Key Takeaways

Skadden

Still Open for Business:
Navigating the UK's New National Security and Investment Regime

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On 11 February 2021, Skadden hosted the webinar "Still Open for Business: Navigating the UK's New National Security and Investment Regime." Our panellists included:[1]

- Rt Hon Greg Clark (MP and former Secretary of State for Business, Energy and Industrial Strategy);
- Robert Hannigan (Chairman of BlueVoyant International and former Head of GCHQ);
- Sarah Mackintosh (Deputy Director for National Security and Investment, Department for Business, Energy and Industrial Strategy);
- Rory Chisholm (Partner and Head of UK office, FIPRA International);
- Mike Leiter (Partner and Head of Skadden's CFIUS, National Security and International Trade Group);
- John Adebiyi (Partner in Skadden's London corporate team); and
- as moderator, Jonathan Guthrie, Associate Editor at the *Financial Times* and Head of the *FT*'s agenda-setting Lex column.

The webinar has been recorded and can be viewed here.

Three Key Takeaways

- There was, and remains, strong parliamentary consensus for reform to the UK's foreign investment screening laws, stemming from sharpening geopolitical and strategic threats and the growing national security implications of emerging technologies. The focus of the National Security and Investment Bill (NSIB) on national security represents an attempt to balance the impact of the regime on foreign investment and parliamentary desire, in some quarters, for a broader public interest regime.
- The NSIB is expected to come into force in late summer or autumn this year, following the passing of secondary legislation.
- The Investment Security Unit (ISU), within the Department for Business, Energy and Industrial Strategy, expects to see in excess of 1,800 notifications annually. A core team of approximately 100 will draw on cross-government resources and sector experts to review transactions. Early consultation with the ISU is encouraged and will help parties to transactions with their deal planning, particularly in the early days of the new regime.

[1] All opinions of panellists were presented as their own and not of their respective organisations.

Key Takeaways
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Sharpening Geopolitical and Strategic Threats and Emerging Technology Have Driven the Reform

The NSIB's mandatory approval regime is notably different from the voluntary-only approach mooted in the government's 2017 *National Security and Infrastructure Investment Review* green paper, but the two key underlying drivers of the reform remain the same.

First, there is increased concern both in Westminster and Whitehall about the changing geopolitical and strategic threat environment. Recent years have seen a noticeable (if not express) shift in the approach being taken by states, such as China and Russia.

Second, emerging technologies have an increasingly outsized impact on national security. The impact of some technologies, such as artificial intelligence, is not yet fully known but demands careful monitoring and regulation. Others technologies, such as data-driven ones, have given (often small) private sector players access to a wide range of government and defence data. In the wrong hands, such access presents the classic national security risks of disruption, espionage and improper leverage.

The existing Enterprise Act 2002 regime does provide a limited framework for the assessment of emerging technology transactions. However, it does not provide a built-for-purpose, mandatory review mechanism that reaches the smallest and early-stage companies (often being key players in emerging technologies). Without a dedicated mechanism, the government's review of national security concerns has often been a last-minute exercise, leading to an inconsistent approach. Softbank's 2016 acquisition of ARM is an illustrative example.

Deal Advisers Will Need To Understand the Broad and Growing Remit of National Security

Consistent with the approach taken in other legislation, the NSIB does not seek to define "national security." This open-ended approach reflects the broad and evolving remit of national security: it is constantly growing and rarely shrinking.

The Committee on Foreign Investment in the United States (CFIUS) approval regime illustrates this well. At the inception of CFIUS in 1988, the US government's focus was on semiconductor technology being acquired by Japanese investors. The focus on semiconductor technology has not changed, though the role of Japanese acquirers has. Today, at least in the US, there are very few areas of the economy that do not have some nexus to national security: from raw material manufacturing, energy and financial systems to companies that hold personal data or participate in a global technology supply chain.

The COVID-19 pandemic highlights how quickly national security priorities can change in practice. In the current environment, for example, pharmaceutical mergers would likely be viewed very differently than before from a national security perspective.

Cooperation between the ISU, the UK's security agencies, Whitehall and the investment community to achieve a common understanding of national security will be key to a successful and effective regime. Unsurprisingly, many issues known to security agencies will not be known or understood by advisers. Intensive informal engagement, and the availability of regulatory guidance, will be invaluable to the investment community as it develops an understanding of the areas of concern and how to design successful long-term mitigations that will be acceptable to the government.

New Regime Expected To Be in Place by Late Summer or Autumn

The NSIB has largely completed its passage through the House of Commons and is due to go into Committee stage in the House of Lords in early March. As the government does not have permission to carry over the Bill, it will be a priority for the government to see it complete all its stages and pass into law during the current Parliamentary session. Secondary legislation and guidance can also be expected to follow thereafter, on various aspects of the Bill's implementation.

The ISU has started recruiting and expects to have a core team of 100 full-time staff, supported by access to cross-government support and sector expertise. While the government's original impact assessment indicated that it expected approximately 1,800 notifications annually, this figure excluded asset and voluntary notifications, so the government's current expectation is that notifications will exceed that number. Notifications will be reviewed by a team of case workers within the ISU, who will coordinate input from relevant government agencies.

Informal and Early Consultation Is Encouraged, but More Guidance May Be Needed

The ISU is and will remain available for consultation on deals and will be willing to give informal guidance, including before definitive deal documents are signed. It will not publish details of its review of transactions it calls in, nor of cases duly approved without any conditions/remedies; however, BEIS can be expected to issue a short statement at the end of the assessment process on cases where it imposes remedies or blocks a transaction (as it has done on public interest cases under the UK Enterprise Act regime).

The ISU will additionally seek to keep Parliament and other observers informed of its approach through an annual report with details of the main themes and types of transactions called in during the year.

This open approach by the ISU towards informal consultation on particular transactions is appreciated by the investment community, but there remain concerns that informal guidance and annual reporting may be insufficient. It was suggested that, with its long history of being an efficient and effective regulator of transactions, the Takeover Panel model of consulting the investment community, regularly publishing guidance notes and taking on deal professionals as secondees, would go some way to addressing this.

Swift and Effective Clearance for Most Transactions Should Avoid a Lobbying Free-for-All

Concerns have been raised about potential over-politicisation of the new procedures being introduced and the fact that Ministers, rather than independent regulatory authorities, will be the final decision-takers on the large number of transactions that will have to be notified. However, outside a limited number of more sensitive and/or higher-profile transactions, swift and effective clearance of the great majority of notified transactions should reduce the level of uncertainty and any perceived need for lobbying on the average transaction.

The government has made clear that it expects most cases (in the order of 90%) to be approved without any conditions in the initial 30-working-day review period. It will be important for the investment community to see this bear out in practice for the concerns about a lobbying free-for-all to be allayed. Even where concerns do present themselves, outcomes will not be binary: with appropriate supporting guidance and consultation from the ISU, mitigation will be an option for many transactions that do give rise to national security concerns.

There may be certain sensitive, potentially high-profile transactions that are exceptions in terms of attracting political interest. Yet as deal professionals start to understand structural and other mitigation options that work for government, they will be better-placed to advise clients on long-term national security-focused solutions. This is likely to echo the US experience, which has seen CFIUS traditionally conduct a professional analysis of national security risks without much political involvement (again, subject to some notable exceptions).

Concerns Remain About Penalties and Breadth of Regime

While the ISU has made clear that it will adopt an evidence-based and documented approach, practical concerns remain. The potential for transactions to be automatically voided creates significant uncertainty for dealmakers, and the possibility of incurring significant criminal and civil penalties also will result in parties proceeding with caution. This is compounded by real world deal timetables and the broad extraterritorial application of the regime.

The NSIB provides for judicial review, but in practice this may not be an effective remedy for a number of reasons, including the cost of maintaining financing for long periods and parties being unwilling to become embroiled in what might well become lengthy and complex litigation. Courts themselves may be unwilling to substitute their own judgments for those of government Ministers on questions of national security, a broad and inherently political topic.

It is clear that the broad mandatory approval categories will lead many parties to file in borderline cases, rather than face the risk of a transaction being void or incurring onerous penalties. While the ISU has in place plans to deal with a large volume of notifications at the outset, the market remains concerned about its capacity to deal with initial volumes.