

UK Government Provides Greater Clarity on New National Security Screening Rules

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On 2 March 2021, the UK government published its response to a consultation on the sectors of the economy which are to be subject to mandatory notification under the new inward investment regime to be introduced by the National Security and Investment Bill (the Bill), which is currently before Parliament.¹

The Bill introduces a new regime empowering the government to scrutinise and intervene in transactions on the grounds of national security. In particular, the Bill provides for a mandatory notification and preapproval requirement for certain sectors of the economy to which national security concerns are considered most likely to be relevant. These sectors are:

- 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
- Synthetic Biology
- Transport

Following publication of the Bill and related materials on 11 November 2020, a number of concerns were raised about the proposed regime and the new burdens it would likely impose on businesses and investors. Many of these concerns related to the potential breadth and lack of specificity in the way the sectors subject to mandatory notification were defined. The potential consequences of completing a transaction within the mandatory regime without having obtained the approval of the Secretary of State for the Department of Business, Energy and Industrial Strategy (BEIS) — including the voiding of the transaction and the risk of incurring substantial criminal and civil penalties — raised the likelihood of a large number of deals being notified where there was no real threat to national security in order to avoid any risk of unintended noncompliance.

¹ See our 11 November 2020 client alert "[UK Government Introduces New Regime for Screening Foreign Direct Investment.](#)"

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The government's consultation exercise on the sectors subject to mandatory notification concluded on 6 January 2021, and the recently published response sets out the government's conclusions following that exercise.

Based on its response, the government appears to have taken on board many of the concerns about its original proposals. Substantial changes have been made to the definitions of all 17 sectors, making them narrower and more targeted to areas likely to pose a national security risk. This should make it easier for market participants to navigate the new regime and reduce the number of protective notifications made due to uncertainty as to whether or not a transaction is in scope of a mandatory sector.

An example of the improvements made is the change to the definition of the Artificial Intelligence sector. In the original proposal, a business would have been in the scope of this sector if it was:

"An entity carrying on activities in the United Kingdom which include developing or producing goods, software or information that use artificial intelligence to perform a complex task."

This definition would have applied to a wide range of businesses, many of which would be unlikely to pose any real risk to national security. Under the new proposed definition, a business will fall within the Artificial Intelligence sector if it is:

1. *"A qualifying entity carrying on activities for the purposes set out in paragraph (2), which include:*
 - a. *research into artificial intelligence; or*
 - b. *developing or producing goods, software or technology that use artificial intelligence.*
2. *The purposes are:*
 - a. *the identification or tracking of objects, people or events;*
 - b. *advanced robotics;*
 - c. *cyber security."*

In addition, the definition of what constitutes "artificial intelligence" has been considerably tightened and made much more specific. Thus, the new definition is clearer and focuses narrowly on areas which are perceived to involve a higher potential risk to national security.

Other notable changes to the sector definitions include:

- the wholesale rewriting of the Advanced Materials sector definition;

- the sector previously named Engineering Biology has been renamed Synthetic Biology and the definition has been comprehensively revised, including by the introduction of a wide range of exclusions, such as "the production of substances ordinarily consumed as food";
- the substantial rewriting of the Public Communications sector definition, for example by adding a range of volume-based criteria that must be met for certain infrastructure providers to be caught, and the inclusion of a minimum turnover threshold of £50 million;
- much greater specificity in the sector relating to Critical Suppliers to the Emergency Services as to which goods and services are "critical" and what is meant by the "operational delivery" of an emergency service; and
- clarification that landowners and leaseholders who own a site on which data infrastructure is located but whose business activities do not yield access to such infrastructure are not within scope.

The sector definitions set out in the government's response remain in draft form so that proposals made during the parliamentary procedure can be taken into account. Final definitions will be set out in subordinated legislation under powers provided for in the Bill. In addition, it should be remembered that under the new regime, the Secretary of State will be able to call in for a national security assessment transactions across the whole of the economy outside these 17 mandatory sectors, whether or not they have been notified to the government.

When it published its response to the consultation on the mandatory sectors, the government also announced that it aims to implement the new National Security and Investment regime by the end of 2021 — somewhat later than had previously been anticipated. The timing is subject to further parliamentary scrutiny and debate on the statutory instruments provided for in the Bill. There is some uncertainty as to how transactions which are not addressed by Clause 62 of the Bill (for example, where the Secretary of State has not intervened under the Enterprise Act 2002), and which have not completed by the time the new regime comes into force, will be dealt with. In addition, the degree to which parties to transactions can rely on informal guidance provided to them by the Investment Security Unit of BEIS in the period prior to the Bill's enactment is unclear. Advisers are monitoring whether the government addresses these areas as it provides further guidance on the transitional arrangements for the implementation of the Bill.

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The government also announced that the powers provided for in Clause 6 of the Bill, to make regulations to exempt acquirers with certain characteristics from the mandatory notification regime, would not be exercised at the start of the new regime. This will come as a disappointment to those who had hoped that the government would provide safe harbours from the regime at the outset for certain categories of acquirers, such as those with an established track record of investing in the UK without raising any national security concerns and institutional investors under the control of friendly foreign governments.

Once it comes into force, the new regime will represent a significant departure from the UK's previous practice with respect to screening inward investment. The government's willingness to listen to the concerns of market participants in the consultation process and to make significant revisions to the definitions of the mandatory notification sectors has helped provide greater clarity that will undoubtedly be of assistance to those eventually making their way through the new regime.

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