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UK FDI: National Security and Investment Bill is Published

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Foreign Direct Investment Regulation

Major Development in UK Foreign Investment Law and Policy

The UK government has published long-awaited draft legislation that, if made law, will introduce significant new powers to scrutinise Foreign Direct Investment ("**FDI**"). The National Security & Investment Bill (the "**NSI Bill**" or the "**Bill**"), is proposed to introduce mandatory filing obligations and pre-clearance requirements for all transactions in the most sensitive sectors, irrespective of transaction value and without the application of any other de-minimis thresholds.

The Bill proposes to allow Government broader powers of oversight of transactions that have the potential to threaten national security, including certain extra-territorial deals and transactions that transfer rights and interests in assets. However, the Government is not seeking powers to intervene in transactions for broader economic reasons. Reflecting the concern that the UK should both tighten its powers to scrutinise foreign investment and remain an open economy and a welcoming place to do business, a new Office for Investment has also been announced this week and tasked with stimulating investment opportunities in infrastructure, clean technology and, more generally, the research and development sector. As Brexit approaches, the NSI regime will form an important element of the UK's soon-to-be independent regulatory framework.

The proposed changes to the UK FDI regime reflect a global tightening of FDI investment screening that has been advancing for a number of years and which has accelerated since the onset of the Coronavirus pandemic. Investments that have broader European elements may also face scrutiny under similar new and enhanced FDI laws in many Member States. The European Union Foreign Direct Investment Regulation was passed into law in March 2019 and came into full force and effect on October 11, 2020. The Regulation creates a framework of minimum standards for FDI laws in Member States (many of which have been strengthened already or are under-going legislative review procedures) and also introduces certain information-sharing and cooperation measures in respect of FDI among Member States.

Mandatory and Voluntary Filing

The NSI Bill envisages a new, comprehensive and standalone regime for Government scrutiny of investments for the purpose of protecting the UK and UK businesses from threats to national security.

The UK Government has proposed that investments into seventeen sectors will be subject to mandatory notification under the new FDI regime:

1. civil nuclear
2. communications

3. data infrastructure
4. defence
5. energy
6. transport
7. artificial intelligence
8. autonomous robotics
9. computing hardware
10. cryptographic authentication
11. advanced materials
12. quantum technology
13. engineering biology
14. military and dual-use technology
15. satellite and space technology

as well as investments concerning critical suppliers to (16) the Government and (17) the emergency services.

A consultation has begun to consider the precise parts of these sectors that will be subject to mandatory filing requirements, which is open for comments until January 6, 2021. The Government has also already indicated that transactions concerning consumer technology are expected to be out of scope.

Across the seventeen sectors, an acquisition of an interest in a qualifying entity (including a company, partnership, unincorporated entity or trust) will be subject to mandatory notification in circumstances where an investor acquires:

1. control in an entity, meaning the acquisition of more than 25%, 50% or 75% of shares or voting rights in an entity, or can stop or pass any form of resolution in an entity;
2. 15% or greater interest in shares or voting rights in an entity;
3. material influence over an entity.

Where mandatory filing requirements do not apply, a system of voluntary notification is proposed to be available. Voluntary notification is likely to be attractive to parties that are unsure whether a planned transaction is in scope of mandatory filing requirements and also those investors who wish to have certainty that a reserve call-in power will not be exercised.

Similar to the German FDI regime, the new UK FDI regime will not be limited to the sensitive sectors overall and the Government will have power to “call-in” investments in any sector that could give rise to national security concerns. This reserve “call-in” power will be available for a maximum five-year period following the date of an investment, subject to the Secretary of State acting within 6 months of becoming aware of the transaction (e.g. from a newspaper report). The Secretary of State is to make regulations setting out how the call-in notice powers will be used in order to give guidance to parties whose transactions fall outside the mandatory regime.

The new regime will have extraterritorial effect -- it will apply to acquisitions of any entity incorporated in the UK, or which is active in the UK, or supplies goods or services in the UK. Acquisition of control of assets which are located outside the UK may still fall within the scope of the regime to the extent that the asset is used in connection with activities carried on in the UK, or used to supply goods or services within the UK.

The NSI regime will be separate from both the UK merger regime and the public interest intervention process which currently apply under the Enterprise Act 2002. Once the NSI Bill is in

force these pre-existing laws will only apply to competition, media plurality, financial stability and public health emergency considerations; national security considerations will be addressed entirely under the new legal framework.

Approach to Intervention

The Government has indicated that prohibition of transactions will continue to be a power of last resort and that the vast majority of deals will receive clearance, and quickly (see below). Where conditions are imposed on an investment, the Government is seeking powers to, among other things, limit the number of shares investors can acquire, restrict assess for investors to commercial information and control access by investors to operational sites.

Investors might also expect other deal mitigation measures currently used -- whether competition or public interest-related -- to remain available. For example, deals that raise competition concerns may be conditionally approved subject to divestment or behavioural remedies acceptable to the Competition and Markets Authority; in past transactions subject to "public interest" intervention under the Enterprise Act 2002, deal conditions have included undertakings in relation to governance and nationality of directors and other key personnel, the maintenance of UK headquarters or jobs, or requiring partial divestments or other structural separation measures.

The Government will also be able to request funds from the Treasury to provide financial assistance to targets in consequence of making a final order prohibiting or conditioning a transaction. The Bill suggests that such assistance could include loans, guarantees or indemnities, as well as other financial assistance -- which appears to open up the possibility of the Government acquiring shares or other interests in a target entity. If such financial assistance exceeds £100 million in an annual period a prompt report to Parliament will be required to be made but the Secretary of State would be unconstrained (other than by Treasury) in making further assistance payments.

Once a transaction has been cleared, the Government will not be able reopen its assessment or impose new measures on the parties unless false or inaccurate information was provided during the original notification. However, by comparison, in relation to transactions that are made subject to conditions or other remedies or mitigation, an active duty is proposed for the Government to keep the terms of the order under review and with power to vary or revoke the order. This appears to be a unilateral power and the procedural and substantive considerations of such a review are unclear.

Timing, Administration and Enforcement

A new Investment and Security Group (the "**ISG**") within the Department for Business, Energy & Industrial Strategy will act as the recipient of notifications under the FDI law. The ISG will carry out the activities of coordinating the input from across Government necessary to identify and assess the national security risks associated with a transaction, and we would expect this to involve a close working relationship with the National Security Adviser and other departments such as Defence and Digital, Culture, Media and Sport.

The ISG will be required to act promptly and will have an initial period of 30 working days to complete a phase one review of transactions, whether notified on a mandatory or voluntary basis. Where the Government decides to issue a call-in notice, it will then have 30 working days to carry out a national security assessment (i.e. a phase two assessment), which may be extended by the Secretary of State up to a further 45 working days (and potentially further on agreement).

The decision-maker in all cases will be the Secretary of State, rather than the ISG. The Secretary of State will have extensive information gathering powers -- including the ability to require witnesses to attend and give evidence -- in support of this decision-making function.

The NSI Bill will introduce a comprehensive penalty framework to address any failure to comply with the new regime. In particular, transactions requiring mandatory notification will be legally void if completed without clearance. Added to this, both criminal and civil sanctions will apply to non-compliance with the mandatory aspects of regime, including:

a. financial penalties in the greater amount of (i) up to 5% of the global turnover of the business in question and (ii) £10 million,
b. corporate criminal penalties, and
c. imprisonment of up to five years for specified directors and officers.

Anticipated Impact on UK Investments

Notwithstanding the ambition of the UK to remain open to foreign investment, the proposed new FDI regime will create new strategic considerations and regulatory hurdles for investors into the UK. Mandatory filing for investments in the most sensitive sectors will add obvious delay and cost to transactions that are within the scope of such notification and clearance requirements. For many other transactions in the wider economy, the question of voluntary filing will need to be addressed and will involve more nuanced considerations.

A new UK FDI regime must also work alongside and will have potential impacts on the approach taken in UK competition law filings, which remain an entirely voluntary regime. There will be fresh balancing of considerations in relation to transactions that fall under both FDI and merger control regimes. And, in transactions concerning listed companies, the new FDI regime may need to be navigated alongside the Takeover Code -- with a separate consultation also currently on-going with a view to simplifying the takeover offer timetable.

At the same time, the publication of the NSI Bill is an important step for the UK and there is much to be welcomed in both the clarity it brings to UK powers to review FDI and the creation of the ISG which will be dedicated to FDI review activities. Transaction risks are certainly increased for those that do not comply, but other investors will find a notification regime easier to navigate than the pre-existing intervention regime, as well as more familiar and comparable to other FDI regimes proliferating worldwide.

The Bill stands apart from peer systems (in Europe at least) in terms of the proposed extra-territorial effect and the power for the Secretary of State to unilaterally review any final order. We would expect these aspects of the NSI Bill (and potentially others) to come under some scrutiny as the Bill progresses through Parliament to become law and to be among the most challenging elements of an NSI Act in practice if implemented.

Next Steps

The legislative process for the NSI Bill has begun following a first reading in the UK Parliament on November 11, 2020. In the ordinary course, there will now follow a number of weeks during which the NSI Bill will be reviewed, considered and potentially amended via committee procedures and votes in both Houses of Parliament. As mentioned, the Government has also announced plans to consult on some key aspects of the Bill. Subject to parliamentary timing, we expect the final NSI Act to become law in the first half of 2021.

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