

Memorandum

U.K. Signals New Direction on National Security Investment Screening Rules: *Government Consultation Launched in Push to Reduce Regulatory Burden*

14 November 2023

On 13 November the U.K. Government called for feedback from businesses and investors on its investment screening powers as part of a review intended to make them “more business friendly.”

The U.K.’s National Security and Investment (NSI) Act came into effect at the start of 2022. It enables the Government to scrutinise and intervene in transactions that pose national security concerns. After nearly two years of operation, the U.K. Government wants to ensure the application of the NSI Act is “proportionate and well-targeted, minimising the burdens it places on companies and investors,” according to the Deputy Prime Minister whose Cabinet Office is in charge of implementation.

The U.K. Government is particularly interested in honing the scope of mandatory notifications to reduce the paperwork required for unproblematic deals (such as internal reorganisations and the appointment of liquidators, official receivers and special administrators), as well as improving the review process itself to minimise business burdens whilst maintaining the Government’s ability to apply effective scrutiny. The Government proposes to clarify the scope of application in relation to AI—which will increasingly be pervasive throughout the economy—but also to improve scrutiny in sensitive areas such as semiconductors (which has attracted enforcement action under the present regime) and critical minerals.

Has the Current Law Been Effective?

The picture emerging from nearly two years of life under the NSI Act is mixed. The vast majority of notifications (93% over the last year) are approved without a detailed assessment, with clearance generally obtained within two months. However, the sheer volume of notifications represents a significant burden on businesses: the Government received 866 notifications in 2022, of which 671 were mandatory.

The Government has also intervened on deals at a much higher rate since the new regime took effect, making 17 final orders in total, including five deals which were prohibited or unwound. The majority of in-depth assessments have related to the military and dual-use, defence and advanced materials sectors, with military and dual-use and communications each accounting for the highest number of final orders.

Notably, whilst the broadly drafted AI and data infrastructure sectors accounted for 15-20% of mandatory notifications each between April 2022 and March 2023, no final orders have been issued in relation to either sector.

Somewhat controversially, at present, internal reorganisations involving no ultimate change in control—and no new investors—can trigger mandatory notifications for businesses active in the 17 sensitive sectors. Amongst other things, this captures administrative actions such as incorporating a new subsidiary within the chain of control. In relation to insolvency procedures, whilst an exemption exists for appointing administrators under the NSI Act, no such exemption exists in relation to other insolvency proceedings such as liquidation.

What Changes Are Expected?

The Government is consulting on a range of amendments to the regime to refine its scope in focusing on the most problematic transactions. Key changes being considered are as follows:

Widening exemptions to mandatory notification. The Government is contemplating a range of targeted exemptions from mandatory notification, notably for internal reorganisations and the appointment of liquidators, official receivers and special administrators.

Revising scope of sensitive sectors. Similarly high on the Government's agenda are amendments to the sensitive sectors to better capture potential risks to national security and make it easier for businesses to understand when their activities require mandatory notification. This includes simplifying the advanced materials and synthetic biology sectors, removing overly broad sections of the AI sector (and potentially expanding its scope to new areas such as generative AI), as well as expanding and/or clarifying the scope of multiple other sectors.

Introducing new sensitive sectors. However, the Government is also considering new rules for semiconductors and critical minerals, which are addressed indirectly under the present system (within computing hardware and advanced materials sectors, respectively). Notably, three of the five instances of the Government prohibiting or unwinding transactions since the commencement of the NSI Act have related to target companies active in the semiconductor industry. Activities involving critical minerals, similarly, are of growing concern globally, with other jurisdictions (*e.g.*, Japan, France, Canada) increasing their scrutiny of this sector in the past two years.

Issuing fresh practical guidance. This is expected to include updating the “Section 3 Statement”, the statutory public statement setting out the types of transactions that are most likely to raise national security risks and be called in for an in-depth national security assessment. The Government has also indicated it will provide further guidance on the NSI Act's application to outward direct investment, particularly in the context of asset transfers occurring as part of an investment, which is an area of current focus in both the USA and the EU.

How to Respond

The Government's consultation will close on 15 January 2024. Anyone who might consider responding to the Government's consultation should contact a member of Simpson Thacher's market-leading European antitrust & foreign investment team.

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