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The UK's new national security regime

Protecting security without deterring investment – issues under debate and key next steps

Since the UK Government published the National Security and Investment Bill (the ***Bill***) in November 2020 (see our earlier briefing), a number of issues have prompted significant debate and investor concerns. Many of these centre on the delicate balance between the UK Government's desire to protect UK national security interests without deterring vital foreign investment in a post-Brexit environment. These challenges were notably recognised in a report published by the Foreign Affairs Committee (***FAC***) – chaired by Conservative MP Tom Tugendhat – which expressed concerns that the lack of sufficiently clear guidance in the Bill on how national security is to be understood is '*likely to hinder targeted application of the new law, with adverse repercussions for the UK's national security and economy*' (see the FAC report: here). Yet despite this tension, the Bill's passage through the House of Lords has continued unabated, having left the House of Commons in January without amendment.

One key factor in determining whether the new regime will be clear and proportionate is whether the sectors in scope of the mandatory regime are appropriately defined and well understood. The Government has therefore been consulting widely on sector definitions for the mandatory notification regime and, on 2 March 2021, the Department for Business, Energy and Industrial Strategy (***BEIS***) published its response to the consultation, together with revised definitions and clearer parameters across the sectors (the ***Consultation Response***: here). It should be stressed though that these revised definitions only relate to the mandatory notification regime and not the Government's call-in powers – which extend to a much broader range of sectors.

UK Government ministers and officials continue to consult widely with all stakeholders on the mandatory and voluntary aspects of the regime and to provide assurances that, despite the large volume of notifications expected, fewer than 10% will face a detailed national security assessment and a much smaller proportion will result in mitigation measures. BEIS has stressed that this new regime is '*not a signal that the Government are reducing their appetite for foreign investment nor is it a signal that the Government will become more interventionist*'. This message has been underlined by the creation of the Office for Investment which is tasked with driving and coordinating activities required for high impact and high value foreign investment in the UK. Whilst the national security regime will inevitably face teething problems in its early stages, continued engagement between the Government and stakeholders should smooth the path towards achieving the Government's ultimate aim of protecting national security without deterring the types of investment the Government is actively seeking to encourage.

This briefing provides an update on the progress of the Bill, taking stock of the main issues under debate, recent developments and current timing expectations for the new regime.

Narrowing sectoral definitions for mandatory regime

The Consultation Response acknowledges that feedback from the consultation '*suggested that many of the sector definitions were very broad in scope and would require further specificity to enable acquirers to identify whether they would be in scope of mandatory notification*'. BEIS states that it is committed to a '*robust and proportionate approach to investment in the UK*' and has therefore '*significantly narrowed the definitions*' for **all** seventeen specific sectors under the mandatory regime – although some, naturally, more so than others. Notable changes include:

- **Artificial intelligence**. The extremely broad definition of artificial intelligence in the consultation has been narrowed to focus on three applications which the Government has identified as being particularly high risk: (a) the identification or tracking of objects, people or events; (b) advanced robotics;

and (c) cyber security. However, it is clear that the definition is **not** limited to AI companies, but also captures companies in other industries which develop their own AI applications.

- **Critical suppliers to Government and the emergency services**. The definition of critical suppliers to Government now focuses on contracts which relate to the handling of classified information or estates and their protection, as well as contracts that relate to the security of government networks and information systems. Sub-contractors have been removed from scope to ensure that the definition is proportionate.
- **Data infrastructure**. The extremely broad definition of data infrastructure in the consultation has been narrowed to include refined definitions of *inter alia* relevant data, relevant data infrastructure and administrative access. Qualifying entities have been amended to just those entities whose business activities yield such access – e.g. landowners and leaseholders are omitted as categories of entities captured by the definition.
- **Energy**. The definition is subject to further consultation but will provide a significantly more detailed breakdown of what is captured, greater clarity on defined terms as well as how thresholds will be measured and over what period. The UK Government has confirmed that electricity suppliers (retail) are not in scope. Interestingly, with a view to sustainability objectives, the Consultation Response states that the definitions 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*.'
- **Military and dual-use technology**. The definition has been reduced to one limb: '*researching, developing or producing restricted goods or restricted technologies*'. A second limb, relating to the mere holding of information capable inter alia of use in connection with the development or production of restricted goods, has been deleted.
- **Quantum technologies**. Feedback received was that the wide draft definition would capture the majority of transactions in the sector, including those involving the academic research community and associated supply chain sectors. The updated definition focuses on entities that develop or produce a specified quantum technology, thereby removing from its scope entities solely engaged in research or at other levels of the supply chain.
- **Synthetic biology (previously Engineering Biology)**. Feedback again suggested that the proposed wide definition would capture the majority of transactions in the sector. The definition has been narrowed to '*synthetic biology*' and comprehensively revised. Interestingly, part of the rationale for including synthetic biology under the mandatory regime appears to have been its technological complexity, which would make it '*difficult for the Government to comprehensively monitor well enough to proactively 'call-in' transactions that are not routinely notified*'.

Whilst many of these sectoral definitions remain broad and open to some interpretation, the Consultation Response does appear to have sought a more appropriate balance between certainty for investors and ensuring any potentially relevant deal would still be captured. The revised definitions should not, however, be regarded as in final form. BEIS is also intending to undertake further targeted consultation with key stakeholders to refine the definitions in preparation for the draft legislation. Changes could therefore be made at relatively late stages in the process, including when the regulations specifying the sectors are laid before Parliament for approval after the Bill has received Royal Assent.

Balancing national security and investment

One of the critical challenges that has been raised by stakeholders, and in particular the FAC in its report, is whether the Bill strikes the appropriate balance between protecting the UK's security interests while '*ensuring that the country's businesses continue to benefit from the valuable foreign investment that enables them to grow, innovate, and access overseas markets*'. The FAC concluded that at the heart of these concerns was uncertainty about the underlying scope of national security and recommended that the Bill and accompanying guidance should therefore be '*as clear as possible about what may or may not constitute a national security risk*' and should '*clearly distinguish between 'national security' and broader 'public interest' or 'solely economic concerns*'. The concerns raised focus on:

- **Lack of transparency about the decision-making process**: A number of witnesses and members of both Houses have raised concerns that the Bill does not provide for a clear, transparent and predictable review process. Although clause 61 of the Bill requires the publication of an annual report which will provide information on the overall number of notifications and reviews and the sectors involved, parliamentarians have sought to increase transparency and accountability over the Secretary of State's decision making by proposing amendments to the Bill (none of which have been successful) – in particular suggesting that the Intelligence and Security Committee should have a greater role in reviewing sensitive materials to '*close the scrutiny gap*' and to

provide an additional level of oversight and accountability. Stakeholders have been particularly worried that this lack of transparency and predictability risks hindering businesses' ability to make informed judgment calls about whether or not the regime is engaged, especially in the early stages of the regime.

- **Risk of politicisation chilling investment in UK Plc**: Although any definition of 'national security' requires a built-in level of flexibility to respond to the rapidly evolving and dynamic security threats facing the UK, concerns have been raised that failure to set out the parameters of 'national security' could allow for decisions to be influenced by political or economic considerations, particularly as the ultimate decision maker is the Secretary of State for Business. The concern is that this unpredictability may disincentivise inbound investment at a time where the Government considers this to be a crucial part of the economy's recovery from Covid-19 and the country's long-term post-Brexit strategy.
- **Uncertainty created by the five year 'call-in' period**: The Bill provides for a five year 'call-in' period that enables the Secretary of State to call in transactions for review up to five years after a transaction has taken place (or within six months of becoming aware of the transaction). This time period could span different Governments and different political interests, risking inconsistency in the way the law is applied and creating considerable uncertainty for business. Concerns have again been expressed that this lengthy period of time creates further uncertainty for investors. However, proposals to reduce the period have so far been rejected given similar periods apply in other key regimes.
- **Volume of notifications**: The broad scope of the Bill and long call-in period, combined with significant financial penalties, criminal sanctions and automatic invalidity of transactions mean that the new Investment Security Unit (***ISU***) is likely to receive many precautionary notifications. Investors expect the volume of notifications to far exceed the already significant numbers expected by BEIS (1,000 - 1,830 notifications) which could overwhelm the ISU, particularly at the outset, denting investor confidence and undermining credibility in the regime. Investors are therefore keenly watching the Government's stated intentions for the ISU to be fully equipped and its systems 'tested to destruction' before the regime goes live.

Whilst the tightening of the sector definitions goes some way to addressing these concerns in respect of the mandatory regime, it is clearly only one part of the wider debate on the scope of the Bill and does not address criticisms relating to the call-in powers. The possibility of including a definition or framework for national security in the Bill has been raised several times during the Bill's progress through Parliament, but has so far been rejected. In response to these criticisms, Nadhim Zahawi MP (the original sponsoring Minister in the Commons and Under Secretary of State at BEIS) has stressed that the Government agrees that the Secretary of State should provide '*as much detail as possible on the factors that will be taken into account when considering national security […] only up until the point that the detail risks the protection of national security itself*' and that '*my final point of reassurance is that there will be further scrutiny on this point*'.

The FAC and other stakeholders have suggested that the Government's Statement of Policy Intent should contain a non-comprehensive list of national security concerns to provide greater guidance to businesses (see FAC Report, page 13). BEIS intends to launch a formal public consultation on the Statement of Policy Intent as soon as possible following Royal Assent of the Bill (currently expected in May). Once any changes from the consultation are incorporated, the policy statement will then be laid before both Houses. Any material changes to the draft statement (originally published in November 2020) are therefore only likely to be known at a late stage in the legislative process.

Engagement with BEIS

Given uncertainty around the mandatory regime and the retroactive application of the Government's call-in powers, BEIS has repeatedly stated its willingness to provide informal guidance to merging parties on what to expect from the regime for the purposes of business planning. We have had a number of positive experiences in engaging with the BEIS team to date and have found them prompt and constructive in providing feedback on queries. Taken as a whole, we understand from BEIS that such queries have been fewer than originally expected but we would expect that volumes to increase significantly in the run-up to the regime coming into effect. BEIS's willingness to engage with businesses at relatively early stages in transactions is to be welcomed, as is BEIS's commitment to continue to add to and refine its guidance on the application of the regime in the coming months to provide additional clarity for investors.

Timing expectations and key milestones

BEIS has stated that its intention is to ensure that the new regime is commenced by the end of 2021. The current expectation is that the regime will come into force in autumn 2021 (subject to any Parliamentary delays). Key milestones in the passage of the Bill include:

- **Parliamentary process**: The Bill moved into the committee stage in the House of Lords on 2 March 2021. The committee stage involves a detailed line by line examination of the Bill by the Lords and debate on the various amendments proposed (see the proposed amendments here). The next sitting in the committee stage will take place on 9 March 2021. Subject to any delays, we are currently expecting Royal Assent in May. The regime will not, however, come into force until at least two months after Royal Assent (to allow the necessary secondary legislation to be passed).
- **Secondary Legislation**: The new regime requires ten separate regulations, eight of which are needed for commencement. Of particular interest for investors will be the draft Notifiable Acquisition Regulations which will specify the sectors subject to mandatory notification (after BEIS's targeted engagement) and will require Parliamentary approval. Other statutory instruments will cover retrospective validation applications, how to determine turnover for the purpose of calculating penalties and the procedure for providing documents in response to information requests.
- **Notification Form**: A separate regulation will prescribe the requirements for parties to notify their investments. The draft questions for the new online portal have been published and BEIS welcomes any comments. Now is therefore an important opportunity to shape these requirements in a way which maximises the chance of the ISU completing its reviews quickly and efficiently without extended periods of pre-notification, whilst minimising the burden on investors.

Please get in touch for more information on the new regime as it continues to take shape, and how best to contribute to the on-going debates.

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