UK INTRODUCES NATIONAL SECURITY AND INVESTMENT BILL TO PARLIAMENT TO INCREASE THE GOVERNMENT'S POWERS TO REVIEW TRANSACTIONS

The National Security and Investment Bill 2019-21 (the Bill) has been introduced to the UK Parliament and given its third reading in the House of Commons and second reading in the House of Lords.

It proposes comprehensive and sweeping new powers for the Government to scrutinise investment which may give rise to concerns for national security. When an investor acquires 15% or more of the voting rights or shares in a company active in one of 17 specified sectors (including transport, energy and defence) they will have to submit a filing to the newly created Investment Security Unit (part of the Department for Business, Energy & Industrial Strategy). An investor will also have to submit a filing when they pass through the 25%, 50% and 75% shareholding thresholds.

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It will not be possible to complete the transaction or investment until clearance has been obtained. The Government also encourages voluntary filings in other cases where national security concerns may arise.

Background

The UK currently uses the Enterprise Act 2002 to examine mergers for the purposes of national security and other areas of public concern. This allows the Government to intervene in foreign and domestic acquisitions on certain public interest considerations, but only where a proposed transaction meets the relevant thresholds for review (subject to limited exceptions).

In October 2017, the Government published a ‘Green Paper’ consultation on national security and foreign investment. The Green Paper highlighted that the UK’s powers were both limited in places and inconsistent, leading to a number of short-term reforms to the Enterprise Act 2002 lowering the thresholds for intervention in specific areas deemed to be of strategic importance. The Green Paper also sought views about long-term reforms, and on 24 July 2018 the Government published a White Paper which set out far-reaching proposals for new powers. These would enable the Government to scrutinise investments and address the potential risks arising from hostile parties acquiring ownership of, or control over, entities and assets that have national security implications. The White Paper contemplated a voluntary notification system under which businesses would be encouraged to notify in advance any transactions which could give rise to national security issues. Where transactions were not notified, the Government would have the ability to intervene by ‘’calling-in’’ a transaction for review.

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The Bill

The Bill confirms many key elements contained in the White Paper, but is more far reaching in many respects, including introducing a new mandatory notification regime for transactions in 17 specified sectors, as well as encouraging companies and investors not required to notify to do so. The key features of the proposed national security screening regime are summarised below.

Trigger Events

Under the Bill the Secretary of State may intervene in an acquisition where it suspects that a ‘trigger event’ has taken place, or is in progress or contemplation. Trigger events include:

- The acquisition of votes or shares that gives the buyer more than 25%; 50% or 75% of the votes or shares in a qualifying entity;
- The acquisition of voting rights that enable or prevent the passage of any class of resolution governing the affairs of the qualifying entity;
- The acquisition of material influence over a qualifying entity’s policy; and
- The acquisition of a right or interest in, or in relation to, a qualifying asset (e.g. land, other physical property or intellectual property) providing the ability to use the asset or to control or direct how it is used.

A qualifying entity is defined widely in the Bill as any entity, whether or not a legal person, that is not an individual and includes a company, a limited liability partnership, any other body corporate, a partnership, an unincorporated association and a trust. An entity which is formed or recognised under the law of a country outside the UK can also be a qualifying entity if it carries out activities in the UK or supplies goods or services to persons in the UK. For an asset situated outside the UK or intellectual property, the asset must be used in connection with activities taking place in the UK or the supply of goods or services to persons in the UK.

Hybrid Regime

Mandatory notification

A mandatory notification system will be introduced where the above trigger events (other than the acquisition of a right or interest in, or in relation to, a qualifying asset) occur in 17 specified high-risk sectors. In addition, a mandatory notification will be required where there is an acquisition of 15% or more of votes or shares if the transaction relates to one of the 17 specified sectors. The Government is consulting on proposed draft definitions to set out the particularly sensitive parts of the economy in which mandatory notification will be required. These cover the following sectors: advanced materials; advanced robotics; artificial intelligence; civil nuclear; communications; computing hardware; critical suppliers to the 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 (maritime, aviation and air traffic control). By way of example, the Government's proposed definitions of energy, transport and defence appear in the Annex below.

Voluntary notification

A voluntary notification system and a ''call-in'' power will be introduced for all other acquisitions. The Bill empowers the Secretary of State to ''call-in'' transactions when it reasonably suspects that a trigger event has occurred or is in the parties' contemplation or that a trigger event has given rise or may give rise to a national security event. Due to the broad definition of ''qualifying entity'', a wide variety and potentially a large number of transactions which give rise to national security considerations can be called in for assessment based on the above trigger events. Importantly, the Bill will legislate for a five-year retrospective period for intervention for trigger events that are not subject to mandatory notification, allowing for a post-completion review of non-notified transactions. This five-year period is reduced to six months once the Secretary of State has become aware of the trigger event, for example from publicity in a national newspaper or an email to the Government.

The Secretary of State expects to intervene very rarely in asset transactions. However where assets are integral to a "core area" entity's activities or, in the case of land, the asset is in a sensitive location, their acquisition is more likely to be called in than other asset acquisitions.

After the Bill has been enacted, any transactions that have completed since November 12 2020, until the commencement date of the legislation, will be able to be called in by the Government for review up to six months after the commencement date of the legislation.

Screening and Assessment

The same screening period will apply to all notifications, regardless of whether they are submitted voluntarily or mandatorily. Following receipt and acceptance of a notification, the Secretary of State must decide within 30 working days whether to call in a transaction which gives rise to national security considerations. The vast majority of transactions will be cleared within this initial 30 working day period, which will commence on the date that the Secretary of State informs the notifying party that the notification has been accepted.

However, a small minority of transactions will be referred for a more detailed review during an assessment period of 30 working days, beginning on the day a formal call-in notice is given to the affected parties following initial screening of the notification. This may be extended by 45 working days if the assessment period is not sufficient to fully assess the risks involved in the transaction. The Secretary of State will also be able to agree a voluntary period for further scrutiny if certain conditions are met. At the end of the assessment period, the Secretary of State must either give a final notice clearing the transaction, with or without remedies to prevent or mitigate any risk to national security, or prohibit or unwind the transaction. The Secretary of State may also make interim orders during the review process, for example prohibiting the parties from taking steps to complete the transaction until the review period has been completed.

Sanctions

Sanctions for non-compliance with the new regime will be severe, consisting of fines of up to five per cent of global turnover or £10 million (whichever is higher), director disqualification and up to five years imprisonment. Transactions covered by the mandatory notification requirement which proceed without obtaining clearance will be legally void.

Likely Implications

Investor Uncertainty

The Government has attempted to present the proposals contained in the Bill as giving investors a clear and predictable process, so that they can continue their business in the UK with confidence. It has also launched an Office for Investment in a bid to attract foreign investment to the UK. However, the scope of the 17 sensitive sectors to which the mandatory notification regime applies is broad, covering a considerable amount of the UK economy. Indeed, it is forecast in the Government's Impact Assessment that the new regime will result in 1,000-1,830 transactions being notified per year, although this could be an underestimate. Parties may out of caution wish to make fail safe notifications in view of the heavy penalties for infringement or gun-jumping, if there is doubt over whether a transaction is caught by the notification requirement. Given that only 13 transactions have been reviewed on national security grounds since the Enterprise Act 2002 was introduced, this number indicates the heightened scope of review. Similarly, the fact that transactions which could have escaped scrutiny under the old regime, such as those involving an acquisition of intellectual property, are reviewable under the Bill shows the increased remit. Given the retrospective nature of the Bill, it is important that investors take immediate action to identify any potential national security concerns involved in their transactions. The Government estimates that around ten transactions per year which give rise to national security concerns will require remedies.

Political Oversight over Foreign Investment

The Bill removes national security reviews from the remit of the Competition and Markets Authority (CMA), bringing in a dedicated Government unit (the Investment Security Unit) to identify, assess and respond to national security risks. At consultation stage, concerns were raised that the new regime disproportionately expands the Government's powers to intervene in the market. The Government has argued that the Bill contains sufficient safeguards on its powers including the requirement for the Secretary of State to have ''reasonable'' suspicion that a national security risk may arise before taking action, and the opportunity for interested parties to apply for judicial review of decisions taken by the Secretary of State. Despite these reassurances, only time will tell how the regime operates in practice, particularly given the imprecise nature of the term ''national security.'' Whilst solely UK-based transactions will also fall within the scope of the Bill, the 2018 White Paper highlighted that the majority of national security risks are posed from foreign investment into the UK. Therefore, the Bill will undoubtedly result in significantly higher political oversight of foreign investment.

It is envisaged that reviews under the national security regime and the CMA competition regime will run in parallel to avoid any delay to the CMA's competition assessment. The intention is, so far as possible, that any national security remedies will be aligned with competition remedies and that timetables will be aligned within the statutory framework to achieve this. In the event of a conflict the national security review may take precedence over the merger control assessment.

Types of conditions which the Government may impose on transactions on national security grounds include access to sensitive sites, access to confidential information, transfer of intellectual property, compliance, monitoring and personnel, including insistence that there are certain UK directors on the board of the corporate entity. The Government may ultimately block a trigger event or require it to be unwound. Unwinding will be an option of last resort, where all possible options for divestment have been explored or exhausted.

The Increasingly Strategic Role of Investment Screening

At the consultation stage, the Government was keen to emphasise that the UK thrives as a result of foreign investment, pointing out that since 2010/11, over 600,000 new jobs have been created thanks to over 16,000 Foreign Direct Investment projects. However, in the Bill's accompanying notes the Government emphasised the UK's vulnerability to actions from ''hostile states.'' There can be no doubt that, whilst the Bill did not mention any specific countries by name, perceived concerns over investment from China were a driver of the new regime. This was reflected in the Government's recent decision to reverse previous plans to allow Chinese telecoms equipment maker Huawei to supply appliances for Britain's 5G mobile phone networks.

However, the Secretary of State will consider the entity's affiliations to hostile parties or countries rather than the existence of a relationship with foreign states in principle or their nationality.

The UK is not alone in its fears over takeovers by hostile parties. The US also has a similar stringent screening system, and the EU has introduced a coordination framework for the screening of foreign investment between its member states. Australia, Japan, New Zealand and Canada have also introduced new national security controls. Therefore, the strategic role of investment screening is not limited to the UK, but is an increasingly geo-political trend. With regard to UK plc the message is clear – UK plc is open for business, just not all business. The decision on where that line is drawn looks likely to be a political one.

What Happens Next?

The Bill started in the House of Commons. The Committee stage in the House of Lords (line by line examination of the Bill) is scheduled to begin on 2 March 2021. Amendments to the Bill may be made as it continues to pass through the Parliamentary process.

ANNEX

EXTRACTS FROM GOVERNMENT CONSULTATION PAPER, NATIONAL SECURITY AND INVESTMENT: SECTORS IN SCOPE OF THE MANDATORY REGIME, NOVEMBER 2020

Proposed definition of Energy:

1. An entity involved in the ownership and operation of:
    a. terminals, upstream petroleum pipelines and infrastructure which forms part of a petroleum production project, with a throughput of greater than 3,000,000 tonnes of oil equivalent per year;
    b. infrastructure (such as import jetties) which forms part of a gas importation and storage project which, if at maximum capacity, could output 20 million cubic meters of gas per day for at least 50 days, where: "gas" has the same meaning as in section 2 of the Energy Act 2008; "gas importation and storage project" means a project carried out by virtue of a licence granted under section 4 of the Energy Act 2008; "petroleum", "petroleum production project", "terminal", and "upstream petroleum pipeline" have the same meaning as in section 90 of the Energy Act 2011 and "tonne of oil equivalent" is a unit of energy defined as the amount of energy released by burning one tonne of crude oil.
    c. Energy distribution and transmission networks that deliver secure, reliable electricity and gas to customers, ensuring continued supply as far as possible in the supply chain;
    d. Energy suppliers that provide energy to significant customer bases, where "significant customer bases" means 250,000 or more final customers;
    e. Gas and electricity interconnectors, long range gas storage and Gas Reception Terminals, including Liquefied Natural Gas that contributes to the security of supply;
    f. Electricity undertakings that:
        i. carry out the function of supply; or
        ii. carry out the function of generation via individual generators that would have a total capacity, in terms of input to a transmission system, greater than or equal to 100 megawatts; or
        iii. carry out the function of generation via generators that, when cumulated with the generators of affiliated undertakings, would have a total capacity, in terms of input to a transmission system, greater than or equal to two gigawatts.
    g. The supply of petroleum-based road, aviation or heating fuels (including liquefied petroleum gas) to the UK market, by companies who provide or handle more than 500,000 Tonnes per annum, and, a downstream facility owner if the owned facility has capacity in excess of 20,000 tonnes, through at least one of the following activities:
        i. the import of any of crude oil, intermediates, components and finished fuels;
        ii. the storage of any of crude oil, intermediates, components and finished fuels;
        iii. the production of intermediates, components and finished fuels through a range of refining or blending processes;
        iv. the distribution of petroleum-based fuels to other storage sites throughout the UK by road, pipeline, rail or ship;
        v. the delivery of petroleum-based fuels to retail sites, airports or end users

Rationale

Energy underpins every aspect of modern life and a secure and reliable energy supply is vital to enable a thriving country.

We are keen that we are able to ensure a safe, secure and reliable supply of energy.

The energy sector covers many industries and, such is its importance, we are keen to include investment in the following sub-sectors in the mandatory regime:

- The UK's gas and electricity networks, supplying gas and electricity to homes across the UK.
- The oil sector, from extraction to refinement and distribution.
- Power generation including renewables.
- New technologies such as battery storage The increasing digitalisation and globalisation of the energy system means we must be extra vigilant in identifying investment in novel energy technologies. While the definitions focus on established technologies, these will be continuously reviewed and updated to ensure they reflect the rapid development taking place within the sector as the UK strives to meet its net zero target.

Proposed definition of Transport

1. An entity which owns or operates a maritime port or harbour which handles at least 1 million tonnes of cargo annually in the most recent relevant year for which the Annual Port Freight Statistics records are published by the Department for Transport, Category 1 goods as listed in paragraph (2.d) or vessels capable of carrying at least 12 passengers. Within such maritime ports or harbours, a company which owns and operates terminals, wharves or other port related infrastructure except where that company does not handle Category 1 goods.
2. In paragraph 1:
    a. "entity" may include a private company, a Board governing a Trust port or a port owned by a local authority.
    b. "operates" means to control the functioning of a machine, process or system.

"The transport sector is essential to keeping the country moving, and many essential services rely on it to function, especially through freight and ensuring people can get to work."

c. "harbour" includes estuaries, navigable rivers, piers, jetties and other works in or at which ships can obtain shelter or ship and unship goods or passengers, in accordance with s313 of the Merchant Shipping Act 1995.

d. "Category 1 goods" are:

   i. Human Medicines, covering Prescription-only, Pharmacy and General Sales List Medicines, clinical trials and children's vitamins (for import and export)

   ii. Medical Devices and Clinical Consumables (for import and export)

   iii. Vaccines (for import only)

   iv. Nutritional Specialist Feeds, including Infant Milk Formula (for import only)

   v. Biological materials such as blood, organs, tissues and cells (for import only)

   vi. All Veterinary Medicines authorised under the Veterinary Medicines Regulation 2013, including finished and un-finished products, and Active Pharmaceutical Ingredients (for import and export)

   vii. It also includes unauthorised medicines permitted for import under the Veterinary Medicines Directorate's Special Import Scheme (for import only).

   viii. Critical food chain dependencies, e.g. chemicals and key additives used within the food supply chain (for import only as required).

   ix. Chemicals for water purification and treatment (for import only as required).

   x. Critical spare parts for the energy sector (for import only as required).

   xi. Items required for Military or National Security purposes (for import or export as required).

3. An entity which owns or operates an airport in the United Kingdom which handled at least six million passenger movements or 100,000 tonnes of freight annually in the most recent relevant year for which records are published by the Civil Aviation Authority.

4. An entity which provides en route air traffic control services or which owns such a provider.

5. In paragraph (3):

   a. "airport" has the meaning set out in section 66 of the Civil Aviation Act 2012;

   b. "freight" means goods transported in bulk in passenger aircraft or aircraft used for the transportation of cargo only;

   c. the owners of an airport are:

      i. a company which owns the airport ("C");

      ii. any holding company of C ("H"); and

      iii. any parent company of C or H;

   d. the "operator" of an airport is the entity with overall responsibility for its management;

   e. "relevant year" means 2018 or such later year as may be specified in regulations made by the Secretary of State.

6. In paragraph (4):

   a. "en route air traffic control services" mean services provided pursuant to a licence under section 6 of the Transport Act 2000; .

   b. the owners of an en route air services traffic provider are:

i. a company which owns such a provider ("C");

ii. any holding company of C ("H");

iii. any parent company of C or H.

Rationale

The transport sector is essential to keeping the country moving, and many essential services rely on it to function, especially through freight and ensuring people can get to work.

Only certain entities in the transport sector are sensitive enough to be subject to mandatory notification, and so we do not seek to include all transport related entities. Instead, this focuses on areas which both have the highest potential to give rise to national security risks from certain types of investment, and do not currently have sufficient alternative controls in place. It covers key transport infrastructure in the maritime, aviation and air traffic control sectors.

The definition will capture entities which own or operate assets in three areas:

- **Maritime:** major ports or harbours are those that handle at least one million tonnes of cargo annually in the most recent relevant year for which the Annual Port Freight Statistics records are published by the Department for Transport, Category 1 goods as listed in schedule 1 or vessels capable of carrying at least 12 passengers. Within such maritime ports or harbours, this includes a company which owns and operates terminals, wharves or other port related infrastructure except where that company does not handle Category 1 goods. The definition incorporates all fifty-one 'major ports'.
- **Aviation:** this captures those airports with significant annual throughput in passengers (six million annually) or freight (100,000 tonnes annually) according to CAA published figures. Initially the definition will work by reference to the published figures for 2018 because of reduced demand due to the Covid pandemic in 2020, but there will be power for the Secretary of State to make regulations to change this to a later year once demand recovers. This bolsters regulation already in place by the Civil Aviation Authority and overseen by DfT. It does not capture those companies that undertake specific operational roles at airports such as aircraft ground handling, maintenance or provision of other passenger services such as catering or retail.
- **Air traffic control:** this is a regulated area but the importance of a secure air traffic system inclusion allows for a greater level of assurance and scrutiny.

Rationale

There are a number of potential risks from nefarious investment, including an enhanced ability to undertake espionage within the sector, targeting intellectual property, identifying vulnerabilities in our systems, and accessing other sensitive information, which could harm the safety and effectiveness of the transport system.

There are risks around an ability to undertake disruptive or destructive actions which could harm security, such as the denial or degrading of key services or supply lines which could compromise our critical national infrastructure. This could endanger lives through creating problems in the movements of critical goods or compromising passenger safety and undermine public trust in a safe transport network.

The transport sector definition broadly seeks to avoid duplication in areas where Government notification is already a requirement or unavoidable – although in some cases, however, the

Bill's provisions will supplement what exists in the current regulatory regime, recognising the value of increased intervention powers in limited areas.

Rail infrastructure operators are not included in the definition as they are either publicly owned (e.g. Network Rail) or other notification processes already exist (e.g. Channel Tunnel Fixed Link). Similarly, the definition does not include roads, which are maintained through local councils or Highways England, or rail franchises, which are established through DfT and use equipment leased and maintained by Network Rail.

Emerging technology within the transport sector, such as AI or autonomous vehicles, is captured under other sector definitions and so is not included here.

Proposed definition of Defence

1. An entity that is involved in the research, development, design, production, creation or application of goods or services which are used or provided for defence or national security purposes where that entity meets the conditions in paragraph (2).
2. The conditions mentioned in this subsection are that the entity:
   a. is a government contractor or any sub-contractor in a chain of sub-contractors which begins with the government contractor who provides goods or services; or
   b. has been notified by or on behalf of the Secretary of State of information, documents or other articles of a classified nature which the entity or an employee of his may hold or receive relating to the activities within the scope of subsection 1.
3. "Defence" has the same meaning as in section 2(4) of the Official Secrets Act
4. "Government contractor" has the same meaning as in the Act of 1989

Rationale

A robust defence sector is vital to our national security. It is essential for the development of innovative and first-class military capabilities that enable us to protect our people, territories, values and interests at home and overseas. The defence sector provides advanced capabilities for our Armed Forces and those of our allies.

The importance of companies with a direct contractual or sub-contractual relationship with defence is clear. These companies hold information and capability that is critical to the defence of the United Kingdom. It is therefore imperative that the Defence supply chain is protected from threats, including hostile investment,

which may provide adversaries with access to sensitive information or capabilities.

This definition focuses on UK defence and the defence supply chain and is designed to include companies at all tiers, including sub-contractors and those in the chain of sub-contractors, where the goods or service that they research, develop, design, produce, create or apply are provided or used for defence or national security purposes. The mandatory notification requirement applies to entities providing goods or service for defence or national security purposes where they satisfy either one of the two conditions.

The first condition in the definition is that the entity is a government contractor or any sub-contractor in a chain of sub-contractors which begins with the government contractor. The government expects that most suppliers who are providing goods and services for defence and national security purposes will be aware of the nature of their contractual arrangements. The Ministry of Defence has a standing contractual requirement for providers to notify the Ministry of Defence of a change of control of the Contractor, including any Sub-contractors. It is expected that the mandatory notification requirement will reinforce this standing requirement and the entities with a statutory obligation to notify will be clearly identifiable by virtue of their contractual arrangements.

The second condition is that the entity has been notified by HMG that they hold, or may come into possession of, classified material. HMG has an established Security Policy Framework and entities who are subject to that framework are notified that they are involved in the handling of classified material. This notification is issued in a number of ways, depending on the nature of the activity concerned, but most commonly through the issuing of a Security Aspects Letter or the designation of a facility as a List X.

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