will enable ministers to review *any* acquisition of control over *any* entity that carries on activities in the UK or supplies goods or services to UK customers, across the entire economy, with no minimum turnover threshold. Consistent with the existing merger control regime, control will be deemed to arise from the point at which the buyer acquires material influence over the target's policy. Changes in the degree of control will be independently reviewable once the stake held passes thresholds of 25 per cent, 50 per cent and 75 per cent of the target's shares or voting rights.[7] Ministers will also be able to review transactions involving the acquisition of any asset (including land, movable property and "ideas, information or techniques") that is either located in the UK or used in connection with activities carried on in the UK or the supply of goods or services to UK customers.[8]

While the call-in power will be discretionary, parties to a transaction will be able to file a voluntary notice if they consider that there is a risk that it will be called in. Once such a notice has been submitted, the government will have 30 working days to call in the transaction or clear it.

Most significantly, publication of the NSI Bill confirmed that the government had reverted to its original proposal to implement a mandatory filing process for the most sensitive investments. This will require all transactions that involve the acquisition of an interest of at least 15 per cent in an entity that carries on activities in the UK of a "specified description" to be notified to the government before control is acquired. Further changes in the level of the buyer's ownership interest will be separately notifiable at thresholds of 25 per cent, 50 per cent and 75 per cent. Similar to the voluntary filing regime, once a notice is submitted the government will have 30 working days to issue a call-in notice or indicate that no further action will be taken, effectively clearing the transaction.[9] Unusually, the NSI Bill includes a power for the government retrospectively to call in any transaction that closed after 12 November 2020, ie the day after the Bill was introduced to Parliament. For transactions closing after commencement (ie the date on which the new regime becomes fully operational), the government will be able to issue a call-in notice up to five years after closing or six months from when it became aware of the transaction.

Any transactions subject to mandatory notification that are completed without notification will be void,[10] albeit it will be possible to apply to the government for retrospective validation.[11] In addition, unless they can demonstrate that they had a reasonable excuse, any person acquiring control as a result of a notifiable transaction without having first gained government approval will commit a criminal offence, punishable by fines of up to five per cent of the investor's group worldwide turnover or £10 million (whichever is higher) or up to five years imprisonment for relevant individuals, including company directors.[12]

The Bill also sets out procedures for gathering information and conducting reviews, both before and after a call-in. These powers include the ability to gather witness evidence, as well as requesting information in writing.[13] If a transaction is called in, whether following a voluntary or mandatory notification, government will have

an initial review period of 30 working days, which can be extended by up to 45 working days.[14] Following a review, the government will have wide-ranging powers to address any risks to national security that it has identified.[15]

Since transactions will be subject to mandatory notification only if the target undertakes "specified activities", the definition of these activities is clearly of critical importance for the impact of the new regime. At the same time as the Bill was introduced to the Commons, the government published its provisional list of mandatory notification sectors for consultation, together with proposed definitions for each sector.[16] The 17 sectors comprised: 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, military and dual use, quantum technologies, satellite and space technologies, engineering biology and transport.

It was unsurprising that the new regime would seek to capture a number of these sectors, many of which (such as military and cryptographic authentication) are simply carried across from the existing national security regime. Others, such as civil nuclear and communications, logically reflect the increased political concerns over investments in those areas that triggered the review of the regime in the first place. The breadth of the list nevertheless caused concerns.

In particular, including the entire communications sector, as well as any entities engaged in research and development of "biological components and systems that do not exist in the natural world", risked bringing a large proportion of the economy within the scope of the mandatory filing regime. While the government continued to emphasise its desire to attract inward investment into the UK, the inclusion of "crown jewel" innovative technology sectors, such as advanced materials and biotech, in the mandatory filing regime also suggested that the lines between national security and industrial strategy may become blurred. In any event, the list clearly went well beyond critical infrastructure or the "essential functions" of the economy originally identified in the Green Paper as in need of protection by an expanded regime.

Fortunately, the government clearly took account of feedback that it received on the proposed sectors during the consultation. As a result, the revised sector definitions, which were set out in the government's formal response to the consultation of 2 March 2021,[17] have been cut back in material respects. Less helpfully, the government also confirmed on 2 March that it would not use mechanisms that are provided for in the NSI Bill to exclude certain types of acquirer or acquisition from the mandatory notification requirement. Part 2 of this article will examine these policy changes in more detail, as well as reviewing the parliamentary passage of the Bill.

Becket McGrath *is a partner at Euclid Law (https://euclid-law.eu/).*

Endnotes

1. There have been only 12 Enterprise Act public interest interventions based on national security concerns since the Enterprise Act entered into force in June 2003, out of a total of 20 cases.
2. *National Security and Infrastructure Investment Review – The Governments' review of the national security implications of foreign ownership or control* (The Green Paper) HM Government, London (2017).
3. Green Paper, at para 47.
4. Now implemented as Regulation 2019/452 *of the European Parliament and Council establishing a framework for the screening of foreign direct investments into the Union.*
5. *National Security and Investment – A consultation on proposed legislative reforms,* HM Government, London, July 2018.
6. Of the six national security cases since 2017, four arose during 2019. Of these four, two were abandoned and the other two were allowed to proceed only after the parties provided undertakings to address Government concerns.
7. NSI Bill, clause 8.
8. NSI Bill, clause 7.
9. NSI Bill, clause 14.
10. NSI Bill, clause 13.
11. NSI Bill, clause 16.
12. NSI Bill, clauses 39 to 41.
13. NSI Bill, clauses 19 and 20.
14. NSI Bill, clause 23.
15. NSI Bill, clause 26.
16. *National Security and Investment: Sectors in Scope of the Mandatory Regime – Consultation on secondary legislation to define the sectors subject to mandatory notification in the National Security and Investment Bill*, HM Government, London (2021).
17. See *National Security and Investment: Sectors in Scope of the Mandatory Regime – Government response to the consultation on mandatory notification in specific sectors under the National Security and Investment Bill,* HM Government, London (2021).