THE CITY OF LONDON LAW SOCIETY

COMPANY LAW COMMITTEE

Response to Commons Sub-Committee on National Security and Investment
Call for Evidence: Information Sharing by the ISU

Introduction

The views set out in this response have been prepared by a working party of the Company Law Committee of the City of London Law Society (the "**CLLS**"). The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This working party is made up of senior and specialist corporate lawyers from the CLLS who have a particular focus on issues relating to mergers and acquisitions.

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1. HOW, AND HOW EFFECTIVELY, DOES THE INVESTMENT SECURITY UNIT (ISU) COMMUNICATE WITH THE FIRMS INVOLVED IN TRANSACTIONS? HOW COULD THIS IMPROVE?

Engagement

1.1 Prior to the Act coming into force, the ISU responded promptly to requests for clarification, both on the Act and The National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021 (the ***Mandatory Sector Regulations***). This was helpful in enabling legal advisors to resolve a few of the grey areas in the Act and Mandatory Sector Regulations and provide advice to the parties to potential transactions.

1.2 The ISU also engaged constructively with parties' legal advisors on specific transactions, and would indicate in appropriate circumstances (without binding future Ministerial decisions) that a transaction was unlikely to be called in after the Act came into force. Responses to queries on specific transactions would typically be along the following lines:

> "*As you will appreciate, until commencement of the National Security and Investment regime, we are unable to give any blanket assurance that your transaction will not be the subject of a call-in notice. Whilst we cannot give any assurance about any decision the Secretary of State may make when the NSI regime is in operation, we are of the view that, based on the information provided and at the current time, your transaction is unlikely to give rise to concerns necessitating the issue of a call-in notice*."

1.3 Since the Act came into force, however, there has in our experience been a significant decline in engagement by the ISU with parties, both outside and within the formal review process. We

consider that the transparency and efficiency of the regime would benefit from more frequent and more open communication between the ISU and parties, particularly during the course of the in-depth review following the issuing of a call-in notice and in relation to potential concerns and remedies.

1.4 It is particularly unhelpful that, unlike in merger control processes, the ISU is not under any obligation to inform the parties (by way of a "state of play" meeting or otherwise) of the concerns which it has identified and is considering in the context of a Phase 2 review, or of concerns that have prompted the ISU to consider opening a Phase 2 review.

1.5 While we appreciate that there may be a limit to the nature and extent of the information which the ISU can share with parties in certain circumstances given the focus of the regime, we note that the parties would be able to assist the ISU more constructively in assessing the risks identified if it were to communicate at least the fact of such concerns, and preferably further detail regarding the nature of the concerns (if possible in the circumstances) to the parties by a particular date in each of the Phase 1 and Phase 2 processes. We also think it would be helpful for the efficiency of the regime for the ISU to have a clear target within the review period by which it provides such guidance. It is also important that a minimum level of transparency is required and consistently applied, rather than subjecting parties to inconsistency between different teams with the ISU.

1.6 We also note that the ISU risks taking decisions, which ultimately may have wide ranging economic implications, on the basis of only partial information in circumstances where it does not communicate with parties on this basis, either because (i) the parties are not given any opportunity to put the relevant information before the ISU, or (ii) there is insufficient time to do so. Allowing the parties the opportunity to provide information that helps the ISU to better understand the relevant concerns would create procedural efficiencies, by avoiding some unnecessary Phase 2 reviews and reducing the risk that final orders are excessive or require subsequent variation.

1.7 This lack of transparency is compounded by the fact that the standard for appeal of ISU decisions is judicial review – so parties are placed in a position of neither having a clear idea of the ISU's concerns leading to a decision, nor often being able to effectively challenge such decisions at court. Transparency and the right to appeal decisions of public bodies are usually seen as important checks and balances on the state's exercise of its powers.

1.8 The situation is further exacerbated by our observation that Government departments are less willing to engage with parties once the formal ISU process begins. This approach is unhelpful, particularly given the lack of transparency from the ISU explained above. We understand that the formal review process under the Act is run by the ISU, which gathers feedback from the relevant Government departments, but this should not discourage other Government departments from sharing their views directly with parties if requested, which will enable parties to consider proactively how any concerns might be addressed.

1.9 There are also a number of issues which are of particular relevance to financial buyers, for example the extent to which the identity of limited partners with no (or very limited) control rights is a matter of concern to the ISU, whether parties whose transactions are frequently cleared by the ISU will be

given "credit" by the ISU as low risk acquirers, specific issues relating to sovereign wealth funds, etc. Any guidance the ISU is able to provide on these topics would help market participants be better informed and prepared in their dealings with the ISU.

Remedies

1.10 A lack of ability and information on remedies also risks an inefficient allocation of capital in the investment market. Deal parties frequently self-assess potential national security concerns for a transaction prior to entering into it. This will include a consideration of potential remedies in the event that the ISU determines they are necessary. On the one hand, where parties cannot, with a reasonable degree of accuracy, scope potential remedy concerns with their deals, there is a risk that deals which might otherwise have been beneficial to investment into the UK (with some protections) stay in the boardroom. On the other hand, without sufficient early engagement on remedies, there is a risk that capital could be deployed by investors into deals which might never have been realistically acceptable to the ISU, or which are abandoned because the remedies imposed are unacceptable to the parties but could have been modified to address the ISU's concerns in a way that was acceptable to the parties. Both risks arise because the ISU does not have any clear process for discussing and agreeing remedies with parties.

1.11 We understand that there has been at least one instance in which a Final Order has been imposed without any consultation with the parties or even any prior indication that it would be imposed. Such practice, in addition to being contrary to the rights of defence, risks being counterproductive because, in order to be effective, the precise terms of the Order should reflect the nuance of how the target and acquirer are operated. Behavioural remedies that are not discussed in advance with the parties are highly likely to over-remedy the underlying concern and/or not to be fully effective in addressing the concern.

1.12 More generally, this lack of engagement on remedies is an unhelpful development compared to the prior practice under the Enterprise Act 2002 public interest intervention regime, in which the parties could actively discuss and negotiate the detailed terms of undertakings with the government, leading to outcomes which were more cognisant of commercial considerations while addressing the government's legitimate national security concerns.

1.13 Another measure that would mitigate deal uncertainty would be the publication by the ISU of remedy "templates" for the various different types of remedy that the ISU typically imposes (divestments, information restrictions, requirements to maintain certain capabilities or activities in the UK, restrictions on influence over staff/director appointments etc). The (non-confidential) text of remedies imposed under the previous Enterprise Act regime were published and gave deal parties useful indications of how the detailed obligations might look, if remedies were to be imposed in their case. Similarly, the CMA publishes a template for divestment remedies.[1] Parties understand that these are not in any way binding and will be adapted to the circumstances of the case, but find that they provide much more useful

[1] Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/562650/UIL-merger-template.docx

information than the two or three line descriptions of remedies that are currently contained in the ISU's final orders.

1.14 It would also help market participants plan and prepare for transactions if the ISU could provide more information or guidance on its approach to the imposition of conditions on transactions and the concerns driving the way that the conditions which have been imposed have been developed. For example, what are the factors which lead to certain conditions being imposed rather than others, and in what circumstances will the ISU determine that no conditions will be sufficient and that a transaction must be blocked/reversed?

Mandatory Sector Regulations

1.15 One of the most difficult issues in practice is how to interpret and apply the sector definitions in the Mandatory Sector Regulations, particularly in "edge" cases where it is not clear whether or not the activities of a relevant entity fall within a relevant definition. The ISU is less forthcoming in the guidance it is prepared to offer in difficult cases, meaning that parties are left with the only safe option of making a voluntary filing given the consequences of failing to do so if the government takes the view that a mandatory filing was required. This is obviously time consuming and expensive for market participants, as well as placing a burden on the ISU in terms of reviewing voluntary filings which need not have been made. If the ISU were able to provide guidance or more clarity on whether or not a particular business fell within the Mandatory Sector Regulations, based on our experience that would likely help to streamline matters considerably.

Contacts

1.16 Finally, we also note two minor administrative points:

(a) First, in the ISU's notification system it is only possible to include the name and email address of one legal advisor. If, for example, that person is on annual leave at the time of any communication then there may well be a delay in receipt of the communication, to the detriment of the parties involved. It would be more effective to be able to include contact email addresses for additional legal advisors responsible for the notification.

(b) Second, it would be helpful to be able to provide in the notification system contacts for the target's legal advisors in addition to a contact within the target entity. We are aware of instances where an RFI addressed to a target (stopping the review clock) was not been received promptly because it was sent only to an individual at the target entity, who did not receive the communication due to screening by their email provider.

2. WHAT METRICS AND INFORMATION SHOULD BE USED TO ASSESS THE IMPACT AND EFFECTIVENESS OF THE INVESTMENT SCREENING SYSTEMS, AND OVER WHAT TIME FRAME?

2.1 We think it would be helpful for the assessment of the impact and effectiveness of the investment screening systems to take into account the following metrics/information, which the ISU's first annual report published in June 2022 did not address (or address in sufficient detail).

(a) **Notifications.** The number of notifications to the ISU, broken down by:

(i) Mandatory and voluntary notifications, and retrospective call-ins (with voluntary notifications broken down as between those actively notified by the parties and those called-in by the ISU);

(ii) The outcome (clearance, behavioural remedies, structural remedies, prohibition, withdrawal of notification or parties abandoning the transaction);

(iii) Number of notified transactions that were wholly intra-group;

(iv) The sector of the economy in which the Target is active; and

(v) Transactions that were also reviewed by other FDI authorities outside the UK, and transactions in respect of which the ISU had direct interactions with other FDI authorities (with a geographic breakdown).

(b) **The duration of the review process.** For each of mandatory and voluntary notifications separately, the (i) average, (ii) longest, and (iii) shortest, number of working days for each of:

- Pre-notification;
- Clearance in the initial screening review period;
- Clearance following the issuing of a call-in notice;
- Remedies; and
- Prohibition.

(c) **Acquirers.** Details of the nationality of acquirers, broken down by notifications, clearances, call-in notices following mandatory notification, other call-in notices, remedies and prohibitions.

(d) **Targets.**

(i) For asset acquisitions, details of the locations of the Target assets (i.e., within the UK (and details of specific nation/region) or outside of the UK); and

(ii) For acquisitions of shares or voting rights in entities, details of the nationalities of any non-UK target entities and the proportion of transactions reviewed where there were no UK target entities.

(e) **Enforcement.** Number of instances of non-compliance with the provisions of the Act or remedies imposed under the Act, and action taken by the government.

2.2 With regards to time frame, given (i) the minimal disclosure obligations on the Government in relation to individual cases, the practice to date of disclosing minimal information in any Final

Orders, and therefore the minimal amount of publicly available information on which parties have to rely in forming their expectations as regards the NSIA process, and (ii) our observation that the regime appears to operate with a strong political connection (emphasised by the recent move of the ISU to Cabinet), we think the assessment should occur more frequently than annually and we suggest that quarterly would be appropriate.

2.3 We also think it would be helpful to include comparative summaries, as against the most recent prior reporting period (and, if quarterly reporting is adopted, comparing year against year).

3. WHAT CAN THE UK LEARN FROM THE WAY OTHER COUNTRIES REPORT ON THE WORK OF THEIR INVESTMENT SCREENING SYSTEMS?

3.1 We have incorporated in the response to the question above some of the reporting fields which we think can be adopted from other countries' reporting systems.

3.2 In addition, we note that each of Australia and France publish detailed annual reports which include a good amount of helpful information and should be considered by the UK in structuring its reporting. Please see examples here and here.