NSI Policy Team
Department for Business, Energy and Industrial Strategy
4th Floor, Orchard 3
1, Victoria Street
London
SW1H 0ET

Email: nsistatementconsultation@beis.gov.uk

2 September 2021

Dear Sir, Madam

Re: NSI Section 3 Statement Consultation

1 Overview

1.1 We are writing on behalf of the British Private Equity and Venture Capital Association ("**BVCA**"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers and investors. Between 2015 and 2019, BVCA members invested over £43bn into nearly 3,230 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ 972,000 people in the UK and the majority o the businesses our members invest in are small and medium-sized businesses.

1.2 We welcome the opportunity to comment on the consultation on the draft statement (the "**Statement**") concerning the use of the call-in power under section 3 of the National Security and Investment Act 2021 (the "**NSI Act**") (the "**Consultation**").

1.3 We support the introduction of updated powers to screen investments which may present a risk from a national security standpoint. At the same time, an adequately detailed description of how the call-in powers will be exercised is essential to ensuring transaction parties, including private equity and venture capital investors, are able to undertake investment decisions and navigate the new regime effectively. However, we are concerned that the Statement does not provide sufficient clarity to help transaction parties understand whether their acquisition is likely to be called in by the Secretary of State and to plan

accordingly. We believe that specific amendments accompanied with targeted additional guidance would help ensure the Statement achieves its stated objective.

2 Response to consultation questions

2.1 Is the statement clear in its description of how the Secretary of State expects to use the call-in power provided by the NSI Act? Does the statement help you to decide whether your acquisition is likely to be called in? Are the risk factors that the Secretary of State will consider set out in an understandable way?

2.2 General observations

2.2.1 First, we note that paragraph 4 indicates that the NSI Act "intentionally does not set out the circumstances in which national security is, or may be, considered at risk. This reflects longstanding Government policy to ensure that national security powers are sufficiently flexible to protect the nation". During Parliamentary debates, it was stressed that any attempts to define national security would only (i) reduce the flexibility of the Government's power to protect against risks to national security; and (ii) encourage hostile investors to seek loopholes to the regime. Nonetheless, in the course of those debates, Lord Fox (amongst others) expressed concerns that the Government had drafted the NSI Bill "as widely as possible to give the department as much leeway as possible in the event of stuff happening, stuff which is as yet undefined or is perhaps undefinable".[1]

2.2.2 While we understand the considerations that have led to "national security" remaining undefined, we urge the Government to provide as much clarity as possible in its Statement to help investors navigate the new regime. We note that the approach taken in other jurisdictions might serve as a helpful benchmark. For example, the Australian regime sets out factors that parties to transactions in certain sectors should consider when assessing the likelihood that foreign investment approval should be sought. The Australian Foreign Acquisitions and Takeovers Regulation 2015 also defines the concepts of "national security business" and "national security land".

2.2.3 We also urge the Government to reconsider whether it would be appropriate for the Secretary of State to review the Statement every five years. If one of the driving forces behind the lack of a definition of "national security" is the desire to preserve flexibility and adapt the upcoming regime to fast-changing national security threats, it might be insufficient for the Statement to be reviewed only every five years. We consider that more regular reviews on a mandatory basis would not only ensure that

[1] National Security and Investment Bill, Volume 811: debated on Thursday 15 April 2021, available at https://hansard.parliament.uk/Lords/2021-04-15/debates/E52526A0-914A-48C5-81CA-32A1244E6D18/NationalSecurityAndInvestmentBill.

the Government remains abreast of national security threats, but also ensure the provision of more frequently updated guidance for investors and targets reflecting lessons learned, particularly during the first years of operation of the new regime.

2.2.4 Second, we note that the Statement unfortunately removes helpful guidance included in previous versions. We urge the Government to reintroduce this, or at least to clarify the reasons behind its exclusion. For example, the Statement omits the clarity that was given with respect to the treatment of loans, conditional acquisitions, futures and options. Previous drafts noted that these transactions would only rarely be subject to scrutiny, and only then at the point of actual acquisitions of control taking place, setting this out with the example of a lender seizing collateral. Removing these statements creates uncertainty for investors and lenders over the treatment of these transactions. Similarly, the Statement removes the previous acknowledgment that pension funds are often long-term investors in the UK's infrastructure, who will not often seek to interfere in their processes, even if they have the ability to do so. Again, removing these statements may create the impression that the Government now views such investors as being of higher risk.

2.2.5 Third, we consider that the Statement needs to include more definitive statements in relation to policy intent. For example, paragraphs 8, 11 and 31 state that the call-in power "could be" more likely to be used, or that national security risks "could be" more likely to arise, in certain circumstances. We suggest rephrasing these to clarify that the call-in powers are more likely to be used in those circumstances.

2.2.6 Finally, paragraph 17 now clarifies that the Secretary of State "*expects to exercise the call-in power where one or more of these risk factors has brought about, or is likely to bring about, one or more risks to national security*". In our view, more than a single risk factor under the three-limb assessment must be present in order for there to be a credible threat to national security. For instance, if there is target risk but no acquirer risk or control risk, it would be helpful for the Government to clarify how there could be a threat to national security. While we welcome the recognition under paragraph 27 that an acquisition where the control risk is high but the target risk is medium and the acquirer risk is low is unlikely to be called in, as a minimum, the Statement should also clarify that the Secretary of State would be less likely to identify a risk to national security in cases where all three risks are not present.

2.2.7 We are concerned that the Statement does not provide clarity on how it will approach situations of low acquirer risk, but high target risk. Although these are relatively rare situations across the entire venture capital landscape, they are a large part of the routine business for deep technology investors. Consequently, if the Government were to call in these transactions as a matter of routine, such approach will have a significant effect on investors' ability to reliably assess transactions and model deal timelines. While the Government's hypothetical examples in the

Statement give guidance as to whether some types of transactions will be called in, transactions with a low acquirer risk and a high target risk are not among them. This uncertainty is compounded in paragraph 26, where the Government indicates that "*when the target or acquirer risk is low, the Secretary of State is less likely to be concerned*." This suggests that there are situations where a low acquirer risk in conjunction with other factors could result in Government concerns, but these are not described in the Statement. To help investors understand the call-in risk, the Government should include greater clarity for transactions with these characteristics.

2.3 Target risk

2.3.1 We welcome the removal of references to "core areas", "core activities" and "the wider economy" as categories for assessing risk, as these were too broad and unclear. However, the Statement creates some new uncertainties.

2.3.2 First, it is unclear whether the "list of the 17 areas of the economy" refers only to those activities within those areas that are described in The National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021 ("**Notifiable Acquisition Regulations**"). While the example relating to transport in paragraph 11 implies it does, it would be helpful for the final Statement to make this explicit.

2.3.3 Second, it is unclear whether the reference to areas of the economy that are "closely linked" to the 17 listed areas refers only to activities within the broader sector (e.g. activities within the wider transport sector, including road and rail, that are not within the port/airport activities that are specified in the Notifiable Acquisition Regulations), or whether it could also be the case that activities that fall outside the transport sector might nevertheless be considered "closely linked" to the specified port/airport activities. If it is the latter, the Statement would benefit from additional guidance on when an area will be considered to be "closely linked" and/or illustrative examples (e.g. the target is a critical supplier of essential inputs).

2.3.4 Third, example 2 (acquisition of a qualifying entity that is unlikely to be called in) appears to indicate that a financial services company with "public contracts" with the Government would be considered to be active in an area that is "closely linked" to the area of "critical suppliers to Government", even if it is not in any sense a "critical" supplier. We suggest clarifying in that example that the financial services company holds public contracts that are critical to the performance of Government functions, in order to avoid implications that any investment in a company with public sector customers carries a medium target risk.

2.3.5 Fourth, paragraphs 19 and 28 refer to "sensitive sites" but do not provide details of how such sites will be identified as sensitive. The Statement should provide further

clarity and examples of the type of sites that are deemed sensitive, to avoid a significant number of non-problematic real estate transactions being notified.

2.4 Acquirer risk

2.4.1 As noted above, the Statement omits the helpful recognition included in previous versions that the Government "does not regard state-owned entities, sovereign wealth funds – or other entities affiliated with foreign states – as being inherently more likely to pose a national security risk", or that it "recognises that pension funds may be long-term investors in entities that operate in the UK's national infrastructure, but will not often seek to interfere in their processes even if they have the capability to do so."[2] It would be helpful for the final Statement to reintroduce the recognition that state-owned entities, sovereign wealth funds or other entities affiliated with foreign states may have full operational independence in pursuing long-term investment strategies with the object of economic return or to clarify the rationale behind this change in position. Otherwise, the inevitable inference that could be drawn from this change is that the Government now perceives state-owned entities, sovereign wealth funds or other entities affiliated with foreign states as riskier compared to its previous position. This would likely deter investment from these key economic actors and/or make other investors more cautious about investing alongside them.

2.4.2 Paragraph 21 of the statement could be interpreted as treating the factors listed as being relevant to the assessment of national security itself (as opposed to relevant to the question of whether an acquirer may have hostile intent). This could open the floodgates to the Secretary of State intervening in mergers on political grounds, such as the acquisition's impact on employment, or the parties' post-merger plans for restructuring of a target, even when these would have no impact on the carrying out of activities specified in the Notifiable Acquisition Regulations. We therefore suggest that this statement is revised to make it clear that a threat to the "interests" of the UK does not automatically equate to a threat to national security, and that the factors listed are relevant only for the assessment of whether a particular investor may have incentives to act in a way that is contrary to national security.

2.5 Control risk

2.5.1 The Statement provides details of how control is interpreted as a risk (i.e. control of an entity's operational business or future strategy and the direction or control or the use of an asset). However, we note that this is broader than the examples previously given, where it was noted that "trigger events" "*might involve gaining control of a*

[2] Policy paper, Statement of policy intent, updated 2 March 2021, available at https://www.gov.uk/government/publications/national-security-and-investment-bill-2020/statement-of-policy-intent.

crucial supply chain, or obtaining access to sensitive sites, with the potential to exploit them."[3]

2.5.2 At paragraph 25, the Statement notes that "a *large amount of control may enable parties to reduce the diversity of a market*". Arguably, if the target is able to affect the diversity or behaviour of the entire market in this way, this is an aspect of target risk, not control risk. Furthermore, it would be helpful if the Statement could provide greater clarity on what would be regarded as "*a large amount of control*". This is particularly relevant given that Example 2 (acquisition of a qualifying entity that is unlikely to be called in) includes an investor acquiring 26% of a target as an example of a "high" control risk. However, for merger control purposes, a 26% stake would not typically be regarded as conferring "control". Consequently, absent further clarity, this example might imply that all acquisitions over 25% raise a presumption of high risk from a control risk perspective.

2.5.3 At paragraph 27, the Statement notes that "*the Secretary of State will not make assumptions based on an acquirer's country of origin*." This statement appears to be an aspect of acquirer risk, not control risk.

2.6 Assets

2.6.1 Paragraph 32 states that "[t]he Secretary of State expects to call in rarely acquisitions of assets which are not in areas linked to the 17 areas of the economy". It would provide clarity if the language of this paragraph mirrored that in paragraph 31 by referring to "areas closely linked to those areas of the economy".

2.6.2 As with paragraph 19, paragraph 28 refers to "sensitive sites" but does not explain how sites will be identified as sensitive. The statement should clarify that sensitive sites are those that are used for, or in close connection with, activities that are specified in the Notifiable Acquisition Regulations, in the same way as for other assets. For example, are transport activities such as road and rail viewed as "sensitive sites" (given that the transport definition in the Notifiable Acquisition Regulations is limited to ports and airports)? Are major train stations sensitive sites such that every acquisition of a building above or near such a station presents a high target risk, and if so, is it the same threshold in terms of passenger numbers for train stations as for airports? These are questions many investors would welcome clarity on, given the large number of buildings located near train stations in London and other major cities.

2.6.3 Additional examples could help illustrate this. As currently drafted, the Statement only includes an example of a land acquisition which is not likely to be called in but

[3] *Ibidem*.

it would be helpful if the final Statement could include an example of a land acquisition which is.

2.6.4 The Statement should clarify (e.g. through a list of factors and/or examples) the circumstances in which assets may be considered to be "closely linked" to the 17 listed areas, or to be in areas that are closely linked to the 17 listed areas. For example, are activities included in earlier drafts of the definitions of the sectors subject to mandatory notification requirements, but excluded in subsequent drafts, such as landlords of government buildings or datacentre landlords (where the tenant is the operator), to be viewed to be closely linked to the sector?

2.6.5 As regards sites that are "proximate" to a sensitive site, it will often be impossible for investors to know whether this is the case, absent a searchable register of sensitive sites - which presents its own national security risks. For example, how would an acquirer be able to ascertain what the neighbouring manufacturing facility is manufacturing; whether the datacentre next door is processing data for a public sector authority; or whether an office nearby is being used to design cryptographic authentication products, or for in-scope artificial intelligence activities? Consequently, and in order to limit the volume of voluntary notifications of benign real estate transactions, the Statement should identify objective characteristics of real estate sites that make them more or less likely to be considered a national security risk, in the event that they happen to be proximate to a sensitive site.

2.6.6 It would also be helpful if the language in paragraphs 19 and 28 was consistent in the use of "proximity" and "located near". While we acknowledge that a fixed distance cannot be given, as it will vary on a case-by-case basis depending on the nature of the perceived threat, the Statement should indicate factors to be taken into account when assessing proximity, e.g. by reference to the proximity needed to carry out espionage (e.g. for high tech or military sites) or acts of terrorism (e.g. for critical infrastructure).

2.6.7 Example 3 (acquisition of a tangible asset that is unlikely to be called in) provides welcome guidance for residential properties. However, the last sentence indicates that the degree of acquirer risk is dependent on the acquirer using the premises for residential purposes (which implies that the acquirer might therefore be asked to enter into commitments to that effect). Clarity over what is required to demonstrate a low risk intended use would help investors effectively navigate asset transactions. It would also be helpful if the guidance could state how the intended use of real estate can impact on the national security risk assessment and, in particular, what sorts of commercial uses might be considered to give rise to such risks, or conversely to be low risk (e.g. would the analysis in Example 3 be any different if Building B was an office block and intended to be used as office rather than residential?). In addition, we note that this type of risk (how the property is intended to be used)

might more accurately be described as a form of target risk, as it is not inherently connected with the characteristics (hostile or otherwise).

The BVCA would of course be willing to discuss this submission with you further - please contact Ciaran Harris (charris@bvca.co.uk) at the BVCA.

Yours faithfully,

Amy Mahon

Chair, BVCA Legal & Accounting Committee