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UK National Security Review Regime

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- The UK has proposed adopting a stand-alone and enhanced regime for reviewing foreign direct investment and other corporate transactions that occur within the UK.
- Although the government first proposed this new regime in 2016, the legislation has not yet been introduced in Parliament because of delays stemming from Brexit and Covid-19.
- Recent events suggest that the government will enact legislation that establishes this new regime in late 2020 or early 2021. This new legislation will require buyers and sellers of UK companies to carefully assess national security issues as part of the transaction process.

Introduction

When it comes to reviewing national security risks associated with corporate transactions, the UK is an outlier compared to many of its allies. Unlike the U.S. and many EU member states, the UK does not currently maintain a stand-alone mechanism for reviewing foreign investments for national security considerations. Instead, the UK utilizes a merger review system – designed primarily to assess anti-trust issues – to review the national security implications of certain transactions.

However, the government now appears poised to change the way it conducts national security reviews. After proposing a revamped screening program in 2016, it now appears likely that Parliament will enact legislation establishing a new national security review regime in the next year. This new development raises a number of questions about how the UK will deal with future foreign investment.

Background

The Current Regime

The government's principal mechanism for reviewing transactions that raise national security concerns is set forth in the Enterprise Act 2002 ("Act"). This legislation is the UK's primary merger control regime and is administered by the Competition and Markets Authority ("CMA"). Section 42(2) of the Act authorizes the Secretary of State to issue an intervention notice to the CMA if certain public interest considerations (including national security) are potentially implicated by a proposed transaction.

Historically, the grounds upon which the government could intervene in transactions on national security grounds were relatively limited. The target company's turnover had to exceed £70 million, and the transaction would have had to result in the combined entity having a "share of supply" of goods or services of at least 25% in the UK (or in a substantial part of the UK).

In 2018, the government amended the Act to lower the applicable thresholds for certain types of mergers. The government is now authorized to review mergers involving "relevant enterprises" where: (i) the target's UK turnover exceeds £1 million; or (ii) the transaction results in the combined entity having a 25% "share of supply." For the purpose of this legislation, "relevant enterprises" are companies active in the development or production of items for military or dual use goods, quantum technology and computing hardware. These changes significantly expand the government's power to review and intervene in transactions on national security grounds.

In addition to the Act, the government has other tools to mitigate potential national security risks. For example, the Ministry of Defense has obtained deeds in which purchasers make commitments regarding the target company's future operations and business plans following completion of a transaction. Furthermore, the government has acquired so-called "golden shares" in companies deemed vital to national security that grant it certain governance rights with respect to such companies.

The Proposed New Regime

In 2016, the government first proposed a new regime to screen investments for national security risk. In July 2018, the Department for Business, Energy and Industrial Strategy ("BEIS") published a White Paper and a Draft Statutory Statement of Policy Intent. The proposal set forth in these documents envisions a stand-alone national security review process that is similar to the foreign direct investment screening mechanisms adopted by the U.S., Australia, Japan, Germany and certain other EU member states.

The White Paper describes a new regime that would authorize the government to review transactions that give rise to “trigger events,” defined to include a wide range of investments and acquisitions that touch the UK. Parties would have the option of voluntarily reporting trigger events to the government, but the government could also elect to unilaterally “call in” trigger events at its discretion. The government would review national security considerations associated with called in trigger events and could impose “conditions” to mitigate national security risks, block transactions prior to closing or even force the parties to unwind the transaction after completion.

Outstanding Issues Regarding the Current and New Regimes

Since the publication of the White Paper, the government has taken few concrete steps to implement the new regime. This delay has led to questions regarding whether the new regime will be implemented at all, and how, in the interim, the government will address national security concerns arising from potential transactions.

Will the Government Adopt Legislation to Implement the New Regime?

Although the publication of the White Paper has been followed by a quiet interlude, the government appears likely to pass legislation enacting a new national security regime in the near future. During the past two years, officials have consistently affirmed the government’s commitment to modernize and update the UK’s ability to review and, if necessary, mitigate national security risks associated with corporate transactions.

In late 2019, the government reiterated its intention to progress legislation to implement this new regime. The Background Briefing Notes to the Queen’s speech in December 2019 detailed a “National Security and Investment Bill” that would “[s]trengthen the Government’s powers to scrutinise and intervene in business transactions (takeovers and mergers) to protect national security.” Tory leadership has also consistently expressed support for this legislation. The Secretary of State for Digital, Culture, Media and Sport recently confirmed that BEIS intends to bring the Bill forward “as quickly as [they] can in this session.”

When Will the New Legislation be Enacted?

Since the White Paper’s publication, the government has been faced with two unprecedented national emergencies. The UK’s preparations for and subsequent departure from the European Union has dominated government resources over the

last two years. Shortly after the UK formally departed the EU, the unprecedented coronavirus pandemic struck, which for the last several months has consumed government time. The government's delay in progressing this legislation is likely attributable to these intervening factors.

Although the government appears committed to enacting the National Security and Investment Bill, the timing for adoption is unclear. The bill has not been formally introduced in Parliament, and the government has not published draft legislation.

Whether the government is able to enact a final version of the National Security and Investment Bill this year remains to be seen. The on-going crisis stemming from Covid-19, along with state-sponsored relief programs designed to combat the health and economic effects of the virus, seem likely to continue to occupy government officials' attention for the remainder of the year. The continued negotiations with the EU regarding the parties' future relationship once the transition period closes will demand significant government resources as well. If the government is unable to push through the National Security and Investment Bill this year, Parliament likely will enact this legislation in early 2021.

What Form will the New National Security Review Regime Take?

The White Paper and Statement of Policy Intent collectively total more than 180 pages and contain a detailed proposal regarding the proposed national security review process as well as the policy positions that the government would take regarding certain aspects of the new regime.

However, BEIS's proposal leaves open important issues. For example, the White Paper does not identify the government agency or senior minister that will be responsible for administering the new review mechanism. In addition, the proposed regime could be modified in the final version of the legislation. Potential changes could include the addition of a safe harbor provision and various geographic limitations that would exclude certain type of investments from review. These and other issues will need to be resolved in the National Security and Investment Bill.

Will the National Security Review Regime Comport With the Standards Set Forth in the EU FDI Screening Regulations?

In March 2019, the Council of the EU adopted a regulation (the "EU FDI Regulation") that establishes a framework for the screening of inbound foreign direct investment. In October 2020, the Regulation will come into force and become binding on all EU member states.

The Regulation does not authorize the EU to directly intervene in transactions involving inbound foreign direct investment. Rather, it establishes minimum standards that EU member states must meet for review mechanisms established at the national level. These include adopting “transparent criteria” for reviews that do “not discriminate between third countries,” protecting “confidential” and “commercially sensitive information,” and authorizing third parties to “seek recourse against screening decisions.” Because the UK has now left the EU, its national security review regime is not required to meet these criteria. However, the UK has elected to adopt laws that are consistent with EU standards in other areas, and it may choose to do the same in this context.

Similarly, the EU FDI Regulation creates an information-sharing mechanism that requires EU member states to notify the EU Commission and other EU member states of foreign direct investments that occur in their countries and that are subject to screening. The EU Commission and EU member states can request additional information about such investments and issue non-binding opinions and comments regarding the foreign investment at issue. Again, the UK is not required to notify other countries of screening it undertakes or solicit input from third parties on foreign investment that occurs within the UK. Nevertheless, in the past, the government has shared information and cooperated with EU member states and other allies in national security reviews and may choose to continue to do so in the future.

How Will the UK Approach Reviewing Transactions Before the New Regime is Implemented?

Recent trends illustrate that the government has become increasingly alive to the national security concerns associated with foreign investment and more active in intervening in high-risk transactions. As noted above, the government currently relies on powers set forth in the Act to review transactions on national security grounds. Since the Act came into force in 2002, the government has intervened in a total of 12 transactions on national security grounds. Four of these 12 interventions occurred in 2019. The government’s increased reliance on the Act to review transactions is likely to continue until the new regime comes into force, especially in light of the new and unique risks posed by foreign investment during the Covid-19 pandemic.¹

Conclusion

The UK national review regime is currently in transition as the government attempts to finalize legislation that would result in a revamped national security review regime.

Until the new system comes into effect, the government will continue to exercise its existing powers under the Act to vet corporate transactions to ensure that they do not undermine the UK's national security interests.

1. See Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452, available at https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf.↵

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Suggested Reading

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