How The UK Investment Screening Regime Is Taking Shape

By **John Schmidt, Ludovica Pizzetti and Ronald Lee**

With the U.K. government publishing a decision on Aug. 7 imposing remedies under the U.K.'s National Security and Investment Act 2021 on the acquisition by EDF Energy of two U.K. businesses, we reflect on what this means for future deals and, more generally, how this latest decision fits within the general trend as the regime is gradually taking shape.

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We also provide some insights on how the remedy landscape in the U.K. compares with the U.S. under its Committee on Foreign Investment in the United States regime.

The U.K. investment screening regime under the NSIA has been around for some 18 months now.

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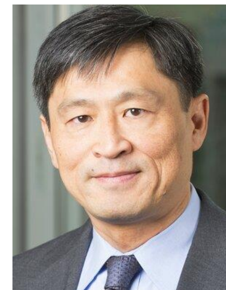
Although the latest statistics show that, so far, the number of notifications filed under the NSIA has been much lower than initially predicted under the U.K. government's original impact assessment,[1] the number of call-in notices — just below the expectation in the impact assessment — evidences the government's willingness to dive deeper into certain transactions, including those falling under the voluntary regime.


Ronald Lee

Like the U.S. system, the U.K. screening regime is very much a black box[1] in terms of internal decision making: Once a filing is submitted, interactions with the case team are extremely limited throughout the process.

Yet, the Investment Security Unit may be somewhat more willing than the Committee on Foreign Investment in the United States to engage in some dialogue before, during or after notification, mainly around notifiability.

While the decisional practice under the NSIA is still taking shape, we are beginning to see some interesting trends. The latest decision imposing remedies on French conglomerate EDF Energy's U.K. subsidiary to address the U.K. government's concerns is in line with these emerging trends.

Based on what we have seen so far, the key takeaways for us are:

- Outright prohibitions are limited and relate to companies with links to China and Russia that are active in sensitive areas.
- Conditions are imposed where a deal may affect U.K. self-sufficiency in core industries or affect important projects, particularly in the defense sector or other sensitive sectors like military and dual use, or communications.
- The identity of the purchaser is relatively unimportant for a deal to be under scrutiny: Acquirers from a very close NATO ally and good U.K. corporate citizens may

still face mandatory notifications requirements or be subject to burdensome conditions.

Final Order Imposed on EDF Energy

On Aug. 7, the U.K. secretary of state issued a final order imposing government step-in rights and other national security remedies on the acquisition by EDF Energy of two U.K. businesses that supply naval propulsion systems, among other things.

The Transaction

A wholly owned subsidiary of EDF Energy Holdings Ltd. agreed to acquire control of GE Oil & Gas Marine & Industrial U.K. Ltd. and GE Steam Power Ltd. This transaction was subject to a mandatory notification under the NSIA.

The Issue

The secretary of state considered the acquisition to be a risk to national security due to the fact that both U.K. target companies deliver critical national security and defense capabilities relating to naval propulsion systems.

The Remedies

The secretary of state imposed a bundle of remedies that:

- Seek to protect sensitive information and ring-fence such information within the target company;
- Place a U.K. government-appointed observer on the target companies;
- Set up a steering committee on the acquiring company's board to oversee compliance; and
- Impose an obligation to maintain capacity and capability with respect to critical Ministry of Defense programs in the U.K.

Crucially, the order also imposed step-in rights in case of serious breaches of the order that would jeopardize Ministry of Defense programs. Here, the secretary of state can take operational control of the relevant part of the business to fulfill those Ministry of Defense programs.

Future Deals and Emerging Trends

The order is generally in line with the current decisional practice as well as the overview of the regime's operation most recently provided by the U.K. government in its first full-year NSIA annual report published in July. It is also interesting in a number of respects when put into context with other decisions.

The following are among the points worth highlighting.

NSIA as a Standard Consideration

The order confirms that the U.K. regime is, at least to a certain extent, country-agnostic. According to the annual report, around 60% of notifications in the reporting period — i.e., April 1, 2022, to March 31, 2023 — concerned investment from the U.K., with the U.S. next highest at around 25% and France to follow.

As such, given that NSIA review can affect the timetable for any deal with potential national security implications, it has become clear that the NSIA should now be a standard consideration in any merger or acquisition transaction with a U.K. angle.

Friendly Investors

Despite the above, acquisitions by so-called friendly investors are less likely to face prohibitions and, even where sensitive targets are at stake — e.g., suppliers of the Ministry of Defense — the government's concerns tend to be largely addressed through the imposition of behavioral remedies.

Conversely, in line with the current approach to national security scrutiny by other Western foreign direct investment agencies, Chinese investments are more likely to get closely scrutinized.

According to the annual report, although China made up less than 5% of total notifications, around 40% of transactions that were called in for in-depth review related to Chinese investment, with investment from the U.K. and the U.S. being, respectively, 32% and 20% of all call-in notices.

It is particularly striking that, of the 15 final orders in the reporting period — either remedy or prohibition decisions — eight related to investment from China, four concerned U.K. investment, and three related to investment from the U.S. Of these, all five prohibitions related to investment from China (four) or Russia (one).

That said, final orders look set to remain the exception rather than the norm, and this holds true also looking at the period after the annual report — with only two final orders imposing remedies issued to date since March 31.

Defense and Military Sectors

The prevalence of the defense and military sectors, both across the number of notifications and across call-in and final orders, is undeniable.

This is a function of both the intention behind the NSIA to capture transactions most likely to raise national security concerns, and — connected to this — the breath of the defense and military headings under the NSIA.

This captures companies at any level of the supply chain providing goods or services for defense or national security purposes in the U.K., including good and services with no clear military application.

Conditions

Where transactions are cleared subject to conditions, one can begin to see which types of remedies are most often imposed to mitigate national security concerns.

The protections of access to sensitive information and technology, security and continuity of supply to the U.K. government, maintenance of operations or strategic capabilities in the U.K., as well as government auditing and reporting obligations are becoming a standard feature of the typical remedies packages.

As was the case in the order, government step-in rights can also be significant and wide-ranging in the case of potential prejudice to the U.K. Ministry of Defense programs.

U.K. Action Compared With U.S. Remedies

The U.K. secretary of state's action also provides an interesting counterpoint to the U.S. regulation of takeovers affecting national security interests.

Like the U.K. regime, the U.S. regime can impose a variety of remedies to address national security risk, including a full prohibition of the deal by the president, and a range of structural, organizational, administrative, and behavioral requirements and conditions.

While step-in authority to take over a business after it closes does not — to date — have a direct equivalent in the U.S., parties that have agreed to comply with requirements and conditions in order to obtain regulatory approval are subject to U.S. enforcement action if they breach those requirements and conditions.

Conclusion

There are increasing burdens and potential hurdles on parties to international deals, and national security reviews are becoming part of the key strategic considerations to be made at the outset.

Parties seeking approval of trans-Atlantic mergers and acquisitions should anticipate and coordinate their filings and discussions with two or more national security bodies, as well as antitrust and trade regulators and any applicable sectoral regulators;[2] where necessary, a coordinated remedy strategy should also be formulated.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934276/nsi-impact-assessment-beis.pdf.