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National Security & Investment Act: UK Government wins first challenge to divestment order

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The first ever judgment on the UK Government's application of the National Security and Investment Act 2021 ('**NSIA**') has been handed down. With a focus on the procedural aspects of the review, the High Court upheld the Government's decision to require LetterOne (ultimately owned by Russian nationals, including individuals subject to UK sanctions) to divest the entirety of its shareholding in Upp, a fibre broadband start-up.

The judgment sets out a high degree of deference that the courts will afford the UK Government in its NSIA reviews, and describes a high bar for parties subject to remedies orders seeking to overturn them. The judgment also makes some interesting comments on the consideration of current versus future national security risks (i.e. whether the Government can take action now to prevent risks from materialising) and on how significant financial losses for parties subject to divestment orders will be viewed (spoiler: they are likely simply part of the economic landscape for those operating in the alt-net sector or other parts of national infrastructure).

In this briefing we discuss the key elements of the High Court's judgment and our views on the future for procedural challenges across the NSIA/FDI landscape.

1. The case in question: acquisition of UK based broadband start-up

In January 2021, the LetterOne group acquired the entire share capital of Upp Corporation Ltd (previously Fibre Me Limited), a next-generation full fibre broadband provider seeking to connect underserved rural communities in the UK. By January 2022, Upp's network had rolled-out across eight towns in the East of England. (Whilst not relevant to the case in question, LetterOne is also present in the UK economy through its ownership of health and wellbeing retailer Holland & Barratt).

The Secretary of State for Business, Energy and Industrial Strategy at the time (Grant Shapps) called the deal in for review under the NSIA and, in December 2022, issued a final order requiring LetterOne to divest the entirety of its 100% shareholding in Upp (the 'Final Order').[1]

[1] The decision maker under the NSIA is now the Chancellor of the Duchy of Lancaster in the Cabinet Office.

2. The national security issues at play: risk of leverage by Russian State

The root cause of the Secretary of State's decision to call in, and unwind, the deal was the ultimate ownership of the LetterOne group. The holding companies within the LetterOne group are registered in Luxembourg. However, at the time of the Final Order, the ultimate beneficial owners ('**UBOs**') of the LetterOne group (and consequently the UBOs also of Upp) included Russian nationals sanctioned by the UK (and EU).

The Government's Investment Security Unit ('**ISU**') was concerned about the UBOs' vulnerability to leverage by the Russian State, meaning that certain national security risks could arise in relation to the roll out of Upp's full fibre broadband network.

The following risks were identified by the ISU:

1. Access to **customer data** which could be used for espionage and other activities which undermine national security.
2. **Disruption** to the operation of the broadband network.
3. Influencing **strategic decisions** of Upp in a way that undermines national security.

On 5 September 2023, LetterOne sold Upp to Virgin Media O2 as a result of the divestment order. The judgment refers to LetterOne receiving less for the sale than the £143.7 million that it had invested by that time. LetterOne had also, according to the judgment, expected to receive a 20% internal rate of return (on a total £400 million investment) upon its provisionally planned exit in 2028.

3. First NSIA court challenge: divestment order upheld

LetterOne appealed against the Final Order, and the hearing before the High Court was held over 4 days in July 2024. It was not in dispute that a risk to national security arose from the deal. LetterOne's case was that the Secretary of State acted unlawfully by imposing divestment as opposed to less intrusive measures (requiring full divestment was not, according to LetterOne, necessary and proportionate for the purpose of mitigating the risk to national security).

LetterOne cited breaches of:

- **Procedural fairness**, on the basis that the Government's national security concerns had not been sufficiently disclosed, nor was it given the opportunity to address those concerns with measures falling short of divestment.
- Common law **principles of public law**, namely that the Final Order was based on irrelevant considerations and also failed to take into account all relevant considerations.
- **Human rights**, i.e. the proportionality requirements of section 6(1) of the Human Rights Act 1998 and rights to the protection of property guaranteed by Article 1 of the First Protocol to the European Convention on Human Rights ('Article 1 Rights').

During the NSIA process with the ISU (and before the High Court) LetterOne advanced a list of "less intrusive" remedies that it claimed could, and should, have been ordered as an alternative to divestment (the 'Alternative Remedies').

Broadly, these less intrusive measures included:

- Restrictions on **flows of information** (including personal information) between Upp and the LetterOne group.
- Restrictions on physical and virtual **access to Upp's sites, data and personnel** by LetterOne representatives.
- Limitations on the **number of Investor Directors** that could be appointed by LetterOne (with Government approval also required for appointments).
- The establishment of a **Security and Resilience Committee** to monitor compliance with the Final Order.
- An **audit** of the Upp network's security to be carried out, as well as the appointment of an **independent auditor** (approved by the Government) to conduct a bi-annual audit of Upp's compliance with the measures and the work of the above committee.
- A requirement for all "**critical physical network assets**" to **remain in the UK**.

However, the Government (now upheld by the High Court) found that a full divestment would be the most effective at mitigating or preventing the national security risks and would carry the highest expectation of compliance and ability to enforce against breaches. The Court's key reasoning is discussed below.

4. Court's role in NSIA challenges is "limited"

In short, in this case, the High Court set out a high degree of deference to be given to the Government in assessing national security risks and remedies under the NSIA – it "*will treat as axiomatic that Parliament has entrusted the assessment of risk to national security to the executive and **not to the judiciary***" (emphasis added).

Section 26(3)(b) NSIA provides that the Secretary of State may make a final order where he or she "*reasonably considers that the provisions of the order are necessary and proportionate for the purpose of preventing, remedying or mitigating the risk to national security*". The Court found it to be plain from the statutory language that this question involves matters of judgment and policy which the Court is not equipped to decide.

The fact that the Secretary of State exercises powers under the NSIA in the interests of the safety of people in the UK also fed into the Court's reasoning - the potentially serious consequences of error mean that decisions must be made by "*persons whom the people have elected and whom they can remove*". The Court held that "*the scope for the intervention of unelected judges is limited*".

The Court also dismissed LetterOne's arguments that the ISU lacked sector expertise, finding that "*the ISU cannot be expected to have personal expertise in the full variety of specialist subjects which*

decisions under the [NSIA] may raise. However, as happened in the present case, the ISU is able to draw on the expertise of others in Government in order that the Secretary of State be provided with necessary and sufficient material when making decisions under the Act".

5. Procedural fairness: a high bar for challenge

The Court stated that it is not enough for LetterOne to say that the Government's decision-making procedure could have been better. They must show that the procedure is actually unfair.

In the NSIA context, the Court found that Parliament had expressly chosen to limit the Secretary of State's duty to consult to a requirement to "*consider any representations that are made*" (which had properly been done in this case). The Court said that, if it were to imply a wider common law duty to consult on all or any part of an adverse case, it would be "*frustrating the legislative purpose*".

LetterOne also took issue with the Government's use of standard procedures (such as the production of standard assessments, including an Investment Security Risk Assessment, Representations Assessment and Remedies Assessment) as opposed to a bespoke approach that varies from case to case. The Court again sided with the Secretary of State, finding its establishment of general procedures to be a "*proper*" approach which satisfied its statutory duties (and would also satisfy a duty to consult at common law).

Whilst dismissing LetterOne's arguments, the High Court did grant permission to apply for judicial review on this ground.

6. Relevant and irrelevant considerations: ISU takes correct approach

Relevant considerations were not missed

LetterOne argued that the Government's remedies assessment was wrong and misleading because it indicated that the Secretary of State needed to make a final order under the NSIA **now** in order to avoid a **future** risk (broadly because the Government only had one shot at reviewing, and remedying, the transaction under the NSIA – and could not come back to an NSIA assessment in the future).
[2] According to LetterOne, the correct approach would have been to consider the other statutory powers that could have been exercised going forward, such as sector specific telecoms legislation and data protection laws.

In dismissing LetterOne's arguments, the Court found there to be "*no possible grounds to criticise the Secretary of State's position that he need not wait to see whether Russian leverage would be applied at some future point*". The national security risks would have grown each year as Upp expanded its network, and the Secretary of State was *"indisputably entitled to take immediate action to prevent risks to national security from materialising*". Indeed it was his "*duty to do so*".

The Court also disagreed with LetterOne on the relevance of other statutory powers, stating that the Secretary of State cannot be criticised for having failed to consider the potential for the exercise of powers under a different piece of legislation involving different statutory objectives in another part of the

national security legal landscape. In short, these other powers do not serve the same purpose as the NSIA - they are not designed to prevent the national security risks which the NSIA is intended to prevent.

[2] Presumably, according to the Court, because the NSIA does not permit more than one call-in notice in relation to any trigger event (section 2(1) NSIA) and because of the limitations on retrospective call-in (section 2(4) NSIA)])

By way of example, LetterOne raised section 252 of the Investigatory Powers Act 2016, which empowers the Government to give UK telecommunications operators a national security notice requiring them to take specified steps in certain circumstances. The Court found that LetterOne had failed to put the section 252 power into its statutory context – which is the regulation of investigatory powers and emergency contingency powers, and not ownership/investment risks.

Irrelevant considerations had not formed part of the Secretary of State's decision

LetterOne referred the Court to sections of evidence in which the ISU had observed that the Alternative Remedies would have resulted in a significant burden on the Government's resources (for example in terms of monitoring). LetterOne argued that this was an irrelevant factor that should not have been taken into consideration.

The Court disagreed, finding that the burden on resources needed to ensure the effectiveness of the Final Order cannot be regarded as irrelevant (or reduced to a matter of expedience rather than necessity).

7. Human rights: divestment satisfies "proportionality" standard

LetterOne made several submissions relating to human rights laws although the Court, whilst expressing sympathy with some of those submissions, found the central issue to be decided was whether the Final Order was proportionate.

The question of proportionality in the context of Article 1 Rights has been analysed as having four limbs, i.e. whether:

1. The **objective** of the measure is sufficiently **important** to justify the limitation of a protected right.
2. The measure is rationally **connected** to the objective.
3. A **less intrusive** measure could have been used without unacceptably compromising the achievement of the objective.
4. The measure's contribution to the objective **outweighs the effects** on the rights of those to whom it applies. (The fourth limb is sometimes referred to as the '**fair balance**' issue).

The first two limbs were not in dispute.

The fourth limb - fair balance

The Court was required to decide whether the decision to impose the divestment remedy struck a fair balance between the general interests of the public and the individual rights of LetterOne. Again drawing on a high degree of deference to the Government's decision making, the Court stated that this does not mean the judiciary is the primary decision maker or that it should assess the merits of LetterOne's case. Rather, the Court should give weight to the Secretary of State's view of the balance between the individual rights and the wider public interest. Further, the weight to be attached to the Secretary of State's view of that fair balance will depend on the context of the interference with the right at stake.

In finding the divestment remedy to satisfy the 'fair balance' issue, the Court found that the vital importance of the public's interest in national security must be given considerable weight and that the Court's lack of institutional ability to make its own predictions about the future warrants a "*high degree of judicial restraint*".

The Court also noted that proportionality is in fact part of the legal test for the Government to make a final order. This is something that the Secretary of State had been advised of, and the evidence showed that such an assessment had in fact been carried out.

The third limb - less intrusive measures?

The question of whether less intrusive measures could have been imposed was found not to be a question of the Court "*searching out a putative single right answer*" but rather *"a matter of according appropriate respect to the answer that the executive has reached*". In short the Court found that, in a national security context (and in the absence of exceptional circumstances) this boiled down to asking whether the measure imposed was "*reasonable*". In this case, the Court found no grounds to interfere with the Secretary of State's conclusion that the UBOs were vulnerable to Russian leverage which posed a threat to national security.

The Court was also not persuaded that the Alternative Remedies (which were based on changes to corporate structures and other restrictions on LetterOne) would have the required impact as claimed by LetterOne. The Court placed weight on the Government's remedies assessment, which concluded that the Alternative Remedies "*would provide limited mitigation, to varying extents, of the national security risks identifie*d" and that they "*may achieve only a limited protective effect, resulting in unmitigated, extant risks*".

The Court reproduced part of a Ministerial Submission to the Secretary of State for DCMS (the Department for Culture, Media and Sport) which it viewed as succinctly setting out the rational for rejecting the Alternative Remedies. It stated that the Alternative Remedies *"would not be sufficient to address the national security risks. While the various restrictions (if implemented perfectly) would theoretically heavily restrict the relationship between the two parties [i.e. Upp and the LetterOne group], there is still a possibility that influence could be asserted. [The Government] would be placing a substantial amount of trust in the [Security and Resilience Committee] and audit arrangements on an ongoing basis in order to implement this remedy. As full fibre infrastructure is likely to be in place for up to three decades and this network, as planned, is likely to grow to be regionally significant, the [National Cyber Security Centre] advised that this remedy was not sufficient to mitigate the risks.*"

In conclusion, the Court found that the divestment remedy was proportionate.

8. Should LetterOne have been awarded financial compensation?

LetterOne submitted that its human rights had been breached by the failure to ensure that it received full compensation for requirement to divest.

Section 30 of the NSIA provides that the Secretary of State may, with the consent of the Treasury, give financial assistance to or in respect of an entity in consequence of the making of a final order.

In dismissing LetterOne's arguments, the Court noted that the language of section 30 NSIA renders the award of financial assistance discretionary, and that the Secretary of State should be afforded a wide margin of discretion in relation to whether a party operating an entity in a way that is contrary to the interests of national security ought to be reimbursed for financial losses upon divestment under the NSIA. In terms of LetterOne's financial interests, the Court found:

"*It is implausible to suppose that the loss of Upp destroyed the livelihood of anyone in the [LetterOne group] or that the [LetterOne group] cannot reinvest the proceeds of sale into profitable investments. Nor can large-scale investors be surprised that they may lose money on investments that threaten national security: the risk of such losses is ultimately part of the economic landscape for those operating in the alt-net sector or other parts of national infrastructure. That geopolitical crises may affect the viability of investments in a way that cannot be recouped should not come as a surprise to sophisticated economic actors, such as the [LetterOne group]. It was not disproportionate – or otherwise in breach of [human rights] – for the financial burden of the sale of Upp to fall on the [LetterOne group's] shoulders and not on the public purse*".

The Court did however grant permission to apply for judicial review on this ground.

9. Other interesting points

Stringent UK company and data protection laws are no defence

LetterOne argued that the risk to national security in this case was derived from a "*remote*" chain of events – consisting of the possibility of the Russian government exerting influence over the UBOs, who would then use their shareholder rights to change the company governance so as to enable LetterOne to cause Upp, through its board or management decisions, to take significant actions that would undermine national security. According to LetterOne, this "*remote*" risk could be resolved by corporate change and operating restrictions such as: amended articles of association, investment management contracts and other corporate governance measures. Amongst other things LetterOne argued that the Secretary of State had failed to appreciate the lack of opportunity within the rigours of company law, and data protection laws, for the UBOs to take steps that might actually compromise national security.

In dismissing these arguments out of hand, the Court found the relevant point not to be whether LetterOne (or anyone else) would breach laws, but rather whether malign actors would exploit the connection between the UBOs and Upp in any manner of ways (such as deceit, manipulation or other forms of pressure) to, for example, get hold of personal information.

Closed and open evidence

The Court reached its judgment on the basis of the open evidence (both discussed in the judgment and disclosed to LetterOne and its lawyers). However, its findings were also supported by closed material, i.e. material which if disclosed would cause damage to the interests of national security (and thus was not disclosed to LetterOne or its lawyers). The closed material was dealt with in a separate closed judgment. We can expect this type of procedure to be used routinely in future NSIA appeals.

On the question of disclosure, Swift J handed down an earlier judgment (on 23 February 2024) in which he considered the Secretary of State's approach to the presentation of "*open gists of closed documents*" ([2024] EWHC 386 (Admin)). The various gists had initially been presented to appear like the original, complete documents (i.e. giving the appearance to the reader that they were the original documents as opposed to being gists of undisclosed documents). Swift J criticised that approach and set out the steps that the Secretary of State had agreed to take in order to remove any misapprehension caused to the LetterOne group. Government lawyers then took the required steps.

Research into individual members of ISU staff not welcome

During the trial, the Court noted that LetterOne's submissions had "*singled out*" an individual, junior member of staff as an unsuitable decision-maker who lacked any relevant expertise. LetterOne had carried out research on that individual and a print-out of his career history from a social media profile had been produced by LetterOne when submitting that key elements of the decision-making process had been entrusted to the junior staff member.

The Court was less than impressed. As well as correcting LetterOne's position, clarifying that the individual was not the decision-maker and that there is no evidence that the individual did anything that could not be expected of a junior official working in an administrative capacity, the Court also found LetterOne's online search for his personal details to be "frivolous and vexatious".

This unfavourable view accords with the ISU's general approach not to disclose the identity of more junior members of staff on cases (except where warranted).

10. Is there a future for procedural challenges under the NSIA and FDI regimes?

This case is the first challenge under the NSIA and hence also the first appeal in which procedural rights have been considered in an area which rests heavily on judgment and policy. The Court sided squarely with the Government in this case, which raises the question of under what circumstances a procedural challenge could succeed in future cases. The Court has also granted permission to apply for judicial review on some of the grounds considered in this case, so this may not be the end of the road for LetterOne's appeal. It is notable, however, that the Court did carry out a review of the procedures and steps that were taken by the ISU/UK Government under the NSIA investigation in this case, and the judgment draws on evidence demonstrating that the views of other Government departments with relevant expertise were sought and taken into account.

The case also falls against the backdrop of recent FDI challenges in the EU, for example in Germany. In November 2023, the Berlin Administrative Court overturned the federal decisions in two German FDI cases purely on procedural grounds (and without having to delve into the substance).[3] Also at the EU-

wide level, the European Commission's proposals to update the EU FDI Screening Regulation introduce various procedural improvements (including requirements for Member States to keep investors informed, to give reasons prior to imposing remedies or prohibitions, and to provide investors with an opportunity to be heard and express their views on Member States' concerns).

Whilst LetterOne's challenge did not succeed before the High Court, the issue of procedural fairness and oversight of FDI decision-making globally is however still alive.

[3] Investitionsprüfung: Erwerb eines Anteils an der PCK Raffinerie in Schwedt gilt als freigegeben (Nr. 44/2023) and Investitionsprüfung: Erwerb eines Medizinproduktherstellers durch chinesisches Unternehmen durfte nicht untersagt werden (Nr. 46/2023)]