

National Security and Investment Bill

Department for Business, Energy and Industrial Strategy

RPC rating: fit for purpose

Overview

The Department has provided a reasonable, monetised assessment of the direct, administrative costs to business of the proposals. These costs consist primarily of familiarisation, notification and engagement with government, including in relation to the undertaking of national security assessments. On this basis, the RPC is content that the final stage impact assessment (IA) is sufficient for better regulation framework purposes. However, there are some areas where the IA would benefit from significant improvement, to assist ministerial and parliamentary decision making further. These areas are primarily in relation to the evidence and analysis presented in support of the rationale for government intervention, effects on regulatory uncertainty and the assessment of potential wider costs and benefits. They are described further below.

Description of proposal

Existing powers

The IA explains that the Enterprise Act 2002 (the Act) covers national security concerns but that the powers under the Act apply, for the most part, only to mergers that meet one of two thresholds: where the acquired company has an annual UK turnover of more than £70 million; and/or where the merger would result in the creation of, or increase in, a 25 per cent or more combined share of sales or purchases in the UK (or in a substantial part of it), of goods or services of a particular description. The Government amended the Act in 2018 and 2020 in respect of six sectors: military and dual-use, quantum, computing hardware technologies, artificial intelligence, cryptographic-authentication technology and advanced materials. This involved reducing the UK turnover threshold from over £70 million to over £1 million and removing the requirement for the merger to result in an increase in the share of supply.

The IA states that a statutory intervention under the Act requires the Competition and Markets Authority (CMA) to provide a report to the Government on jurisdictional and competition issues as part of a Phase 1 investigation. If the Secretary of State considers there are concerns, he may refer it to a Phase 2 investigation or clear the transaction by accepting remedies offered by the parties. If the Phase 2 investigation considers that the merger operates, or may be expected to operate, against the public interest, it will make recommendations as to what action the Government should take to remedy any adverse effects. If the Secretary of State considers that no remedies can address the public interest concerns adequately, he can block the deal entirely. There have been twelve national security interventions under the Act since 2002. In addition to those under the Act, the IA describes other powers and levers available to protect national security. These include sector-specific regulation, the ability to act in an emergency under the Civil Contingencies Act 2004 and export control legislation. The measures also include voluntary arrangements in the form of engaging with businesses that are considering transactions and agreeing measures to ensure that national security is not at risk because of the transaction. In addition to this, government departments may seek voluntary commitments and undertakings from businesses, to ensure that the national security risk from businesses being acquired is minimised (paragraph 26, page 11).

Proposed changes

The Department states that the Government are clear that current powers are no longer sufficient to address the challenging and changing national security threats the UK faces. The IA refers to significant national security, technological and economic changes in recent years, including innovative technologies developed by new start-ups or small companies, which fall outside the scope of the Government's existing formal powers under the Act (paragraph 14, page 9). There are also other references to reasons for intervention, including providing greater certainty for business. Broadly, the proposal would introduce a mandatory notification regime for sectors, which pose the greatest national security risk, with a voluntary notification regime for all other sectors. 'Core' sectors are listed on pages 15-16 of the IA and include civil nuclear, communications, defence, energy, transport and a number of technology sectors, such as artificial intelligence and autonomous robotics.

The IA states that three policy options have been considered: do nothing; a regime based on voluntary notification across the economy, underpinned by a call-in power; and a mandatory notification regime for those sectors that pose the greatest risk, with a voluntary notification regime for all other sectors with an enhanced call-in power. The last of these is the preferred option and the focus of the IA.

The proposed voluntary notification regime would be underpinned by an enhanced ‘call-in’ power based upon ‘trigger events’. A call in under the proposal can take place whether or not a company has submitted a notification, if the Government’s market monitoring suggests that a transaction should be called in or if it considers that a further assessment should be undertaken beyond the initial notification screening. The proposed ‘trigger events’ go beyond the Act’s present turnover and share of supply thresholds and would allow for national security investigations of additional cases that do not meet the current tests. These relate to the degree of control transferred and would include possible different thresholds in relation to the acquisition of shares or votes in an entity; the acquisition of material influence over an entity’s policy; and the acquisition, use or control of assets.

Separate to the national security and investment provisions, the IA also covers a proposed amendment to Part 9 of the Act, which the IA states would enable public authorities to disclose confidential merger information without consent through the ‘overseas disclosure gateway’. The proposal intends to facilitate co-operation between the CMA and public authorities in other countries and lead to better decision making and enforcement in a cross-border context.

Impacts of proposal

Costs to business

Proposed national security and investment regime

Monetised costs have been grouped into four main categories or stages. For each of these, the Department estimates the number of ‘trigger events’ or businesses affected, and an associated unit cost, to arrive at an aggregate cost figure or range. The Department reports that estimates of cost to business have been informed by data provided by some stakeholders. The estimated costs for familiarisation, early

engagement with government and notifications were also informed by the IA on *The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018*.¹

Stage 1: Familiarisation and early advice costs

The annual frequency of investment activities was estimated from publicly-available data. For example, *Capital IQ* was used to gather evidence on the number of completed mergers and where a share of 15 per cent or over (the lowest threshold of the trigger events) was acquired. Based upon this, the Department estimates that 6,340 to 14,480 businesses would be affected. The estimated cost per case ranges from £1,000 (for a business with a turnover less than £10 million) to £19,000 (high scenario for a business with a turnover greater than £36 million). (Data presented in table 3 on page 26 of the IA).

Stage 2: Early engagement with government

Of these cases, it is estimated that between 280 and 2,220 would involve businesses seeking early advice from government about the regime, including the areas that could be of national security concern and whether their investment warrants a notification. The estimated cost per case ranges from £1,000 (low scenario for a small business) to £14,000 (high scenario for a large business).

Stage 3: Notifications

The Department estimates that there would be between 1,000 and 1,830 notifications each year. It is assumed that all transactions in the mandatory notification sectors would submit a notification to government. Half of the cases where parties outside the mandatory elements of the notification regime engage early with government are assumed to submit notifications. Notification would involve the completion of forms, providing relevant information and, if required, meeting officials. The Department estimates a cost per case ranging from £1,000 to £21,000.

¹ <https://www.legislation.gov.uk/ukdsi/2018/9780111167441/impacts>

Stages 4 and 5: national security assessment and remedies

The Department has estimated the number of call ins and remedies from a review of data in 2019 and 2020. The review identified trigger events that would have met the proposed criteria for call in. It is estimated that there would be around 70 to 95 detailed national security assessments per year. In the Department's central case, it is estimated that the proposed measures would increase the number of assessments (compared to the baseline) by 17 per cent. Costs to businesses could reflect legal fees, providing additional information and attending further meetings. The estimated cost per case ranges from £66,000 (standard case) to £374,000 (very complex case). The Department estimates around 8-10 remedies each year. It expects that these would formalise remedies, which are currently undertaken on a more-informal basis.

Uncertainties and limitations of the analysis

The Department describes, in some detail, the necessary limitations of the analysis. The estimates of number of cases affected are particularly uncertain. The White Paper included some initial impact estimates, which have been refined in light of developments to the policy, consultation responses and improved data. The Department also notes that cost data were provided by a limited number of stakeholders and were based on the stakeholders' experiences of either competition assessments or national security assessments in other jurisdictions. These estimates were used as a base and were revised as appropriate to reflect the updated policy. The range of estimates is intended to reflect these significant uncertainties.

Based upon the estimated number of cases and unit costs above, the Department estimates a cost to business of between £22.6 million and £62.7 million each year, with a best estimate of £39.8 million.

Amendment to Part 9 of the Act

Currently, information gathered by UK public authorities during the exercise of their merger functions can be disclosed to overseas authorities only once all the relevant consents are obtained or to fulfil statutory obligations. The proposed amendment would extend the categories of information that could be disclosed without consent through the 'overseas disclosure gateway' in Part 9 of the Act to include merger information.

The Department explains that this measure would not create a significant cost burden for businesses because it would not impose additional requirements or duties upon parties involved in, or contemplating, a merger in order to secure clearance. However, using *Capital IQ* data the Department estimates that up to 10,000 businesses could incur some small familiarisation and legal costs, at an aggregate cost to business of between £2.7 million to £3.1 million each year, with a best estimate of £2.9 million.

Added to the cost to business of the proposed national security and investment regime, this gives an overall net direct cost to business of £42.8 million each year.

Non-monetised potential wider costs

The Department has also considered how the proposed new national security and investment regime would alter measures on the UK's openness to foreign direct investment (FDI). As part of this, external research was commissioned on the sources of capital for companies from the UK national infrastructure sectors. Overall, the Department's analysis suggests that national security regimes do not play a major role in informing the investment decision-making process, provided that the regime is clear and predictable. The Department does not, therefore, expect significant impacts on FDI. Details of the Department's analysis is presented in the annex to the IA.

Costs to government

The proposed new national security and investment regime would also result in costs to government from engagement, screening notifications, carrying out national security assessments and administering remedies. These costs have been estimated using evidence provided by government departments and the CMA, and are partly based on costs under the current regime. Costs to government are estimated at between £3.7 million and £10.4 million each year.

Comparison against 2018 White Paper estimates

Estimates of cost have increased significantly since 2018. This reflects policy changes, with the core sectors of interest having been expanded and a mandatory regime being proposed for these sectors. An additional 15 per cent trigger event has now also been included. The methodology that has been used to calculate the number of national security assessments has also been revised, taking account of

historical evidence of cases in which the Government have been interested, from a national security perspective.

Benefits

The Department provides a qualitative discussion of the likely benefits of the proposed national security and investment regime. These are in terms of benefits to society, by enabling government to mitigate and reduce potential threats to safety and security, and the wider economy by providing a clear framework to investors, consumers and businesses. The Department provides two case studies/examples to illustrate potential benefits (pages 17-18).

The proposed amendment to Part 9 of the Act is intended to facilitate co-operation between the CMA and public authorities in other countries, and lead to better decision making and enforcement in a cross-border context.

Quality of submission

The Department has made significant improvements to the IA following consultation, a number of which are in response to RPC comments. In particular, the estimation of familiarisation costs is now more comprehensive; the small and micro business assessment now estimates costs for smaller businesses and discusses disproportionality and mitigation of impact; and sections on international comparisons, evaluation plan and trade impacts have been added. The Department has also gathered additional evidence and refined its methodology since consultation. The Department's estimate of the direct, administrative cost impact on business has increased significantly since consultation and, although this partly reflects changes to the policy, the assessment now appears to be more robust. The Department acknowledges the uncertainty in its estimates, in part due to uncertainty over the number of cases that might be affected by the proposal. The Department has presented, appropriately, quite wide ranges of potential impact.

In view of the above, the RPC is content that the IA is sufficient for better regulation framework purposes. However, there are a number of areas where the IA would benefit from significant improvement.

Small and micro business assessment. The IA should consider further the potential impacts on small and micro businesses, given that innovative technologies developed by new start-ups or small companies might be particularly affected by the proposals (paragraph 14). The potentially disproportionate familiarisation and possible legal costs should also be discussed further. The IA could also discuss any structural consequences for small and micro businesses, such as being locked into complex supply chains. Further explanation of how cost assumptions have been broken down into small, medium and large businesses would be useful. The overall cost impact of the proposed amendment to Part 9 of the Act is small but the assessment at paragraph 151 would, nevertheless, benefit from further explanation.

Areas for improvement related to the equivalent annual net direct cost to business (EANDCB)

Explanation and evidence base for some assumptions. The IA would benefit significantly from explaining further the basis for some of the assumptions in the IA, especially those relevant to the calculation of the EANDCB figure. In particular:

- *Early engagement with government.* That only foreign investor transactions and transactions affecting medium/large businesses will participate in early engagement with government (paragraphs 71 and 74).
- *Notification.* For those businesses outside of the mandatory elements of the notification regime, half, which engaged early with government, would submit a notification (paragraph 77).
- *National security assessments.* The central case that 18 per cent of assessments are assumed to be additional compared to the current regime (paragraph 82).
- *Cost to government.* For assets, the associated costs to government for early engagement and initial notification screening being half of that for direct and indirect merger and acquisition transactions (paragraph 97) and the basis for the £1.5 million figure at paragraph 98.
- *Size of business.* Why costs are assumed to vary by size of business.
- *Degree of confidence around the upper end of the assumed unit costs.*

The IA would also benefit from discussing to what extent the data received from stakeholders is representative of the sectors potentially affected. More specifically, this could also address how robust the evidence is likely to be in relation to the profit ambitions of stakeholders with respect to this proposal, given that it is a protection measure for some businesses and a barrier to financing, expansion and market to access for others.

Other areas for improvement

The following points do not generally affect the EANDCB but are areas where the wider cost benefit analysis could be improved.

Explanation of rationale. The IA would benefit from explaining in more detail the reasoning for further intervention at this stage, particularly in the sectors covered by amendments that have only very recently come into force. More generally, the IA would benefit from providing greater evidence or analysis to demonstrate the existence of the problem, the necessity of government intervention and the sufficiency of the specific measures proposed. In particular, the IA could provide:

- clear examples of criteria relating to innovative technologies developed by new start-ups or small companies, which fall outside the scope of the Government's existing formal powers under the Act;
- evidence that the proposal would provide that a more coherent, proportionate, formal system for scrutinising the national security implications of acquisitions could give greater certainty to business;
- extended analysis or explanation for the public goods/externalities argument presented for national security risks, particularly as it is not clear that national interest and allocative efficiency are aligned in this case; and
- discussion around whether the rationale for UK action is linked to other countries taking greater protectionist powers, to secure the benefit of the option to control strategic assets in the future.

Options. Although it is not a better regulation framework requirement for a final stage IA, the IA would benefit from consideration of a broader range of options. This could be administrative options, potentially providing greater objectivity in order to reduce regulatory uncertainty (see comments later in the opinion). These could be formulated by reference to international comparisons (for example, the role of the national security commissions in other countries, which are independent of ministers).

Regulatory uncertainty. The IA would benefit from explaining further how the current regime creates significant levels of uncertainty for businesses (paragraph 28). The Department states that the proposals would provide clarity to businesses and investors about the relevant rules, which will give them confidence about the rules and systems in this area, allowing long-term business and investment planning (paragraph 57). However, apart from the list of mandatory notification for some sectors, the proposal appears to increase discretion and subjectivity available to government. The trigger events are more varied and focus on control, rather than turnover, and remedies can be decided by the Secretary of State. Such discretion and the lack of precedent set from one case to another is likely to increase uncertainty about the final outcomes of investigations.

Given the increased separation of national security and competition investigations, the IA would benefit from discussion about the co-ordination between analysis and the setting of remedies, to prevent regulatory uncertainty where there are potential conflicts between national security and competition.

Furthermore, the proposal includes additional powers for the Government, for example to add, remove, or amend the list of sectors for which notification of transactions is mandatory (paragraph 41). The IA would benefit significantly from discussing how this additional discretion could add to regulatory uncertainty and how far this could extend across the economy, for example where firms produce or distribute assets with multiple uses (e.g. computer chip designers). More generally, the IA would benefit from addressing potential chilling effects on competition (see below), UK asset valuation, profitability and innovation.

Impact of remedies and mergers/takeovers/transactions involving assets not going ahead. The Department explains why only a small number of additional remedies are expected (paragraph 88e). However, the IA would benefit from further discussion of possible remedies and their potential impact, and potential impacts should the proposals result in takeovers or mergers being halted or withdrawn. The IA would

also benefit from addressing whether the formalisation of existing remedies taking place would increase compliance. The IA should also address potential costs associated with ‘monitoring trustees’ assurance on undertakings and remedies.

Impact on the valuation of UK assets. Given extended powers to investigate, remedy or block the transfer of UK assets to foreign actors, the IA would benefit from analysis of the overall impact on the valuation of those assets, given that the proposals are likely to reduce the number of potential transactions involving foreign buyers.

Impacts on competition and competitiveness. The IA refers to impacts on competition under ‘wider impacts’ but would benefit significantly from a specific section with a more-detailed analysis of this area. Given that national security investigations would be likely to reduce the number of pro-competitive transfers of assets, the IA would benefit from an assessment of the reduction in competition that may ensue and any longer-term impact on competitiveness.

Potential impact on FDI and wider costs. The Department has provided a useful annex, which looks at how the proposed new regime might alter the UK’s openness to FDI. It helpfully makes use of limited commissioned external research to inform its assessment. Nevertheless, the IA would benefit from further discussion and investigation of the conflicting views, to support its conclusion that the proposal is unlikely to have a significant impact. The annex would benefit from addressing further EU exit-related uncertainty and potential developments such as the recently-launched National Data Strategy proposals. The research would also benefit from taking into account changes in the willingness of the foreign governments involved to use such powers, either to meet perceived threats or as a manifestation of economic nationalism/disguised trade barriers.

Presentation of the calculation of aggregate cost estimates. The Department helpfully presents tables of trigger events/cases and unit costs. However, given that unit costs vary significantly by size of business and complexity of case, it is not easy to see how the aggregate costs (for example, in table 5) have been calculated. The IA would benefit from presenting the calculations explicitly, particularly for stage 4 costs.

Alternative finance/spin-offs. Many transactions are likely to involve multinational acquisitions where small business units are divested. Divestments need to be financed; for example, a purchaser needs to be found or the assets need to be

‘corporatised’ and spun off. The IA would benefit from discussion of the potential impacts of the proposal on the availability and cost of alternative finance.

Direct impact on the CMA. The Department states that under the new regime many of the functions would not be carried out by the CMA and, therefore, it does not expect that the CMA would face any additional costs. The IA would benefit from including confirmation that the CMA agrees with this assessment.

Clearer definitions. The IA would benefit generally from clearer definitions (e.g. of assets) and key concepts being more clearly distinguished or explained how they relate to each other (e.g. advanced technologies, core sectors, definitions of an entity, control and material influence, and the definition or scope of an asset). This should include specifically the nature of intellectual property acquisitions that will be caught by the regime. Some discussion of economic and organisational relations (e.g. indirect or interlocking ownership, joint ventures, technology licensing, etc.) would also be helpful.

Adequacy of the trigger events. The IA would benefit from setting out how the proposed trigger events would cover sufficiently all cases where national security interests are potentially affected, in particular where there are complex networks of ownership, non-equity finance, or non-asset-based forms of influence, control, information leakage etc.

Use of Standard Industrial Classifications (SIC). The IA would benefit from explaining the level of granularity of the SIC used or how the information in the FAME database can be used to identify either complex (multi-sector) activities of single firms or intermediation/joint venture activities that collectively affect a given SIC sector (even when none of the participating firms is ‘in’ that sector or on a list of ‘firms of interest’). The IA should also justify the use of SIC codes over the newer, internationally-accepted ISIC codes.

‘Avoidance strategies’. The IA would benefit from a description of measures to counter ‘avoidance strategies’ (for example, where the controlling legal entity over strategic assets is transferred from the UK to another jurisdiction purely to avoid a national security investigation, or where a business changes its country to the UK - or recruits a local partner - purely to avoid an investigation).

Benefits. The Department explains why it has not been possible to monetise the benefits to society of the proposal. It has provided a qualitative assessment and presented two case studies/examples for illustration. However, the IA would benefit from further discussion and description of potential benefits, subject to sensitivities. As noted above, a key potential benefit is the option for the UK Government to control strategic assets in the future and the IA would benefit from discussing the value of this option. The IA would also benefit from explaining how many of the twelve national security interventions under the Act since 2002 were resolved at Phase 1, subject to Phase 2 remedial actions or were blocked transactions (and how many involved mergers, acquisitions and other transactions). It would also benefit from discussing the estimated costs to the affected businesses and government.

Sensitivity analysis. The IA usefully adopts low and high assumptions (e.g. on unit costs) to address uncertainty but could benefit additionally from some sensitivity analysis on key drivers of impact.

Transparency. The IA would benefit from setting out how the use of the powers and the outcome of the investigations etc will be made available publicly, to help those potentially affected to assess better the likely prospects for getting approvals for future transactions in particular circumstances.

Departmental assessment

| Classification | Qualifying regulatory provision (IN) |
|--|--------------------------------------|
| Equivalent annual net direct cost to business (EANDCB) | £42.8 million |
| Business net present value | -£368 million |
| Overall net present value | -£425 million |

RPC assessment

| Classification | Qualifying regulatory provision (IN) under the framework rules for the 2017-19 parliament |
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| | To be determined once the framework rules for the current parliament are set |
| EANDCB | £42.8 million To be determined once the framework rules for the current parliament are set |
| Business impact target score | £214.0 million To be determined once the framework rules for the current parliament are set |
| Small and micro-business assessment | Sufficient |

Regulatory Policy Committee