Rt Hon Oliver Dowden CBE MP
Deputy Prime Minister and Chancellor of the Duchy of Lancaster
Cabinet Office
70 Whitehall
London

By email: nsipolicy@cabinetoffice.gov.uk

15 January 2024

Dear Deputy Prime Minister

BVCA Feedback to the National Security and Investment Act Call for Evidence 2023

The British Private Equity & Venture Capital Association (BVCA) is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of around 650 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and investors. In 2022, £27.5bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized enterprises (SMEs).

The BVCA understands the concerns regarding national security and supports the government's goal of protecting the UK's national security. In terms of implementation, our initial impression is that the National Security and Investment (NSI) Act is working as it is designed to do and so far, it has not yet hindered the majority of investment decisions. However, with the publication of the National Security and Investment Act 2021 Annual Report 2022-2023 it is clear to us, and the Government recognises, that the number of notifications is too high and that a review of the regime is needed. We therefore applaud the Government for recognising this and for publishing the Call for Evidence.

Based on feedback from our members, **we believe that the regime is not as effective as it could be, is overly burdensome and does not strike the right balance between protecting national security and encouraging investment in the UK.** Although our overall impression is that the NSI Act is broadly meeting its objectives, a number of "teething" issues remain which are causing uncertainty and delay for investors. In our view there are specific areas where small improvements could help to address these issues, which are outlined below.

Without these clarifications and improvements, **it is our view that the difficulties faced by private capital investors will continue and could potentially lead to the UK becoming a less competitive location** for attracting investment, impacting negatively on innovation and growth.

A summary of these points is as follows:

1. **Compared with some international peers, this regime is overly burdensome.**
    - The number of transactions being caught is higher than the equivalent number in the US, a much larger market. The total was 866 in the full year to 31/3/23[1], which is almost double the number of the 440 filings lodged in the US[2].
    - There is a lack of flexibility or pragmatism around the nature of private capital investment. In some cases this is leading to unnecessary delays. For example, we know of members that have had to go through very time consuming processes for co-investment and top-up arrangements,

[1] National Security and Investment Act 2021 annual report 2022-23 (PDF) (publishing.service.gov.uk) pg 41
[2] Treasury Releases CFIUS Annual Report for 2022 | U.S. Department of the Treasury

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despite the underlying firms and individual investors previously having being cleared. This is burdensome, while at the same time unnecessary, as the ownership has not changed.

2. **The Investment Security Unit is not functioning as well as it could, presenting a drag on investments and causing difficulties for investors.**
   - It is important that the Investment Security Unit (ISU), which is implementing the regime, is appropriately staffed and skilled; and that the regime itself is easy to understand and functions smoothly and efficiently.
   - In dealing with the ISU, administrative and communication issues can arise which can make the timetable and approval process unnecessarily long, burdensome, and unclear.

We therefore continue to recommend that the Government take steps to address these issues and act on this feedback from businesses and investors. This should help improve the regime and make it more effective in achieving the Government's goals whilst at the same time striking the right balance between security and prosperity objectives.

BVCA key recommendations

1. Narrow the scope

   The Government should not increase the scope of certain aspects of the regime, as suggested in the Call for Evidence, **and should instead look to narrow and focus it**. As noted above, the number of transactions being caught is higher than that in the US. The regime's extensive scope, broad definitions and somewhat insufficient guidance has rendered it challenging for investors, leading to unnecessary notifications and a considerable number of benign deals being caught.

   Currently, investors and advisors bear full responsibility and full risk to assess whether a notification should be made. A narrower scope of the NSI Act and/or better drafted definitions would be welcome as well as additional guidance and engagement from the ISU. We think there is a need, as is the case in other regulatory contexts, for something akin to the Takeover Panel's Practice Statements or FCA Market Watch briefings which provide guidance to the market, and ensure consistency and equal access to information.

   Mandatory sectors should be refined and types of transactions (such as internal restructuring) should be removed from scope. We have recommended that the Government put in place measures to help narrow the scope of, or have clearer drafted definitions of, in particular, the 17 specified sensitive areas of activity to assist all parties, as well as providing additional guidance and better engagement from the ISU. Comparable regimes, in jurisdictions such as the US and national Member States within the EU, are **less expansive and onerous than the UK approach, which risks putting off investors**. The problem is that this regime is not running efficiently and proportionately and so it is a drag on business, investors and deal making. The UK is a world leader for this sort of commercial activity and we need to retain that position.

2. More official guidance and communication from ISU

   Members are finding that the ISU is inconsistent in its approach and can be slow to communicate. This creates uncertainty and delay in a transaction and the risk is that it could cause the business, for example a small startup looking for venture capital investment, to collapse due to cost pressures. Often the ISU calls for a notification without providing any explanation or giving appropriate consideration as to why a notification should be made. This lack of clarity around the notification process is therefore often perceived by investors to be a "black box". While some members report having received useful and timely guidance from the ISU, there have also been instances in which guidance was not received for a number of weeks. Furthermore, there is no named case handler assigned to the investor and no feedback or process updates are given which combine to make the

process difficult to engage with. We would therefore advocate for **a case officer to be assigned to each filing from the outset** to allow parties to follow up on the progress of a notification and for any queries the parties have.

It was understood that prior to the legislation being enforced, the ISU would engage closely with the business community to ensure a smooth transition; however, members have experienced inconsistent engagement, leading to delays and uncertainty. We would welcome more communication between the acquirer and the ISU which would lead to an improved understanding of the regime.

We also recommend that **existing guidance should be updated to clarify matters** in response to queries and requests to feedback **and new guidance should be created** via engagement with the investor community. The three areas in which additional guidance would be useful are remedies, indirect acquisitions and fund specific guidance. This should be done via the established Expert Panel.

The ISU's market guidance on the interpretation of certain aspects of the regime (such as the question of whether veto rights conferred by shareholder agreements could satisfy the test in s.8(6) of the NSA Act) has been very useful for our members. We would like to see the ISU continue to adapt its guidance in this was by **giving views on the interpretation of the NSI Act and the Notifiable Acquisition Regulations** in the absence of any judicial interpretation by the courts. Our members and their advisors would much prefer to have more detailed guidance, even if there is a risk that a court might subsequently disagree with it. For example, the CMA's jurisdictional and procedural guidance (CMA2) has around 30 pages of guidance dedicated to explaining how the CMA has interpreted its jurisdiction under the Enterprise Act 2002, very little of which is based on case law of the courts. This is all the more important given the broad and vague wording of many provisions in the NSI Act.

3. Administration issues

We would suggest that timetables are reduced further, clearer signposting is provided from the ISU and the "clock-stopping" function is removed so that deals can be cleared as quickly as possible.

The ISU should aim to **speed up the timing of reviews**, which are often prolonged. This delay can significantly impact Venture Capital firms in particular which need to invest nimbly into fast growing companies. These portfolio businesses rely on cash flow to survive. This is especially the case for clearly benign deals which shouldn't need to wait for the full 30 working days (6 weeks) to clear. We would like to see an expectation set amongst businesses that benign deals are cleared in a shorter period of time.

Another way to improve the smooth-running of the ISU would be to **remove the need for duplication of work, such as adding a way for repeat notifiers to pre-populate sections of the notification form.** The private capital industry continuously invests in companies and may submit multiple notifications depending on what industries they invest in. The repetitive input of the same information for each form not only consumes valuable time but also incurs additional cost as often external lawyers are hired to complete this work. We recommend removing the need for the duplication of work for repeat notifiers to pre-populate sections of the notification form. Where an acquirer has already gone through a filing process and received clearance, it could benefit from a partial exemption, i.e. confirming that previous details regarding the acquirer are still accurate and just providing details of the new investment/target.

The Cabinet Office and ISU could also streamline how their online guidance and forms are organised, as it can be challenging to navigate. Some members have found inconsistencies with regard to sector scope, so it would be useful to have these clarifications, as well as correcting the errors in the online form, for example around the use of certain punctuation and special characters in documents

uploaded to the system. The Government should also consider implementing a single form for both mandatory and voluntary filings, to eliminate the delays that are caused when a filing is rejected on the basis that the wrong form has been used.

4. Improvements to the Legislation

Remove the clause in legislation related to Automatic Invalidity for failure to file under the mandatory regime. Under the mandatory regime, if a notification is not made where it should have been, there is automatic invalidity. We believe that this is legally flawed for agreements governed by laws in jurisdictions other than the UK, it is disproportionate and should therefore be reviewed. We are concerned that at some time in the near future, a completely innocent transaction could be invalidated because of an oversight in filing which would lead to significant economic and regulatory disruption to the parties involved in the transaction, as well as unaffiliated third parties.

Additional safe harbours should be included: Exemptions should be included now that the regime is in place and becoming established. We note there is provision for secondary legislation to exempt certain transactions and would ask the Government to consider the following exemptions:

- Businesses/funds that have been vetted by and receive funding from UK Government sources aimed at promoting innovation and growth in certain sectors should be deemed as presenting no acquirer risk and therefore exempt from voluntary or mandatory notification. This, again, would be a proportionate approach consistent with the Government's aim of supporting innovative new business.
- The UK should also consider an analogous framework to the Excepted Investor concept adopted by the CFIUS regime, whereby UK investors and investors from certain key states that are close allies of the United Kingdom are subject to less restrictive notification requirements.
- Internal reorganisations where there is no change in the ultimate controlling entity should not be subject to mandatory notification.
- In addition to the officeholders identified in the Call for Evidence, as already mentioned we think there is merit in including receivers and administrative receivers who also act as agents of the insolvent company and in our view ought to benefit from the same exemption in terms of their appointment. Otherwise, the same potential adverse effects apply in relation to their appointment. Likewise, trustees in bankruptcy should for the sake of consistency also be included within the scope of the exemptions.

We have responded to the specific questions set out in the Call for Evidence below. Please note that a number of these questions are not relevant for the BVCA. Additionally we have provided real life examples that have been shared by our members at the end of this submission.

We would like to thank you and your officials for their continued engagement including via the Expert Panel and stakeholder roundtables. Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor, ttaylor@bvca.co.uk and Ciaran Harris, charris@bvca.co.uk).

Yours sincerely,

Sarah Adams and Isobel Clarke

Directors of Policy, BVCA

BVCA responses to specific questions

1. **Respondent info**
    1. What type of organisation do you work for?
    2. What area of the economy do you operate in?
    3. What is the headcount of the organisation you work for?
    4. In what countries does your organisation operate? Please tick any of the following that apply and provide details if relevant.
    5. Have you submitted a notification under the NSI Act or been involved in other ways with the NSI Act? Please tick any of the following that apply and provide details if relevant.

Please see opening remarks for responses to the questions in this section.

2. **If you have submitted a notification under the NSI Act**
    6. If you have submitted a notification under the NSI Act, or been involved in an acquisition subject to NSI screening, did you interact as:
    7. If you have submitted a notification, was it a voluntary or mandatory notification, or retrospective validation application?
    8. What was the final outcome of your acquisition screening?

This section is not relevant for the BVCA. However, it is important to note that members from across the private capital industry make notifications under the regime. We have given examples of members' notifications at the end of this submission. Additionally, our technical committees include antitrust and FDI private practice lawyers who work with their clients to submit notifications.

3. **Call for Evidence Follow-Up**
    9. Please indicate if you are content for the ISU to contact you about your response to this call for evidence.

    Yes, we are more than happy to be contacted by the ISU. We are members of the NSI Act Expert Panel and will continue to engage.

    10. If Yes, then please provide your name, an email address and your organisations' name below.

    Please see opening remarks for our response to this question.

4. **How the NSI Act works and how it is likely to be used**

To what extent do you / does your organisation agree with the following statements:

11. I / my organisation understand(s) the types of risk the Government seeks to address through the NSI Act.
    Strongly Disagree – Disagree – Neither Agree nor Disagree – Agree – Strongly Agree
12. I / my organisation understands(s) how the NSI Act works and the requirements it places on my organisation.
    Strongly Disagree – Disagree – Neither Agree nor Disagree – Agree – Strongly Agree
13. I / my organisation understand(s) the circumstances of an acquisition that make it more likely that the Government will call it in or impose a final order under the NSI Act.
    Strongly Disagree – Disagree – Neither Agree nor Disagree – Agree – Strongly Agree
14. My / my organisation's approach to investment has changed since January 2022
    Strongly Disagree – Disagree – Neither Agree nor Disagree – Agree – Strongly Agree

15. The commencement of the NSI Act was an important factor in changing my / my organisation's approach to investment.
    Very unimportant – Unimportant – Neutral – Important – Very important – not applicable
16. Tick any of the below that apply to how your approach has changed:
    - Seeking investment
    - Advising on investment
    - Making investments
    - Seeking research collaborations
    - Planning research programmes
    - Supplying goods and services to the UK
    - Doing business in the UK
    - Other, please specify (word count)
    - Not applicable

17. Please provide any additional detail on your answers to Questions 14–- 16, including why your approach has changed (if applicable).

Based on the feedback received, most business decisions have not been affected. However, we would note that our members are now, more than before the regime took effect, considering whether they should invest or exit an investment and are analysing the risks associated. Our members may now seek more advice, include applicable warranties, spend significant time negotiating co-investment and shareholder agreements, or alter the structure of their investments. The rules have an active bearing on exits as well as acquisitions, as members consider whether the rules will delay closing due to an NSI review. Having spoken with various law firms about those cases that are being reviewed, the call-in rights seem to be being used in respect of buyers from certain jurisdictions so our members may be more wary about exits to such buyers.

When investing or exiting, our members have found that the breadth of the regime, the wide sector definitions and a lack of sufficient and clear communication has made the regime challenging for investors and led to a considerable number of benign deals being notified – deals we do not believe the Act intended to capture and have resulted in more notifications under the NSI Act in the UK than for example under CFIUS in the US. The main concerns from members point to the lack of communication from the ISU, as well as insufficient guidance for certain industries and sectors.

The current guidance is substantial although it comprises a significant number of documents, and in its current form is either too generic and unclear or simply re-states legislation. This is costing time, causing confusion and creating uncertainty.

18. How could Government improve its communication regarding the scope and operation of the NSI Act?

The number of notifications being made is more than the US, a much larger market–- 866 in the full year to 31/3/23, which is almost double the number of the 440 filings lodged in the US. This means that the scope is too broad and the operation is not as clear or helpful as it could be.

Members are finding that the ISU is inconsistent in its approach and is either slow to communicate or does not communicate when appropriate. Our understanding before the legislation was implemented was that the ISU would work closely with the business community to try and ensure a clear and efficient process, however members are often finding this is not the case and this lack of and

inconsistent engagement with the business community is leading to further delays and uncertainty, and ultimately leads to more, not fewer, notifications.

The ISU, in some examples given, did not appear to be engaging appropriately with the notifying parties over and above stating that they have 30 working days to clear a transaction. In a member transaction that was called-in for an in-depth review, there was no feedback provided to the parties on the reasons for the call-in being issued, the potential national security concerns being investigated, the potential outcome including whether remedies would be required and the anticipated timetable to clearance. During the in-depth review, the only meaningful interaction between the parties and the ISU was responding to a short information notice. Ultimately, an unconditional clearance decision was received. We understand this is because the ultimate decision maker is the Secretary of State (SoS), and the ISU cannot speak on their behalf and risk giving the parties a steer as to the potential outcome of the investigation may change as the investigation proceeds. However, investors would find it very useful to understand better the likely timetable of a review as it progresses. This can be particularly important where NSI clearance is the final condition to completion and therefore an unexpected clearance decision (including unexpectedly fast) can have implications for completion timetables e.g., finalising financing arrangements within a short period of time as set out in the transaction documents. The key is transparency and predictability. Investors would also likely appreciate a better understanding of any potential concerns that have been identified and are being investigated. Such insight would allow the parties to better assist the ISU by proactively providing further information or documents that may aid their understanding and may expedite the review process.

More generally, no named case handler is assigned to the investor, and no feedback or process updates are generally provided. We would advocate for a case officer to be assigned to each filing from the outset for any queries the parties have. The ISU is often perceived by investors to be a "black box". Indeed, updates and reasons are not provided even when cases are called in, leading to a lack of clarity over the concerns and the eventual timeline. In contrast, other comparable screening regimes do allow for formal and informal contacts. It was our understanding that the ISU would work with the parties to a transaction to streamline the process. When this engagement does take place, our members find it helpful and the ISU appears to take a practical approach.

A further concerning issue is around the decision to extend the reviews and the clock-stopping function. In one member example a transaction was called in and went into a second review. The ISU did not communicate the concern or a theory of harm. Unfortunately, the notifying parties were left in the dark and were thus not able to discuss or challenge these decisions. In a second similar example, the clock stopped while the ISU gathered information, which significantly extended the review timeline and resulted in a long delay. This means that the statutory review periods, for any cases that are called in, cannot be considered a good indication of process length. Instead, timings may vary significantly depending on the number of formal requests issued and their accompanying deadlines. This could be solved by amending the Act so that the clock is not automatically stopped on issuance of an information/attendance notice. Instead, and similar to the process in the UK's merger control regime, the SoS could be given the statutory power to stop the clock in the event that a party failed to provide a timely and/or complete response to a formal request. Alternatively, the ISU could be instructed to issue informal requests in the first instance, and only issue formal requests with clock-stopping effect if a party has failed to satisfactorily comply with an informal request.

The ISU should adapt to begin giving views on interpretation of the NSI Act in the absence of any judicial interpretation by the courts. Our members and their advisors would much prefer to have more detailed guidance, even if there is a risk that a court might subsequently disagree with it. For example, the CM''s jurisdictional and procedural guidance (CMA2) has around 30 pages of guidance dedicated

to explaining how the CMA has interpreted its jurisdiction under the Enterprise Act 2002, very little of which is based on case law of the courts. This is all the more important given the extremely broad and vague wording of many provisions in the Act.

19. Are there areas of the NSI Act on which you would like additional guidance, for example around acquirer, control, or target risk, or the scope of the Act?

The key areas in which additional guidance would be useful are:

1) Remedies:

The ISU has previously confirmed that it does not have a "shopping list" of preferred remedial measures but, given that there are now almost two years of precedent final orders and their associated remedies, some further guidance should be possible. Useful guidance in this area could include examples of the types of remedies that can be imposed and the types of risks they seek to address as this could help parties and their advisors to gauge what sort of remedies would be required in certain circumstances. Guidance in this area would create more deal certainty by allowing parties to foresee potential remedies when identifying targets and negotiating agreements.

2) Indirect Acquisitions:

We would welcome additional examples of indirect transactions particularly focusing on complex scenarios. For example, the guidance on Indirect Acquisitions of Control (in the guidance document 'Check if you need to tell the government about an acquisition that could harm the U''s national security') provides two examples of tracing through majority stakes where there is one majority stake of 51%. It would be particularly useful to provide examples where the majority stake is less than 50% due to multiple shareholders and situations of joint control (e.g. two 40% shareholders alongside other minority shareholders).

As we have previously raised at government roundtables and in consultation responses, it would also be useful to have further guidance as to whether an "oversight" test applies for the purposes of assessing whether a parent or holding company may be considered to carry out activities that are specified in the Notifiable Acquisition Regulations purely through the oversight of a subsidiary that actually performs those activities. The guidance goes further than the NSI Act and it is causing considerable uncertainty in the market.

For example, Buyer acquires 26% of Company A, which already owns 100% of Company B. Company B carries out activities in the UK that are specified in the Notifiable Acquisition Regulations, and Company A oversees the activities of Company B but does not perform them itself. On a literal reading of the legislation, this would suggest no filing in required on the basis that: (i) Company A is not a qualifying entity with specified activities, because it does not itself perform those activities; and (ii) the rules in paragraph 3 of Schedule 1 to the NSI Act also provide that Buyer is not treated as indirectly holding Company A's interest in Company B, since Buyer will not acquire a majority stake in Company A.

However, this is contradicted by the BEIS guidance "How the National Security and Investment Act could affect people or acquisitions outside the UK" under the heading "Common circumstances that could allow the government to investigate an acquisition", which indicates that a company may be "carrying on activities in the UK" for the purposes of section 7(3) of the Act, even if it does not itself perform such activities, but "oversees" a subsidiary that does. The courts have adopted a similar view when interpreting the test for "carrying on business in the UK" under the Enterprise Act 2002 and other legislative regimes – see, in particular, the Court of Appeal judgment in Akzo Nobel v.

Competition Commission [2014] EWCA Civ 482. If a similar oversight test also applies for the purpose of section 6(4) of the Act, with the result that a parent/holding company may be considered to be carrying out specified activities in the UK through its oversight of a subsidiary, then a filing would be required. Clarification of this scenario should be provided through additional guidance.

3) Fund-specific Guidance:

It would also be useful if the ISU could provide more detailed guidance on how the NSI Act applies specifically to fund structures. It would be particularly helpful to have guidance on the application of the control and tracing rules to fund structures, General Partners and Limited Partners.

20. Where else do you go to seek guidance or support on national security considerations when approaching investments in your sector or forming research partnerships?

21. Do you understand where the NSI Act may apply to Outward Direct Investment (ODI), and would you welcome additional guidance?

We understand that the NSI Act applies to ODI in the same way it applies to inbound investment in the UK i.e. it requires a UK nexus but does not necessarily require a UK entity or assets. However, given it is less intuitive to consider the NSI Act for ODI, additional guidance setting out the specific instances in which the NSI Act could apply to ODI would be helpful. We think that this guidance would also benefit from the use of examples (e.g. a UK bio-technology company invests in production facilities overseas which requires the transfer of relevant IP and know-how).

5. Scope of the NSI system

22. Are there particular types of acquisitions that are currently subject to mandatory notification requirements that you do not think should be?

We believe that the following should be excluded:

- Certain asset deals should be excluded – asset deals can be caught by the mandatory regime for entity deals simply because the assets are gathered into a 'newco', which is then acquired by the buyers. This may be inevitable but it is hard to see the logic, especially when buying the assets direct wouldn't be notifiable. Please see the illustrated example section at the end of this paper for further information.
- Internal group re-structuring should be excluded – mandatory notification of internal reorganisations is an abnormality and catches deals that, in our view, should not be notified. These should be taken out of the mandatory regime altogether and captured by the call-in right where appropriate.

Additional safe harbours should be included to carve out certain types of transaction. We have listed these in our opening remarks.

23. Have the timelines associated with mandatory notification affected acquisitions in which you have been involved?

Yes, in particular for our Venture Capital members who invest in nimble and fast growing companies. These companies may need investment more quickly than other types of companies or indeed may need continuous investment to ensure they can continue to innovate, grow or even just survive. The

timescales that the regime imposes can generate a high risk of companies simply failing before an investment is cleared. These portfolio companies are the feedstock for later stage investors.

24. Are there types of internal reorganisation that are more or less likely to result in substantive changes in who controls or influences an entity, and if so, how would you characterise these types of reorganisations?

We do not consider any particular type of reorganisation or restructuring to be more or less likely to result in substantive changes in who controls or influences an entity. The more important point to stress is that we consider it to be highly unlikely that any internal reorganisation or restructuring would give rise to any significant national security concerns. In such cases, a transfer of shares in an entity with specified activities (**ESA**), or in a holding company of such an entity, to another group entity has no impact on the degree of control that may be exercised over the ESA, or on the identity of the entity that exercises that control. In particular, direct or indirect subsidiaries of the ultimate parent have no independent agency when exercising their governance rights over an ESA: they must act as directed by their ultimate parent and under the oversight of the parent. If they do not, the parent can exercise its rights to replace the subsidiaries board of directors and senior management and/or to give directions as to the conduct of the subsidiary's business. There is therefore no meaningful distinction to be made between a subsidiary's control rights over the ESA, and those of its ultimate parent. An entity that is closer to the ESA in the chain of ownership (e.g., a direct shareholder in the ESA) has no greater ability to control the activities of the ESA, or to access information relating to the ESA's activities, than its ultimate parent, irrespective of how many intermediate holding companies sit between them. There is therefore no national security risk that could arise from a transfer of shares to another group entity that would not also have arisen absent the transfer. Consequently, there is no causal link between the transaction and any potential national security risk, contrary to the statutory requirements of s.1 NSIA (in respect of opening an investigation) and s.26 NSIA (in respect of final orders), which both require that the relevant national security risk must arise from the trigger event. Consequently, it would be reasonable to amend the scope of the NSI Act to the effect that internal reorganisations or restructurings fall within the scope of the call-in power i.e. for voluntary notification, rather than being subject to mandatory notification.

25. Have you had to notify an internal reorganisation under the NSI Act and, if so, what impact did it have on your organisation?

Since the adoption of the NSI Act, our members have engaged in various internal reorganisations/restructurings that have fallen within the current scope of the NSI Act, thus triggering a mandatory notification requirement to the ISU. The impact of this mandatory notification requirement has included delays to completions, procedural burdens and costs (e.g. legal fees).

26. Are liquidators, official receivers, or special administrators likely to use their temporary control of shares in solvent entities to influence the policies of those solvent entities and, if so, how?

We very much welcome the proposal to extend the scope of the exemptions to other formal insolvency appointments. We consider that these proposals are very much in keeping with existing exemptions and policy objectives of the NSI Act.

<u>Liquidators, receivers, and special administrators</u>

It is worth noting that when a liquidator, the official receiver in respect of companies or a special administrator is appointed over an insolvent company which holds shares in relation to a solvent entity, there is no change in ownership/control in relation to the shares. The shares continue to be

owned/controlled by the insolvent company with the officeholder acting as agent of the insolvent company, essentially the officeholder steps into the shoes of the insolvent company's directors. As such, these types of officeholders share the same agency status as administrators, whose appointment is already expressly exempt from the NSI Act. As such we can see no policy reasons for not extending the exemption to the appointment of these types of officeholders, who often have a part to play in safeguarding the assets, and in the case of special administration, the assets may be of wider public importance.

Receivers

We would also suggest that the exemptions go further to include receivers and trustees in bankruptcy. Receivers like administrators act as agents for the company over which they are appointed so the same rationale applies notwithstanding the fact that they act in the interests of their appointees rather than creditors more generally. We would suggest that scope of the exemption for receivership appointments ought to be limited to receivers who are also licensed insolvency practitioners to ensure that the appointees are subject to appropriate supervision and regulation akin to those imposed upon administrators and liquidators.

Trustees in bankruptcy

The legal analysis is different in relation to the appointment of officeholders in respect of individuals, where trustees in bankruptcy or the official receiver acting in the capacity of trustee benefit from an automatic vesting of the bankrupt's estate immediately upon the commencement of the bankruptcy by reference to s.306 of the Insolvency Act 1986. The vesting provision is based upon a policy designed to safeguard the assets of the bankrupt. Under the current NSI Act, while it may be less likely in practice for an individual subject to bankruptcy proceedings to have interests in solvent entities that are subject to the NSI Act regime, it is possible. However, as the NSI Act legislation is currently drafted, it has the potential to render the otherwise valid appointment of trustees and automatic vesting provisions void. Extending the exemption to the appointment of trustees in bankruptcy who are also licensed insolvency practitioners does not in our view increase the risk to national security, indeed it may serve as additional protection.

Licensed insolvency professionals

Each of the officeholders proposed under the wider exemption are licensed professionals, all are subject ultimately to the supervision of the court. Their appointment as such ought not to be a concern from a national security perspective. The absence of such exemptions currently (especially in the context of administration and foreign insolvency proceedings benefitting from an express exemption) does create an uncertainty as to whether the appointments of such officeholders are intended to be within the scope of the NSI Act. We further note that any subsequent disposal by any of those officeholders on behalf of the companies or individuals over which they are appointed where they are within scope of the NSI Act, would at that stage be subject to clearance. We suggest that the application of the NSI Act in relation to insolvency situations would at that stage achieve the ultimate policy aims of legislation.

Benefits of exemptions and enhancing national security objectives

Providing more targeted exemptions in this respect would in our view achieve a significant reduction in the potential costs, time and certainty burdens, that compliance with the current NSI Act regime imposes upon businesses and investors. These changes would be an effective way of ensuring that time and energies are focused on cases where there is a real risk to national security. The extended exemptions would also minimise the burdens on business, especially in circumstances where those businesses are already subject to financial distress.

27. Are there other circumstances which give temporary control over entities in financial distress where complying with mandatory notification requirements presents challenges? If so, what are the circumstances and has this happened to your organisation?

In addition to the officeholders identified in the Call for Evidence, as already mentioned we think there is merit in including receivers and administrative receivers who also act as agents of the insolvent company and in our view ought to benefit from the same exemption in terms of their appointment. Otherwise, the same potential adverse effects apply in relation to their appointment. Likewise, trustees in bankruptcy should for the sake of consistency also be included within the scope of the exemptions.

As with the other officeholders, if they seek to realise assets/interests as part of that appointment within the scope of the 17 sensitive areas, notifications would be required at that stage.

28. Have you had to notify the appointment of a liquidator, receiver or special administrator under the NSI Act and, if so, what effect did it have on the insolvency process and your organisation?

To the extent that BVCA members have had cause to be involved in the mandatory notification of restructuring transactions to the ISU, we are pleased to report that those notifications have been dealt with in a timely manner and have not had a significant impact on the ultimate outcome. We would however note that they have added an additional layer of time, cost, complexity and overall uncertainty to the transactions.

The relative lack of applications to date should not be interpreted as obviating the need to extend the exemptions. There is a significant amount of analysis that is undertaken when advising companies in relation to contingency planning where having express exemptions would provide benefits and in particular save time and costs. For future cases, where an appointment is necessary and required on an urgent basis, excluding the appointment of insolvency officeholders would also save valuable time and costs and may also have a role to play in the preservation of the business and its employees.

Therefore, we consider that further refinements in the context of the exemptions would be very much welcomed, especially in the case of formal insolvencies or restructurings which may require as an implementation technique the use of formal appointments. It does not seem to make sense for example that currently the appointment of a special administrator for a relevant licensee nuclear company would not be possible without first seeking NSI Act clearance despite the fact that such an appointment can only be made upon an application to the Court by the Secretary of State or OFGEM with the consent of the SoS.

On a separate note we would encourage the ISU to ensure that the expedited system operates effectively to facilitate and assist in urgent cases. Perhaps the most obvious example may be in the context of pre-pack administrations. While the current exemption would allow the appointment to take place, it would not extend to the pre-pack sale and being able to effect such sales on an urgent basis is essential to its effectiveness. We therefore hope that should future cases arise, the ISU appreciates the immediate attention that such cases may need, therefore having a dedicated means of communication (including availability outside of ordinary business hours) would be very much appreciated.

29. Are lenders holding shares under Scots law share pledges likely to use their temporary holding of those shares in solvent entities to influence those solvent entities against the wishes of the borrower? If so, can you give examples of when this has happened or might happen?

30. Have you had to notify the appointment of a Scots law share pledge under the NSI Act and, if so, what effect did it have on the lending or borrowing process?

31. Do you have views on whether certain public bodies should be exempt from mandatory notification? How would you characterise these public bodies?

We think that this proposal sounds sensible, however the principle of what would in effect be a passporting regime can and should be extended further. If the Government is willing to recognise NDPBs as "safe" investors/acquirors, we would like see recognition extended to other types of entity. We believe that this would improve the administrative efficiency of the regime. There are other investor/acquirors that would be straightforward candidates for a passport. We have set out examples in our response to question 22.

For example, private capital funds may need to submit more information regarding who the LPs are, whether they have any influence etc., but as a fund may make several investments requiring notification under the Act, it may be a more efficient process to sign off on the fund once rather than potentially several times over a number of transactions. Even in a syndicated scenario it reduces the number of parties to be unnecessarily re-scrutinised.

If we look at one specific example, one part of the private capital market (EIS funds and angel investors) have an ever-shifting population of EIS investors, who make tax-advantaged VC investments and present no threat to national security. As many angel-funded companies can need multiple rounds of funding, often at short notice, the timescales that the regime imposes can generate a high risk of companies failing before an investment is cleared – and our EIS fund manager members cannot deploy money from these investors unless they have certainty that it will attract EIS reliefs, so most forms of bridge funding are not possible. These companies are the feedstock for later stage investors, so this end of the spectrum shouldn't be overlooked and should be able to passport if such a regime is considered.

It would be helpful for the ISU to make use of shelf filings/standing data as part of a passporting regime so that all the questions that the unit asks of investors/acquirors would be held on file (perhaps with an obligation on those parties to certify that the standing data is materially correct as part of a notification).

32. Has the inclusion of Automatic Enforcement Provisions under mandatory notification affected your ability to access loans, or to enforce such provisions?

The guidance around the taking of equitable share security and whether this fell within the control test under the NSI Act has been extremely helpful and removed the friction that would have arisen on financing transactions as well as the legal uncertainty that would have ensued. However, there is still the potential for friction and legal uncertainty when such share security comes to be enforced particularly when the security agent on behalf of the syndicate of lenders, acquires the voting rights in respect of the charged shares. Typically, before any voting rights can be acquired by the security agent under these arrangements, an event of default under the facility agreement has to occur and, in most cases, this also needs to be followed by an acceleration event (for example, on the instruction of the majority lenders, the facility agent cancels the commitments and declares all amounts due and payable immediately). A default under a facility agreement is a factual matter and is not something that is within the control of the Lenders or the Security Agent. Only the question of whether to waive the default or whether to accelerate the loan as a result is within the control of the Lenders and both decisions typically are majority lender decisions (usually 66 2/3rds % of the total commitments). The voting rights are therefore only acquired as part of the enforcement action of the lenders following a

default and in acquiring the voting rights the lenders are able to use them to ensure, as far as possible, the rescue of the corporate group in order to obtain the best possible chance of their debts being repaid.

The delay of at least 30 days in having to seek clearance before being able to obtain those voting rights will cause unnecessary friction and could be the difference between a rescue and an insolvency process. In a syndicated loan scenario where the acquisition of the voting rights is linked to a factual default under a facility agreement which requires a majority lender decision to call and involves the voting rights being acquired on behalf of the lenders by a professional security trustee, it would seem an extremely remote possibility that a hostile actor could in any way take control over a company in such a scenario. In such a case, there is a very strong argument that the acquisition of the voting rights should be outside of the mandatory notification regime. This may well have been the intent of paragraph 7 of Schedule 1 of the NSI Act (Rights attached to shares held by way of security) but it is not clear what type of enforcement action would fall within this paragraph and so reliance is not generally being placed on this in this context given the potential criminal and civil consequences of a failure to make a mandatory notification. These issues could be resolved in a number of different ways including, for example, (i) providing a carve out from the mandatory notification regime for voting rights acquired by the security agent following a default or acceleration under a facility agreement (possibly with an information notification to the ISU); (ii) a time limited carve out for such voting rights to enable the lenders to act quickly once a default has occurred to ensure the ongoing survival of the company or (iii) guidance around the applicability of paragraph 7 of Schedule 1 to make it clear that the acquisition of voting rights by the security agent following a default under or acceleration of the loan does not require pre-clearance so long as the voting rights are being used by the security agent on behalf of the lenders to maintain the value of their security and/or ensure the rescue or restructuring of the group and its financing arrangements.

Clearly any proposed sale of the secured shares as part of the enforcement of the share security would continue to require a prior mandatory notification to be made.

Share security agreements that our members are now putting in place financing transactions no longer provide for the automatic acquisition of voting rights on an event of default or acceleration event. Any such acquisition is now made conditional on compliance with any NSI Act requirements. It is now market practice to include this in all share security agreements irrespective of whether or not the shares that are charged are in an entity that carries out a specified activity in one of the 17 specified sectors. This is because the analysis around this may have changed by the time of any default if the entity or any entity it controls begins to carry out such an activity or the specified activities or sectors are changed. This very clearly impacts the ability of lenders to act quickly in an enforcement scenario because they have first to consider whether the NSIA applies. Even if the NSIA doesn't apply, the analysis takes time and requires legal advice to be obtained which is costly. If the NSIA does apply, the lenders are looking at a 30 day period to obtain clearance which is valuable time lost in an enforcement scenario and when a company is in distress.

33. Have you reflected NSI mandatory notification requirements in the terms within lending agreements, either as part of new agreements or through updating existing agreements? If so, how?

As mentioned in our answer to question 32, it is now market practice for share security on financing transactions to require any NSI Act conditions to be complied with before voting rights are acquired by the security agent. If a matter involves a restructuring, refinancing or amendment of a transaction which predates the NSI Act, companies are typically advised to amend the share security agreement to incorporate the standard NSI Act wording in the voting rights provisions. This adds time and cost

to the transaction. Moreover, the repapering that our members have undertaken to take account of the NSIA is always associated with a refinancing, restructuring or amendment and is therefore a tiny fraction of the pre NSIA share security that our members have in place.

34. Do you have existing Automatic Enforcement Provisions or similar agreements which cover security over entities in the 17 mandatory areas and do not account for NSI mandatory notification requirements if they were to arise?

The bulk of the share security agreements that pre-date the NSI Act included a provision conferring voting rights on the security agent automatically on the occurrence of an event of default or an acceleration event under the facility agreement. Many of those share security agreements continue to be effective and the security agent and/or the lenders in those transactions (it is not entirely clear who would acquire the control for NSI Act purposes in these circumstances) could find themselves holding voting rights illegally because of the provisions of their security documents. The trigger for such an acquisition is also outside of their control. This is hugely problematic and extremely serious given the criminal liability that attaches to a failure to make a prior mandatory notification. The NSI Act has therefore changed the law retrospectively in this regard which seriously undermines the robustness of the rule of law in this country for those undertaking business here. A robust legal system should not change the goal posts for transactions that were put in place in good faith and in accordance with the law at the time. As a matter of principle, share security that was put in place prior to 12 November 2020 as security for a loan and which includes an automatic acquisition of voting rights clause should not be made subject to the mandatory notification regime. It is accepted that if amendments are made to the terms of those transactions after that date, there is an opportunity to remediate those share security agreements and so, subject to the comments made in question 22 above, could be made subject to the NSIA regime. Absent any assistance from the Government on this issue, the only course of action for the holders of such share security is to audit every existing share security agreement they have entered into and to amend each of them to make the automatic acquisition of voting rights provisions subject to the NSI Act. This is a very difficult message to give to the financial markets given the time and cost involved in such an exercise and the number of institutions affected by it and the message it gives about the robustness of the rule of law and the resulting affect it has undoubtedly had on confidence in the UK financial markets.

35. Do you understand what activities might bring an entity into scope of mandatory notification requirements, as set out in the Notifiable Acquisition Regulations?

It is essential to the efficient conduct of investment in the UK that potential investors are able to identify quickly and clearly whether the mandatory notification requirement would apply to a proposed transaction. The definitions set out in the Notifiable Acquisition Regulations ("NARs") are clearly a key factor in this, and must therefore be both precise and detailed enough to enable investors to assess whether the notification requirement is triggered, and accessible enough for investors to assess their own risk as far as possible independently of the potential investee. This is especially important given that it is not possible even to make an application on a cautious basis, due to the ISU's practice (indicated in the most recent Annual Report) of rejecting notifications made using the wrong form (i.e. rejecting notifications made as voluntary notifications that in fact fall within the mandatory regime, and rejecting notifications made under the mandatory regime that do not trigger a mandatory requirement and so should instead have been voluntary notifications).

The response provided below seeks to highlight areas where clarification on the application of the specified sectors might be of benefit, whether by way of guidance or by amendment to the NARs, based on both our members' actual experience of the regime and perceptions based on the existing guidance. Given the importance of the specified sectors and the implications of triggering a

mandatory notification requirement, any further clarification that can be provided, ideally including worked examples, would be beneficial.

Moreover, in the context of the private capital sector specifically, it should be noted that financial investors are inherently less likely to have intricate knowledge of the technologies and methods employed by the companies in which they invest prior to engaging with them with a view to a potential investment or acquisition. This means that potential investors must, at least initially, base their assessment of the transaction risk with respect to the NSI Act solely on a comparison of publicly available information about a company's activities with the activities described in the NARs. While it is perhaps inevitable that a complete assessment will always require the cooperation of the investee company, the use of worked examples to illustrate where particular business activities might be expected to fall within the scope of the NARs would be helpful to allow investors to consider this risk at an earlier stage of a transaction.

Advanced materials

As a general proposition, we support the view that reducing complexity and adopting a clearer structure in the definitions set out in the NARs is likely to be beneficial. This seems especially likely to benefit the Advanced Materials section, which is comparatively lengthy and has a lot of technical detail. For example, it may be helpful to break down the Advanced Materials section into smaller, distinct categories, as has been proposed in respect of critical minerals and semi-conductors.

We are, however, not in a position to comment on specific elements of the definition of Advanced Materials.

Communications

The definition of PECS/N is based on a cross-reference to the Communications Act 2003. This means that the definition is subject to the interpretation placed on the relevant provisions of that Act, which it is understood remains subject to uncertainty. As well as creating uncertainty for providers of PECS/N and investors in those entities, this creates uncertainty for entities which might make available an "associated facility" to a qualifying PECS/N (as their status is dependent on that of the PECS/N). Additional uncertainty may arise from the need to establish whether the PECS/N has turnover meeting the £50m threshold.

It would be beneficial, especially for potential investors in this sector, for the mandatory notification requirement to apply to entities that can be readily identified on the basis of a known definition and externally available information. This might, for example, involve making reference to formal designation of PECS/Ns under the relevant provisions of the Communications Act (sections 34 and 38), which could provide an easily verifiable list of relevant entities (provided Ofcom is able to maintain publicly available records in this regard).

Critical suppliers to Government

We note the feedback referred to in the Call for Evidence document, regarding the difficulties that arise where it is not clear whether an activity falls within this definition or another, such as Defence. Clearly, the removal of such uncertainties would be welcome, especially from the investor perspective given that, at least at the early stages of a transaction, investors may not be well placed to precisely define a potential investee's activities so as to identify the correct part of the NARs that should be applied.

In addition, there are aspects of the definition in Schedule 7 that are likely to be especially difficult for an investor to assess prior to in-depth engagement with a potential investee. For example, the

reference in paragraph 3(a) to "the processing or storage of material to which a security classification of SECRET or TOP SECRET has been applied" and the reference in paragraph 3(c) "requirement for employees of the qualifying entity to be vetted at or above 'Security Check' level" both refer to factors which are highly unlikely to be known outside of the company in question (and, indeed, may not even be known widely within the company) due to the security measures put in place to protect the information. Providing examples of the types of arrangement that are likely to fall within these categories may assist investors in assessing up-front whether a mandatory notification requirement is likely to arise.

Suppliers to the emergency services

As a general observation, many of the terms used in this definition refer to other legislation. It may be that incorporating the relevant definitions within the NAR could make this section more accessible.

As regards the proposal to add sub-contractors to this definition, we are unable to comment specifically on this in the abstract. As noted below, however, it is generally preferable that the mandatory notification requirement applies to as limited a category of activities of possible.

Synthetic biology

Schedule 16 of the NARs provides, in paragraphs 3 and 4, two definitions of synthetic biology, the latter of which "includes but is not limited to" the examples given in paragraph 4. This wording will inevitably make it more difficult to conclude whether a given activity is within the scope of the definition, potentially increasing the risk of parties making mandatory notifications where one is not required, or failing to do so where one is required. Greater clarity should be provided as to the circumstances in which activities not listed in paragraph 4 might nonetheless be deemed to fall within the definition of Synthetic Biology, for example. by reference to specific purposes for which activities are undertaken.

36. Are there activities specified in the Notifiable Acquisition Regulations that you do not think should be included? If so, what activities?

In general, mandatory notification requirements should apply only to those activities where it is clear that the risk to national security is highest, such that it is reasonable to assume that every transaction in that sector should be subject to review under the NSI Act. This implies that the specified activities defined in the NARs should be drawn as narrowly as possible.

Adopting such an approach would, of course, not prevent the ISU from reviewing transactions across a wider range of activities, including any of those currently listed within the NARs which might in future be removed. But it would allow the ISU the ability to refrain from investigating those transactions where it is clear both to the ISU and to the transaction parties that national security concerns do not arise. From an investor perspective, this would clearly be attractive insofar as it would reduce costs and uncertainty, benefitting investors, sellers and investee companies.

By way of illustration, it is noted that the figures published by the ISU in its Annual Report for the period to 31 March 2023 indicate that out of 671 mandatory notifications received, only 37 were called-in for detailed review. Given the high proportion of mandatory notifications that do not proceed to a detailed review, it seems highly likely that at least some are being made subject to a mandatory notification due to the NARs being drawn too broadly.

The comments below focus primarily on the examples raised in the Call for Evidence. There may, of course, be additional examples that we are not in a position to identify, and we assume that the Government will consult in due course on its specific proposals for updating the NARs.

Artificial Intelligence

AI is an increasingly important sector of the economy and increasingly present in all manner of economic activity. As is already acknowledged in the Call for Evidence document, the scope of the definition in Schedule 3 to the NARs is likely too broad and capturing activity that is unlikely to give rise to a national security risk. This issue is likely to become more severe as AI becomes more prevalent.

We are not in a position to make definitive proposals for a narrower definition. However, one option that could be considered is modifying the definition so as to exclude parties who merely incorporate into their products or services AI that has been developed by other parties, without undertaking any further development of that technology, such that only entities that develop AI or own its underlying technology would be subject to the mandatory notification requirement. This may present a more proportionate approach, and although it might leave open the possibility of malicious parties obtaining AI technology via a product in which it is used it may be hoped that the ISU would be able to address this through the use of the use of its powers to call-in transactions that have not been notified.

We consider that in future, AI may become embedded in a wide range of products, and the current provisions as drafted may capture a large number of non-threatening qualifying entities if they simply use AI in their products, even if they do not develop or create the underlying AI technology themselves. For example, a kitchen company may develop ovens with AI capabilities such as food item object identification, procured from a third party (i.e. Open AI); or a vacuum cleaner company could procure AI technology from a third party in order to develop an automated vacuum that cleans based on perceiving dust levels in the environment. Both of these examples would not raise national security concerns, but appear to be captured by the current definition. While there are arguments that such technologies in these products could be purchased and repurposed by a bad actor (if the entity developing these products is purchased), we consider that unless the entity using the AI technology in its products develops or owns that AI technology IP itself, there appears to be a lower risk of such repurposing for a malicious cause in the context of national security.

Communications

As set out in response to question 35, it would aid certainty if this category was defined by reference to designated PECS/Ns rather than the more open interpretation of this category under the Communications Act.

In addition, it may be appropriate to limit this category by applying a financial threshold to providers of associated facilities. This may help, for example, to avoid bringing entities within the scope of the mandatory notification requirement where they provide only limited services to qualifying PECS/Ns.

Defence

We note the indication in the Call for Evidence document that stakeholders have already highlighted concerns that it can be difficult to understand whether activities are within the scope of the Defence definition in the NARs. That in itself is good reason for developing improved guidance in this area.

Paragraph 2 of Schedule 10 to the NARs sets out a broad description of activities falling within the Defence category. It may be observed, first, that this paragraph refers to "defence or national security purposes", but only part of this (defence) is defined in paragraph 1 – "national security purposes" are not defined within the context of Schedule 10.

As the definition is dependent on the purpose for which products and services are "used or provided", difficulties could arise, for example, where the ultimate use of products or services is not clear. Possible examples might include circumstances where it would be open to the MoD to use products for activities going beyond UK defence, such as cooperation with NATO allies, or circumstances where a potential investee is in negotiations with the Government such that it is not yet clear whether it will fall within the scope of Schedule 10. This has the potential to be particularly difficult from the perspective of an investor, which is likely to have very limited (if any) visibility of how products are used even during negotiations with a potential investee.

Similarly, the existing Guidance appears to suggest that a broad range of services could be within the scope of Schedule 10 even if it is not obvious that they serve a defence or national security purpose. The reference in the Guidance to "[c]ontracts which provide access to defence facilities" appears to imply that this could include any services (e.g. catering or cleaning) that takes place on MoD premises. Clarification of this point would be helpful.

The conditions set out in paragraph 3 are also very broad. Paragraph 3(a) extends the definition to cover any party in a chain of sub-contractors, irrespective of how remote they may be from the relevant government contractor. This raises the risk that transactions that should not give rise to concerns will trigger a mandatory notification requirement by extending the circumstances in which a supplier's activities might ultimately bring it within the scope of the NARs.

Moreover, the inclusion of sub-contractors seems likely to give rise to difficulties in identifying whether a company's activities are within the scope of Schedule 10 at all, due the potential remoteness from the actual government contractor. For example, a sub-contractor may not have visibility as to the purposes for which the government contractor ultimately supplies its products or services, and whether that is for "defence or national security purposes".

Options for addressing these concerns might include:

- providing guidance as to the meaning of "national security" for the purpose of Schedule 10 of the NARs;
- providing further guidance as to the circumstances in which a product or service is "used or provided for defence or national security purposes", for example excluding product/services which are obviously not critical or sensitive, such as administrative or off-the-shelf products/services not designed for defence or national security purposes;
- narrowing the list of entities in a supply chain whose activities fall within the scope of Schedule 10;
- where possible, encouraging the MoD or other relevant Government departments to indicate to suppliers if they consider their products or services are being provided or used for defence or national security purposes, especially if such purposes would not be obvious from the nature of the product or service; or
- clarifying the circumstances in which having access to particular premises would be sufficient to bring an activity within the scope of Schedule 10. (e.g. cleaning services).

<u>Data Infrastructure</u>

Removing duplication or overlap between the specified sectors is likely to improve clarity. On that basis the proposal to remove duplication between the definitions of Data Infrastructure and Critical Suppliers to Government seems likely to be positive. It may be noted, however, that removing contracts involving material classified OFFICIAL-SENSITIVE or involving any entity with staff cleared at Security Check or above raises the question as to whether transactions involving lower security gradings should be considered less problematic than under the existing definition.

As with many other sectors, the definition of Data Infrastructure is wide, and we understand that some of our members have found this to be a particularly difficult area. In particular, Data Infrastructure can be fairly easily triggered even if an investee company processes or holds only benign data that ought not to give rise to concerns around national security.

An alternative approach would be that adopted under the Australian FIRB regime, in which guidance clarifies that where the data infrastructure/processing is not the primary purpose but simply a by-product for another service (for example accounting software), then this would not be caught. It provides, in particular, as follows:
"The definition [of Critical Data Storage or Processing Asset] does not cover instances where data storage or processing is secondary to, an enabler for, or simply a by-product of, the primary service being offered – for example, accounting services. In a scenario where a business has shared business critical data with a SaaS provider, but only for the purposes of the SaaS provider providing its primary service (such as running the business' payroll), the SaaS provider is not to be considered a critical infrastructure asset."

A similar clarification in the UK regime would be very helpful as well, and would help to clearly exclude non-sensitive data infrastructure operations.

Energy

Paragraphs 3(c) and 3(d) of Schedule 11 to the NARs provide that certain activities will be within the scope of the NARs where either (i) they are carried out under a licence granted under the Electricity Act 1989 or (ii) they are carried on in pursuance of an exemption from the licensing requirement. A concern with this approach is that it brings within the scope of the NARs activities which are of such a small scale that it is not considered necessary for the to be licensed activities. This suggests a degree of inconsistency between the NSI regime and the electricity regulation regime, and implies that the Energy category defined in the NARs is too broad.

For example, exemptions from licensing requirements are available for the following:

- Electricity generation assets with capacity of less than 50MW (see Schedule 2 of The Electricity (Class Exemptions from the Requirement for a Licence) Order 2001, SI 2001/3270). This means that assets falling well below the materiality threshold set out in paragraph 4(6)(a) of Schedule 11 to the NARs can nonetheless contribute satisfying the conditions for a mandatory notification to be required.
- Providing a private wire for the purpose of domestic supply that does not distribute more electrical power than 2.5 megawatts (see Schedule 3 of The Electricity (Class Exemptions from the Requirement for a Licence) Order 2001, SI 2001/3270). Therefore an acquisition of such a wire can be is technically subject to a mandatory notification requirement, despite being clearly de minimis in scale.

Removing the exemptions to licencing requirements from these definitions could therefore help to tighten the focus of the regime onto energy assets that are more likely to pose a national security risk.

37. Are there activities not included in the Notifiable Acquisition Regulations that you think should be included? If so, what activities?

As set out above, we consider that the activities specified in the NARs, and therefore subject to the mandatory notification requirement, should be defined as narrowly as possible. This does not mean

that activities should never be added to the NARs, but it does mean that this should only be done where it is clearly necessary in view of a clear risk to UK national security.

Comments are provided below in respect of certain of the activities referred to in the Call for Evidence document as being potential activities to be added to the NARs.

Communications

The Call for Evidence document indicates that the Government is considering whether the current £50m turnover threshold for PECN/S should be lowered. It is not clear to us on what basis the Government considers this might be necessary, and we would not advocate widening the scope of the mandatory notification requirement in the absence of clear reasons for doing so.

Data infrastructure

As set out in response to question 36 above, the definition of Data Infrastructure is arguably already too broad. The proposed expansion of the Data Infrastructure area to include entities that own, operate, manage or provide services to colocation data centres risks exacerbating that problem. It is in any event not clear that this addition would be needed. The existing Guidance already provides an example of a colocation data centre as potentially being within the scope of the mandatory notification requirement (notwithstanding that in the example no notification requirement is triggered due to the company not having a direct contract with a public sector authority and not having been notified it is a sub-contractor to a public sector authority).

Suppliers to the emergency services

As noted above in the context of Defence activities, the extension of mandatory notification requirements to sub-contractors has the potential to create difficulties for those sub-contractors (and potential investors in them) in establishing whether they are part of a supply chain that falls within the scope of the NARs. This is likely to be even more of a difficulty for Suppliers to the Emergency Services, since it is less likely that the lead contractor (whose contract is with the relevant emergency service provider) will be under any obligation to notify sub-contractors of the nature of its contractual arrangements.

Similarly, suppliers of products or services that would not otherwise fall within the scope of the NARs may not have sufficient visibility of the onward supply chain to know that their product or service is used to supply the emergency services. Again, this would make it very difficult for the sub-contractor, and any potential investor, to assess whether a mandatory notification requirement might be triggered.

38. Are there areas of the Notifiable Acquisition Regulations that would benefit from additional guidance? If so, what areas and what guidance?

As set out above, there are various elements of the NARs that would benefit from additional guidance. As a general principle, additional guidance will always be welcome insofar as it enables investors to more readily assess the likelihood of a transaction triggering a mandatory notification requirement, especially where it enables this assessment to be carried out at an earlier stage of the transaction.

Artificial intelligence

Given the continuing development of AI, it may be most helpful to have additional examples of AI that would be considered to fall within each of the specified categories. This is unlikely to be comprehensive, but rather would provide more reference points against which to assess AI activities

in future. Ideally such examples would draw from actual examples and explain the ISU's reasoning, though hypotheticals may also be helpful where actual examples do not exist.

39. Are there areas of the Notifiable Acquisition Regulations that would benefit from drafting changes to improve clarity on the activities covered, either by changing drafting within areas of the Regulations or by carving out new areas? If so, what areas?

Please see the comments on questions 35-38 above regarding activities which could benefit from modified definitions and/or further guidance.

6. Operation of the NSI Act

40. Are there any other changes you would like the Government to consider to the operation of the NSI Act?

41. If you have completed a notification form, how much time did this take?

Our members have provided feedback and the amount of time needed varies. However, what is clear is that it is taking longer than expected when the regime was created, with unnecessary extra cost and disruption to the normal course of business.

42. Would you prefer that the forms ask for more information if that reduces the likelihood that the Government asks for additional information during the review or assessment process?

No, we do not believe that the forms need to ask for further information. There should be fundamental reasons as to why the Government is asking for more information. We are not sure that asking for more information will reduce the number of questions from the ISU. Our members' preference would be to have more communication from the ISU and better formed guidance.

43. What, if any, functional improvements would make submitting a notification on the NSI Notification Service easier?

One area in which there is scope for greater efficiency is the possibility for filing form to be rejected if the ISU determines that a transaction notified using the mandatory form in fact falls under the voluntary regime, or that a transaction notified using the voluntary form falls under the mandatory regime. We note from the NSIA Annual Report that around 33 filings were rejected for this reason in the year up to 31 March 2023 and this was the main reason for filings being rejected.

This means that in the (relatively common) scenario that it is not clear whether a mandatory filing is required, parties must either incur delays in seeking a view regarding notifiability from the ISU, or risk incurring delays by submitting a notification that may be rejected as using the wrong form. Given that almost all of the information required by the mandatory and voluntary filing forms is the same, this approach creates unnecessary obstacles for parties that want to obtain clearance in the shortest time possible. It should be possible to notify using a form that satisfies the requirements of both the voluntary and mandatory filing forms such that, if there is uncertainty as to which is appropriate, there is no risk that the form is rejected. The government should consider adapting the online filing portal accordingly. Alternatively, the government could clarify in the market guidance that it will not reject a mandatory filing form on the grounds that it should have been submitted using a voluntary filing form, so that parties can adopt a cautious approach of making a mandatory filing if there is some uncertainty, without risking delays to the clearance.

44. Do you understand what kind of information would be classified at SECRET and TOP SECRET and how to provide that information to the ISU if necessary?

45. If you are a legal advisor submitting a notification form on behalf of a client, do you check the classification of material provided in the form with your client before submitting?

46. Is there any further feedback you would like to provide?

Real life examples from BVCA members

Example 1

An early stage venture capital investor in the deep tech and life science sector. Most (if not all) of our companies are R&D intensive, loss making companies.

The VC firm completed the following deal which was delayed following signing. The firm received advice from external counsel and the ISU called in the deal. The impact of the delay to closing was very significant in this case – the target company was loss making and running out of money very quickly. This financial position was included in the private submission in April 2022 as it was made clear the impact this had – if the ISU hadn't cleared the transaction when it did, there was a very strong possibility that the target company would have become insolvent and then investors would have lost their investment and the sale would not have occurred.

The key difficulty was the lack of communication – as noted below, the first time the firm was given details of what the ISU's concern centred around was in a call on 22 April 2022 – that was a full month and half after the transaction had been called in. An explanation from the ISU was needed earlier in the process but certainly none was forthcoming.

- *Early February 2022 – deal signed, with completion subject to NS&I approval.*
- *11 February 2022 – Voluntary Notifications accepted. 3 big City law firms had opined that the target company's operations did not fall within the 17 high risk sectors.*
- *9 March 2022 – Transaction called in by ISU and Interim Order issued*
- *24 March 2022 – Information Notice issued by ISU (with deadline of 7 April 2022)*
  - *Clock stops on 23 March*
  - *Information and correspondence sent back and forth but clock stops until ISU confirms restart on 11 April 2022*
- *14 April 2022 – ISU review period extended until 19 July 2022*
    - *Call with ISU held on 22 April 2022*
      - *First time details given of ISU concerns*
      - *Revealed technology being reviewed by Ministry of Defence*
    - *Additional submissions made by target company (one shared with purchaser and one private) and made separately by purchaser*
- *21 June 2022 – Clearance received*

Total time: circa 4 months.

Example 2

An established, independent investment company, with a balance sheet of more than £2.5bn supporting earlier stage and established private businesses, and smaller listed companies. We invest across all regions and industry sectors, backing founders and management teams who are powering the future of the economy.

We were advised to apply for clearance on initial investment for an early stage investment where the aggregate percentage of funds managed by us was in excess of 25% - this was funded via two different LPs, one for our shareholder funds and the second for bank funds which we manage via the UK Enterprise Fund. On a subsequent follow on investment, the LP which represents shareholder funds went through 25% individually and we had to put in another notification despite the previous clearance.

The transaction was an acquisition of additional control / shares – we routinely invest in companies via more than one limited partnership, each acting via the same management company. In some situations we will be acquiring more than 25% of the share capital on an aggregate partnership basis, and then as a result of further funding rounds one of our limited partnerships individually moves through a threshold. We understand that under the requirements of the NSI Act both acquisitions would require prior clearance, notwithstanding clearance has already been obtained to the acquisition by our partnerships on an aggregate basis (via one manager) of more than 25% of the share capital and the same management entity acts for each LP on an individual basis. In this scenario we would suggest it would be helpful that, provided both investing partnerships/entities are managed/controlled by the same entity, that a mandatory notification is only required on an aggregate partnership/entity basis.

Example 3

We have included this example to illustrate a timeline of the process for obtaining clearance by way of a commitments decision, based on member experience in a previous filing. As you will see, this covers the 30 WD "initial period" process, 30 WD "initial period" following the call-in notice, and 45 WD "additional period" (of which 26 WD were used in order to reach the commitments decision. References to "Days" are calendar days, whereas "WD" are working days relevant to the statutory time limits for the ISU to issue its decision.

Calendar day (Working day (WD) in ISU review process)	Event
Day 1	Filing submitted
Day 5	Filing accepted as complete by ISU
Day 42 (WD 27 of 30 WD initial period)	Call-in notice issued
Day 53 (WD 6 of 30)	Information notice issued (clocked stopped on review)
Day 66	Clock resumed
Day 102 (WD 30 of 30 WD call-in period)	Additional period notice
Day 105 (WD 2 of 45 WD additional period)	Call with ISU on timing/setting out financial concerns
Day 117 (WD 9 of 45)	Call with ISU where they revealed concerns/discussed potential remedies
Day 119 (WD 11 of 45)	Second information notice received requesting confidentiality policies
Day 122 (WD 12 of 45)	Second information notice replied to/ ISU confirms clock restarts

Day 123 (WD 13 of 45)	Further call with ISU on potential remedies. ISU request for representations by the parties on proposed remedies
Day 126 (WD 16 of 45)	Call with ISU to discuss potential contents of representations/remedies to propose
Day 131 (WD 19 of 45)	Joint representations sent to ISU via email
Day 140 (WD 26 of 45)	Final order issued with conditions in the form proposed to ISU