

UK Government publishes key updates to NSI Act guidance

United Kingdom · 13/06/2024

Overview of the key updates

On 21 May 2024 the UK Government published updated guidance on the scope and application of the UK National Security and Investment Act (NSIA). The changes respond to some of the stakeholder feedback received during the Government's November 2023 Call for Evidence on how to hone the scope of the NSIA. They also aim to fulfil the Government's commitment in April 2024 to provide further clarity on the NSIA to institutions, businesses and advisers grappling with its application in practice. Key updates include:

- **Guidance on higher education:** New guidance has been published on the application of the NSIA to higher education and research-intensive sectors, including specific examples intended to assist universities and academics decide when to notify.
- **Amended statement on the use of the call-in power ('Section 3 Statement')** : In the first update to this guidance since the NSIA came into force in January 2022, the new Section 3 Statement provides more detail on the risk factors that feed into the Government's decision to call-in an investment or transaction for review.
- **Guidance on Outward direct investment:** The Government has provided explicit guidance and further specific examples on how the NSIA can apply to UK persons acquiring an entity or asset outside of the UK. This is a nod to an international trend which considers whether national security might just as well be put at risk in outbound investment transactions, where sensitive know how and information might be accessed and controlled in ways that foreign investment control regimes do not necessarily envisage or capture.

The Government also published minor updates to its guidance on completing NSIA notifications and the timing of reviews. Most notable among these is the confirmation that review timelines may only be expedited in exceptional circumstances, which include where Target is suffering material financial distress and there is a body of evidence available to substantiate this.

The focus of this update is on (i) the updated Section 3 Statement, and additional detail that has been provided on the risk factors that help determine the use of the power to call-in transactions; and (ii) clarifications on how the NSIA applies to outward direct investment. We will cover the updates to the guidance on higher education in more detail in a separate standalone article.

The updated section 3 statement

Much of the approach in the previous Section 3 Statement has been retained, and the updates are not intended to mean a wholesale change to the NSIA or change of policy. The updated statement reaffirms the Government's reluctance to define 'national security'. It intentionally does not set out exhaustive circumstances in which national security is, or may be, considered to be at risk, to protect the Government's ability to intervene flexibly where needed. It restates that the NSIA is only intended to safeguard national security, rather than other objectives, obliquely addressing concerns that the NSIA was a way to promote wider economic or other objectives (e.g. protecting employment in the UK) through the backdoor.

However, perhaps most significantly, it has removed the section of the guidance regarding areas of the economy subject to the call-in power. The previous version explicitly stated that qualifying acquisitions across the whole of the economy were within the scope of the NSIA, and therefore potentially subject to the call-in power, provided there was a suspected risk to national security. This is a distinctive feature of the NSIA as compared to other foreign investment control regimes, where scope is typically limited to sensitive areas of the economy. The updated guidance still states that acquisitions relating to the 17 mandatory sectors are more likely to be called in than those outside of those areas, given their sensitivity. But the removal of that section does represent a change in emphasis which seems to reflect the Government's intention to use its powers in a targeted and proportionate manner.

The updated guidance also adds a number of declaratory statements as to the purpose of the NSIA, including statements that the NSIA is a 'proportionate and targeted regime', which, although of limited value in terms of guidance, will frame the Secretary of State's decision to exercise the call-in power.

The new Section 3 Statement provides helpful further guidance in relation to each of the Target, Acquirer and Control risks that may lead a transaction to be called-in for review. In particular:

- **Target risk:** in relation to both entities and assets, the guidance confirms that a connection with activities in the 17 sensitive areas of the economy which trigger a mandatory notification (i.e. entities active in those, or closely linked, sectors and assets used in connection with those or closely linked sectors) are more likely to be considered high risk, and therefore called in – as are transactions involving entities with a sensitive supply chain relationship to the Government. The updated statement includes a specific example of when the incorporation of a new entity may be called in (namely if it includes a change of control over an existing asset or entity).

With respect to assets, the new guidance includes a list of examples where national security could be at risk, all of which relate to assets with dual-use capabilities. A number of the transactions blocked under NSIA involved dual-use items (among others). The examples are helpful in highlighting areas the Government may want to probe in its review, such as the asset's potential to be repurposed in a manner which could undermine national security, security processes and governance structures. The guidance provides a helpful reassurance that the Secretary of State expects to only rarely call-in acquisitions of assets that do not fall into these higher risk categories (i.e. connection to sensitive sectors or in the case of land, proximity to sensitive sites).

- **Acquirer risk:** Whilst country of origin will not be the sole factor considered when weighing a call-in decision, any political, military or state-backed influence will be relevant, especially where those links are to countries with high degrees of Government surveillance or with powers to compel acquirers to share data or provide assistance to e.g. intelligence agencies. Acquirer intent and historic behaviour will also be taken into account. In addition, the Government has expressly confirmed that acquisitions of certain Targets would be considered so sensitive as to warrant a review, regardless of acquirer risk. This seems like an oblique justification of the wide scope of the NSIA, which has been criticised for capturing acquisitions by domestic companies, unlike most foreign investment control regimes. The guidance notes that national security can still be put at risk by a UK acquirer with poor information security, or by acquirers that have previously been cleared.
- **Control risk:** The Government will assess "control" in the round, having regard to historic patterns of voting / shareholder activism, and if needed may also make use of information gathering powers to determine whether the combination of shares and voting rights being

acquired will enable the acquirer to materially influence the behaviour of the target. The guidance states repeatedly that the Government will consider any risk arising from cumulative investments across a sector or supply chain.

The new guidance provides welcome clarity in respect of the intended application of the NSIA and appears to demonstrate an effort by Government to improve transparency and visibility over the core aims of the legislation. There are certainly new elements to the guidance that will assist investors and practitioners as they seek to weigh up the prospect of a transaction being called-in and the resulting impact on their deal timelines. The updates to the market guidance and the illustrative examples provide a helpful steer for companies on maintaining the capacity and capability of supply chains across sectors. But whether these updates alone achieve the increased transparency that parties have been seeking since the inception of the NSIA, or make the NSIA the 'proportionate and targeted regime' the Cabinet Office claims, is very much still up for debate and will have to be tested in practice.

Explicit guidance on outward direct investment

Whilst the updated guidance includes a new section titled 'Outward Direct Investment', there is nothing new in the principle that the NSIA can apply to overseas transactions with a sufficient UK nexus. The decision to include this guidance alongside new practical examples is likely borne from a desire to raise awareness among the investment community as to the extraterritorial reach of the NSIA in prescribed cases. Indeed, the examples provide helpful colour on how to interpret the legislation and coupled with the examples given in the updated guidance on higher education should help clarify the circumstances where the NSIA applies to overseas investment. In particular, the new examples explain that:

- In an M&A context, the acquisition of IP originating from a UK-based company would constitute a qualifying asset and gives rise to a sufficient connection to the UK (which may then be subject to the call-in power or potentially need mandatory notification if the other requirements are also met);
- A JV with a business with no legal or physical presence in the UK but which will provide access to the foreign JV parent to sensitive intellectual property and technical expertise held by the UK company could be subject to the Government's call-in powers on the basis that the transaction involves the acquisition of a qualifying asset.

The guidance also clarifies that a qualifying asset can include an asset(s) used to generate energy or materials that are used in the UK (as distinct from supply to the UK).

Further rationale for including this new section on Outbound Direct Investment may lie in the general trend we are seeing towards considering proactive screening of outbound investments in sensitive sectors. The UK Government has indicated that it is giving thought to whether further screening mechanisms may be required for outbound investment. US President Biden issued an Executive Order in August 2023 directing the Treasury to set up a program for prohibiting and requiring notification of certain types of outbound investments. The Treasury then issued an Advance Notice of Proposed Rulemaking detailing the intended contours of the outbound investment restrictions, which are still being debated and finalised. The European Commission (EC) issued a White Paper and launched a consultation in relation to proposals for the analysis of EU outbound investment in January 2024. The EC is assessing whether the current regime (which includes e.g. restrictions on the export of dual use technologies) is sufficient or ought to be replaced or supplemented by a dedicated framework for the consideration of EU outbound investment. Following assessment of the consultation responses, the EC together with Member States is aiming to launch a data gathering

(including retrospective data) and scoping exercise this autumn, followed by a risk assessment during summer 2025. If risks are identified, the EC aims to recommend next steps in Autumn 2025.

What's next?

Given the upcoming general election and the resulting dissolution of parliament, it remains to be seen whether the incoming Government chooses to prioritise amendments to the NSIA. However, the Government's response to the Call for Evidence signalled that we can expect a consultation on the 17 sensitive areas of the economy that are subject to mandatory notification requirements and later in the year, consideration of technical exemptions to the mandatory notification requirement. We will report on these developments as they happen.

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