

Report On UK Investment Act Offers Welcome Insights

By **Andrea Hamilton and Ajal Notowicz** (July 28, 2023)

On July 11, the U.K. government published its heavily anticipated annual report on the National Security and Investment Act, or NSIA 2021, surveying the act's first full year of operation.[1]

Overall, the annual report gives a sense of how the notification system under the NSIA has worked in the first year and gives insight into the sectors and investor origins that have attracted the greatest scrutiny.

It broadly aligns with the more limited report published after the first three months of the act's enforcement and indicates that the government is generally achieving its aim of an efficient screening process, with 93% of notified transactions cleared within the first 30 business days.

The overall intervention rate over the last year also seems to be roughly in line with the experience of the first few months, with just over 7% of transactions called in for further review.

This practical steer is helpful from a timing and process perspective, but it tells only part of the story. Indeed, beyond these basic figures, the government has opted to disclose more information than its statutory obligations require.

This is to be applauded as exploring these disclosures enables a better understanding of the government's enforcement practices and priorities to date and provides a sense of what the next year may hold.

Fewer Notifications Than Expected

The NSIA ushered in a new era of investment controls in the U.K. Previously, under the Enterprise Act 2002, there were only around two dozen interventions on public interest grounds over nearly two decades.

When the government introduced the NSI bill, its scope and initial estimates of reportability appeared eye-watering in contrast, with the government impact assessment anticipating that around 1,000-1,830 notifications would be made annually under the NSIA.[2]

Looking back at the first year, the annual report shows that the U.K. government's Investment Security Unit received far fewer notifications than initially expected under the 2020 government impact assessment.[3]

However, the level of intervention measured by transactions called in for in-depth review was nearly as high as expected. The number of cases resulting in final orders — remedies or prohibitions — while low in absolute terms — was substantially higher than expected.

In greater detail, the actual number of notifications under the NSIA was 866, between 47%-86% of what the government had expected.



Andrea Hamilton



Ajal Notowicz

The report does not provide reasons for the lower number, but this is probably largely due to the increase of the mandatory control threshold from 15%-25% during the legislative process, as a result of which fewer cases are caught.

Slower than expected M&A activity provides another likely reason. Whatever the reason, the number of transactions notified to the Investment Security Unit was substantially lower than expected.

However, the number of transactions called-in for closer assessment was much closer to the mark. A call-in assessment extends the waiting period by a further 30 working days and can be extended by a further 45 working days in some cases.

The government initially estimated that between 70-95 transactions would be called in per year. In the first full year, the government actually called in 65 transactions — or, between 68%-92% of its expectations.

If the government's estimates had held, it would have meant an intervention rate of around 4%-7%, whereas the actual intervention rate in the first year is just over 7%.

Furthermore, of the transactions called in, the government expected to impose remedial action on around 10. In the first year, the government actually imposed remedial action on 15 transactions, including transactions prohibited — around 150% of the total.

Ultimately, the actual number of transactions called in and those in which remedial measures are imposed is low, and therefore differences in proportion can appear overstated.

Nevertheless, given the substantial shortfall in anticipated notifications, results showing nearly as-expected levels of call-ins and a higher-than-expected number of remedies cases could suggest a system that is at least somewhat more interventionist than expected.

Greater Scrutiny

In his foreword to the annual report, the Deputy Prime Minister Oliver Dowden emphasized that the NSI regime is country-agnostic, which means that the NSIA applies equally to investors from all jurisdictions, including the U.K.

Indeed, 58% of notifications were actually made by acquirers associated with the U.K. This aspect of the NSIA is noteworthy because most foreign direct investment regimes exempt acquisitions by domestic acquirers.

After the U.K., investors associated with the U.S., France, Canada and Germany comprised the top five countries that accounted for notified transactions under the NSIA. Investments associated with China came in sixth, amounting to less than 5% of all accepted notifications, of which there were 806, or around 40 notifications.

Yet, at the same time, investors associated with China accounted for a much higher proportion of transactions called in for greater scrutiny — 42% of all call-ins — of which there were 65, meaning around 27 acquisitions involving investment from China were called in.

In addition, more than half of cases in which remedial measures were imposed involved

investors associated with China.

A deeper dive into these figures paints an even starker picture. Last year, in absolute terms, investments associated with China accounted for around 40 notifications, and around 27 call-ins under the NSIA.

This suggests that nearly 70% of all notified investments associated with China were called in for in-depth scrutiny, which is much higher than the overall rate of call-in at around 7%.

Taking the analysis one step further, the annual report also discloses that eight investments associated with China resulted in a final order, i.e., remedial action, including prohibition.

This represents more than half of the 15 total cases that resulted in a final order, and around 20% of all notified acquisitions associated with a Chinese investor, and is considerably higher than the proportion of all transactions that face a final order — less than 2%, including prohibition — well under 1%.

At the opposite extreme, 58% of accepted notifications came from U.K. investors, or around 467 in total. In addition, investors associated with the U.K. accounted for around 32% of the 65 call-ins, or around 21. This implies that around 4% of investments associated with the U.K. were called in.

With final orders associated with U.K. investments accounting for around 30% of total — or around 5, rounding up — this means that an investment associated with the U.K. has a less than 1% chance of such intervention.

Taken together, the information disclosed by the annual report shows that investments associated with China are subject to greater scrutiny and intervention, and that a given investment associated with China has a greater than two-thirds chance of a call-in.

At the same time, it is also the case that the vast majority of such investments — 90%+ — associated with China are eventually cleared. While impossible to verify, it is at least possible that even the perception of higher scrutiny could have deterred investments associated with Chinese investors that could potentially be seen as higher risk, and thus lead to a relatively high overall clearance rate.

Ultimately every case must be assessed on its own facts. However, if the enforcement trend remains unchanged, investors associated with China may expect longer reviews under the NSIA and a higher likelihood of remedial action, but ultimately are likely to be cleared.

The focus on China is unsurprising, as Oliver Dowden, the decision maker in NSIA cases, is on record describing China as the largest state-based threat to Britain's economic security.[4]

Guidance and Transparency

With only one full year to report, the NSIA remains a new legislative regime. In the first year, the U.K. government has published extensive guidance, market guidance notes and modified its procedures to provide greater transparency — all of which are measures to be welcomed.

Indeed, such steps in many cases exceed the level of guidance afforded under other foreign investment control systems.

At the same time, the actual substantive analysis underlying individual cases under the NSIA remains largely outside of the public eye, and even the parties to a transaction may not have the full picture.

This is not a phenomenon that is limited to the U.K., however, as foreign investment controls generally involve sensitivities that touch on matters of national security and may not be subject to disclosure.

The annual report nevertheless gives at least a sense of sector focus, which, taken together with information on investor origin, gives a helpful steer as to current and potentially future enforcement priorities.

Most scrutiny under the NSIA relates to core national security sectors. For example, nearly half of all mandatory notifications are related to the defense sector. Almost 40% of the call-ins were in the military and dual-use sector.

By contrast, only 2% of the mandatory notifications related to transport, a sector that is less commonly associated with national security considerations.

The annual report also provided some further insight on areas of focus. Indeed, the government has made it clear in the act's so-called Section 3 statement that land is mainly expected to be an asset of national security interest where it is at or close to a sensitive site, such as critical national infrastructure or government buildings.[5]

As property acquisitions do not normally require mandatory notification, the practical upside is that purchasers of sensitive sites will need to consider whether to volunteer a notification to the government.

The annual report shows that 14 real estate deals were voluntarily notified, of which two were called in for an in-depth investigation — a rate of 14%, and nearly double the overall call-in rate of 7.2%.

Beyond transactions that are notified, the annual report disclosed that around 10 of the 65 cases called in for in-depth assessment were non-notified transactions — around 15% of total call-ins.

The origin of these non-notified transactions is not disclosed, so it is not known if the Investment Security Unit detected these transactions themselves, or they were identified pursuant to cooperation with the Competition and Markets Authority under their memorandum of understanding.

Nevertheless, while the overall number remains low, it serves as a reminder that even non-notified transactions can be called in and result in an in-depth review.

The Year to Come

Ultimately, much of NSIA substantive enforcement remains outside of the public view. Nevertheless, the annual report suggests that government's objective of an efficient, light touch regime appears to be met and — despite the lack of transparency that is often characteristic of foreign investment control regimes — works relatively smoothly.

We understand that there are currently two cases on appeal in which the government issued

final orders — the acquisition of Newport Wafer Fab by Nexperia and the acquisition by Upp Corp. Ltd. of L1T FM Holdings U.K. Ltd., known as LetterOne.

In those cases, the High Court of England and Wales will need to manage the inevitable tension between transparency and due process for the parties on the one hand, and the U.K.'s national security interests on the other. This is a key issue to watch in the coming year.

If current practices hold, a key headline is that investors associated with China should anticipate continued scrutiny, although this is likely to impact timing rather than ultimate clearance — at least on the face of the published numbers.

Likewise, acquirers with investments in the defense and military and dual use sectors should be prepared for greater scrutiny, but again with the main impact being on timing, since the vast majority of transactions are approved — in all sectors.

It is also hoped that the government continues its practice of issuing market guidance notes in line with its growing experience with the NSI regime.

Andrea Hamilton and Ajal Notowicz are partners at Milbank LLP.

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[1] <https://www.gov.uk/government/publications/national-security-and-investment-act-2021-annual-report-2023>.

[2] <https://www.gov.uk/government/publications/national-security-and-investment-bill-2020-factsheets/overview-of-the-investment-security-unit-factsheet>.

[3] <https://www.gov.uk/government/publications/national-security-and-investment-act-2021-annual-report-2023/national-security-and-investment-act-2021-annual-report-2022-23-html>.

[4] <https://www.dailymail.co.uk/news/oliver-dowden/index.html>.

[5] <https://www.gov.uk/government/publications/national-security-and-investment-statement-about-exercise-of-the-call-in-power/national-security-and-investment-act-2021-statement-for-the-purposes-of-section-3>.