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UK Government Appears Ready to Bring Forward Legislative Proposals for More Rigorous FDI Screening

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Foreign Direct Investment

The UK has, in recent years, been one of the most attractive and open climates for foreign direct investment ("**FDI**"). Whilst the UK's net FDI inflows have fallen significantly since 2016, it remains, as of 2018, one of the highest ranked countries in the world by FDI inflows. [1]

However, the UK Government's power to scrutinise and intervene in FDI transactions relating to UK businesses with national security implications is more limited than many of its peer nations. In particular, the notification system is voluntary, and the scope for government intervention is limited to certain sectors and requires specific turnover thresholds to be met.

Efforts had been made towards reforming this regime in recent years, but these have effectively been on hold since 2018 while Brexit negotiations have taken precedence.

The perceived risk of foreign takeover of UK businesses with national security implications arising from the financial impacts of the ongoing COVID-19 pandemic, appears to have brought forward the UK Government's desire to implement legislative reforms in this area. Publication of draft legislation, or perhaps fresh proposals and consultation, concerning FDI and national security appears to be imminent based on a recent statement at Prime Minister's questions and on-going coverage in several media outlets.

Recent Updates on the UK's Proposed Legislative Reform

In December 2019, the UK Government set out its legislative agenda for the current Parliamentary session in the Queen's Speech. A somewhat overlooked inclusion was the proposed National Security and Investment Bill (the "**NSI Bill**").

[1] Foreign Direct Investment Statistics, House of Commons Library, 20 December 2019 (accessible at: https://commonslibrary.parliament.uk/research-briefings/cbp-8534/).

The NSI Bill builds on a previous White Paper and draft Statement of Policy Intent published by the UK Government in July 2018[2] in order to consult on proposed legislative reform to the UK Government's powers to prevent or mitigate national security risks arising from hostile actors' ownership of, or influence over, UK businesses.

The White Paper recognises the reality that, currently, the UK's powers to intervene in proposed transactions to prevent or mitigate these risks are more limited than in other countries. In particular the United States (though the Committee on Foreign Investment in the United States ("**CFIUS**")), and the other countries forming the "Five Eyes" intelligence partnership, already have much greater powers to screen FDI for national security reasons. More recently, across the European Union, Member States are revising their existing powers or implementing new laws to review foreign direct investment in anticipation of the EU FDI Regulation[3] coming into full effect in October 2020. Indeed, legislative initiatives related to FDI across the EU Member States have gathered notable pace during the COVID-19 crisis, as described in several of our recent alerts and blog posts. Taking Germany as one example, the Federal Ministry for Economic Affairs and Energy (or BMWi) has brought forward both measures in connection with the EU FDI Regulation and emergency legislation on FDI in recent months (which we commented upon in this post). The same concerns arising from the COVID-19 pandemic have also brought forward revisions to similar regimes in other countries, such as Australia, India, France and Spain.

In this wider context (and although the UK will not participate in the EU screening and cooperation mechanism under the EU FDI Regulation), the apparent plans of the UK Government are in line with developments in other jurisdictions. At Prime Minister's Questions on 21 May 2020, the UK Prime Minister, Boris Johnson, signalled his Government's intention to provide more information about the draft NSI Bill in the coming weeks.[4]

Although the timescale for publication of the draft NSI Bill (or perhaps further consultation concerning FDI) is not yet clear, it is very likely that this subject has been brought to the fore due to the ongoing COVID-19 pandemic and the fear of the greater ease with which hostile foreign investors might be able to acquire critical British businesses which may have been financially weakened by the pandemic.

What Can Be Expected in the Draft NSI Bill

The previous White Paper proposed a significantly more comprehensive regime of FDI screening for the UK.

[2] National security and investment: a consultation on proposed legislative reforms, July 2018 (accessible at: https://www.gov.uk/government/consultations/national-security-and-investment-proposed-reforms).
[3] Regulation (EU) 2019/452 of the European Union and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union
[4] Oral Answers to Questions, Hansard, Vol. 676, 20 May 2020 (accessible at: https://hansard.parliament.uk/commons/2020-05-20/debates/E6FA5427-887B-485C-AE0C-FED9599F75B0/OralAnswersToQuestions).

In very brief summary, the White Paper proposed allowing the UK Government to intervene in FDI transactions in any sector on national security grounds without reference to turnover, provided that there is a "UK nexus". Whether intervention is required would be based on an assessment of the national security risk, and the question of control of the target expressed by reference to both a voting or share percentage criteria, as well as a more vague "influence or control" test.

The national security risk criteria were themselves not well defined, with reference made to three risk categories: (1) target risk (i.e., whether control over the target could damage national security on its own), (2) trigger event risk (i.e., whether an entity could be used to damage national security), and (3) acquirer risk (i.e., the risk that the acquirer has malicious intent).

The draft NSI Bill has not yet been published, so there remains uncertainty as to how closely it will follow the White Paper. However, the UK Government's briefing paper, published with the Queen's Speech in December 2019,[5] provides some guidance as to what to expect:

- The overarching policy aim appears to remain the same as set out in the White Paper. The briefing statement confirms that the NSI Bill is intended to strengthen the UK Government's powers "*to scrutinise investments and consider the risks that can arise from hostile parties acquiring ownership of, or control over, businesses or other entities and assets that have national security implications*."
- The briefing paper suggests, in particular, that some approaches set out in the White Paper, such as the use of broad definitions of "assets" and "entities" that might be caught by the new regime, are likely to be adopted. This is reflected in a statement in the briefing paper noting that the NSI Bill is intended to ensure that "*hostile parties cannot circumvent the law by acquiring an asset that has national security implications, such as intellectual property, rather than acquiring the business itself*."
- Other summary aspects of the proposed regime set out in the briefing paper include (1) creating a notification system with the onus on businesses to report potential security concerns to the UK Government for "*quick, efficient*" screening, (2) providing the UK Government with powers to add conditions to transactions or, as a last resort, to block transactions, with a range of available sanctions for non-compliance, and (3) creating an appeal mechanism to act as a safeguard for businesses and investors.

The exact details of the new regime are therefore still unknown. The devil will be in these details, but even after the publication of the NSI Bill the effectiveness of the new regime in striking the right balance between protection of the UK's national security, and continuing to foster an open and attractive investment climate will likely remain to be seen until it is implemented in practice.

[5] Queen's Speech and Briefing Papers, 19 December 2019 (accessible at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853886/Queen_s_Speech_December_2019_-_background_briefing_notes.pdf#page=104).

Conclusions

The role of FDI in the UK's economy is already significant. The advent of the end of the Brexit transition period (currently due to conclude on 31 December 2020) is likely to place an even greater focus on ensuring that the UK remains open and attractive to foreign investment.

The COVID-19 pandemic appears to have accelerated the UK Government's desire to put in place a revised legislative regime to guard against the risk of businesses critical to national security being taken over by potentially hostile foreign actors.

The NSI Bill may well be a landmark change in the UK's regime for the review of FDI, and we continue to watch developments in this area with keen interest.

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