CLIENT BRIEFING

JUNE 2022

THE OPERATION OF THE NSIA SO FAR: THE REGIME'S FIRST ANNUAL REPORT

The National Security and Investment Act 2021 (the "**Act**") introduced a new national security screening regime in the UK. The Act establishes a mandatory notification and approval regime for transactions in 17 sensitive areas of the economy and gives the government powers to scrutinise other transactions to protect national security. On 16 June 2022, the National Security and Investment Annual Report 2022 (the "**Report**") was published, providing information about the functioning of the regime in its first three months of operation (from 4 January 2022 until 31 March 2022).

Also published on 16 June 2022 was a Memorandum of Understanding ("**MoU**") establishing a framework for cooperation and coordination in the operation of the Act between the Competition and Markets Authority ("**CMA**") and the Investment Security Unit ("**ISU**") (that sits within the Department for Business, Energy and Industrial Strategy ("**BEIS**") and is responsible for the operation of the Act).

This briefing sets out the main findings of the Report and identifies what has worked well so far as well as areas for potential improvement. It also touches on the possible consequences of the new MoU.

Notifications almost in line with expectations

The Report showed that a total of 222 notifications were made in the first three months of the regime. Interestingly, the government previously estimated that the ISU would receive between 1,000 and 1,830 notifications each year, and a simple extrapolation shows that the number of notifications so far has been slightly below this estimate (although the Report refuses to draw conclusions about trends longer-term).

Only 25 voluntary notifications were submitted within the first three months (with even this low number flattered by some mandatory notifications that appear to have been downgraded to voluntary notifications by the ISU). This demonstrates a sensible approach to notifying: where the requirements for a mandatory notification are not met, investors are not then submitting voluntary notifications merely for the sake of precaution. In addition, the total number of notifications being rejected – either because the notification does not meet the requirements or does not contain sufficient information – is small, totalling eight notifications. This shows a strong understanding of the regime as well as a sensible approach to notifications being taken.

Time limits observed

For the most part, the notification process runs smoothly. The Report shows that the average number of working days between receipt of a mandatory notification and parties being informed of a decision to accept or reject that notification was five working days. The Act does not prescribe a time limit for this decision so the relatively quick turnaround is welcome.

In addition, all cases so far have been dealt with within the relevant statutory time frames. Once the Secretary of State has accepted a notification, they have 30 working days to decide whether to call in the acquisition for a more detailed assessment or to clear it. The Report states that this time limit was met in every case, and that the average number of working days to call in a notification once accepted was 23 working days. All called-in notifications also had their assessments completed within the first post-call-in review period of 30 working days. This may give some comfort to those who feared the government routinely extending reviews of called-in transactions into a second review period of 45 working days, although it is of course still early days.

The government has also demonstrated willingness to take a pragmatic approach, for example by accepting a single notification which covers multiple (related) qualifying acquisitions.

Low numbers of call-ins in narrow sector range

Of the 222 notifications received, 17 were called in for further scrutiny. The Report states that this is fewer than

predicted by the government. Of those 17 call-ins, three were cleared during the period covered in the Report and the other 14 were still undergoing assessments by the reporting deadline. Areas of the economy that saw the most called-in mandatory notification notices were Military and Dual Use (7), Defence (6), Critical Suppliers to Government (6) and Data Infrastructure (4), with Critical Suppliers to Emergency Services, Artificial Intelligence and Advanced Materials seeing two call-ins each, while Satellite and Space Technology, Cryptographic Authentication, Computing Hardware and Civil Nuclear each saw one.[1]

While it is difficult to draw any firm conclusions from these data, a call-in rate of 7.7% across a relatively narrow range of sectors of the economy may indicate that the scope of government concerns is in reality quite limited, reassuring investors that, despite the Act's broad reach on paper, the level of government intervention will be relatively low and targeted.

Things to watch

While the Report is positive about the first three months of the regime, there are some things to watch and some possible opportunities for refinement.

Transparency and rights of defence

One aspiration of the Act was that investment in the UK could continue with transparency and predictability. However, there have been some criticisms levelled at the regime's adherence to these principles. These include complaints about the fact that communication has to be made to an anonymous email address, whereas identification of a main case handler and case team members (as is the case in UK merger control) would be preferable. There is also a lack of communication from the ISU in the first 30 days after notification, with little to no information as to the direction of travel of reviews given. There is even a suggestion in the market that BEIS is not transparent with parties as to the reasons for call-in and that parties are not offered the opportunity to make representations on the government's concerns (again as is the case in UK merger control). While transparency will inevitably be compromised to some extent in matters of national security, the extent to which parties' rights of defence are protected in the regime is currently unclear. It will be interesting to see how this plays out in the coming months and years as more challenging cases come up for review and whether any aggrieved parties seek judicial review of any decisions under the Act.

Unnecessary notifications and inconsistencies between guidance and the Act

The regime's broad scope has been criticised since it was first consulted on, with its application to transactions not perceived to be capable of raising any national security concerns such as internal reorganisations and acquisitions by UK acquirers drawing particular comment. It was thought by some that this would be ripe territory for a scaling back that would be made necessary by the government's failure to deal efficiently with the huge number of notifications received. The Report makes clear that this deluge has not come to pass and the Act's machinery has not been overwhelmed. It therefore remains to be seen whether the government will retain the current scope of the Act or seek to reduce it in some areas.

Another common complaint relates to the breadth and specificity of the mandatory sector definitions which determine whether or not an acquisition must be notified to the government and approval obtained before closing can legally occur. A number of the 17 definitions are extremely broad and not always capable of ready application to specific facts. While there is - as the Report notes - extensive government guidance available, including on the mandatory sector definitions, in some instances there are inconsistencies between a plain reading of the mandatory sector definitions in the regulations and the government guidance. It is potentially interesting in this context that the Report reveals an instance of BEIS rejecting a mandatory notification on grounds that the acquisition did not fall within the scope of the mandatory notification regime. While doubts can generally be resolved by seeking clarification from the ISU, there may be scope for the government to tighten up the guidance and definitions going forward.

Further specific criticisms and teething troubles

Other criticisms have been directed at the idea that the regime works best for corporate acquisitions by trade buyers and is not well-geared towards other areas of investment activity. For example, lack of specific treatment of investment funds and fund managers leaves such investors in a complex legal position that often requires a case-by-case analysis. Similarly, whilst the notification process is reasonably straightforward, the online portal could be refined to better handle complex

[1] Some acquisitions which were called in were associated with more than one economic area, which is why the total number of call-ins associated with each area is higher than the total number of call-ins.

transaction notifications by allowing their details to be appropriately described.

The MoU and interaction with the CMA

The MoU sets out principles for collaboration between the CMA and the ISU on the timing of investigations, interim measures, remedies and the sharing of relevant information. Although it is not anticipated that either body will rely on the other as a matter of course to identify transactions of interest to either the Act's regime or to the merger control regime operated by the CMA, the MoU does set out circumstances in which one may consider disclosing information to the other (as had already been specified in the Act itself). In particular, the MoU notes that the ISU may engage with the CMA on acquisitions which the ISU "*considers may be considered by the CMA at the same time*." It is unclear whether this rather elliptical formulation means that the ISU would alert the CMA to transactions notified under the Act but not notified voluntarily to the CMA, but in the absence of firmer guidance to the contrary this is a risk that may need to be taken into account by merging parties.

Conclusions

The overall consensus is that the new regime works well, though there are still creases to be ironed out. Some of these are relatively minor and it is inevitable that there will be some areas for improvement in such an ambitious new regime. Others, such as the concern around rights of defence, are potentially more significant and it will be interesting to see how the regime develops in this regard. We can look forward to updated notification and timing data in the next annual report to be published after 31 March 2023. In the meantime, we await the publication of Market Guidance Notes in which the government promises more practical advice about using the system that will hopefully address concerns and queries about the regime's operation so far.

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