National Security and Infrastructure Investment Review
Consumer and Competition Directorate
Department for Business, Energy and Industrial Strategy
1st Floor
1 Victoria Street
London
SW1H 0ET

By email: nsiireview@beis.gov.uk

9 January 2018

Dear Sirs

Re: National Security and Infrastructure Investment Review – BVCA response to the Green Paper (Chapter 8)

1. We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers and investors.

2. Our members have invested over £27 billion in nearly 3,800 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 448,000 people, and 87% of UK investments in 2016 were directed at small and medium-sized businesses. Further information in relation to the BVCA and the private equity model can be found in our letter of 14 November 2017 in response to the consultation set out in Chapter 7 of the National Security and Infrastructure Investment Review Green Paper.

3. We welcome the opportunity to comment on the questions posed in the National Security and Infrastructure Investment Review. This response relates to the questions raised in Chapter 8 of the Green Paper. We have responded only to those questions on which our members have a view or contribution to make.

Our overall view on the Chapter 8 proposals

4. The BVCA is supportive, in principle, of measures to protect the UK's national security interests and consider that such measures should be helpful in ensuring the UK remains an attractive location for investment and conducting business. However, any such measures must strike a balance between protection of genuine areas of critical national security interest and unnecessary interference with foreign investment in UK infrastructure and businesses, and with economic activity benefiting the wider UK economy. Clarity, transparency, precision and proportionality are key.

5. We agree that a clear distinction should be drawn between any new national security review

British Private Equity & Venture Capital Association
5th Floor, Chancery House, 53-64 Chancery Lane, London, Wc2A 1QS
T +44 (0)20 7492 0400 F +44 (0)20 7492 0401 bvca@bvca.co.uk www.bvca.co.uk

oversight powers and the existing competition regime. However, we would like to make the following overall recommendations:

- Any new filing process should be **voluntary**, with the Government having time-limited 'call-in' powers. We consider a mandatory notification regime would be disproportionate and costly.

- Areas of activity covered by the new regime should be **carefully and clearly defined** with a clear substantive test that is focused on critical national infrastructure and concerns of national security only, to give certainty to those investing in UK businesses.

- The test should be focussed on parties who have control or material influence over the activities in question, in line with the understood **definition in the Enterprise Act** (and the related body of law that has built up around this), rather than using the concept of significant influence from the PSC regime.

- There must be flexibility to obtain **informal prior guidance** from the authority enforcing the regime, in order to facilitate transparent and clear implementation.

Responses to Chapter 8 questions

Question 7. What are your views about the benefits and costs of amending the current voluntary regime to more clearly separate national security concerns and the competition assessment?

6. We agree that it is logical to separate more clearly the regimes for national security concerns and competition assessment. We do not expect that such a separation will, in itself, impose significant additional costs on purchasers of interests in UK assets.

7. However, any broadening of the scope of the national security overview regime will, inevitably, result in additional costs and impediments to foreign investment in UK infrastructure and businesses – see below. It would be helpful however to align the statutory time periods under both regimes (or make the time period for national security assessments shorter) so as not to have a more extensive time period for transaction approvals.

Question 8. What are your views about extending the scope of the Government's powers in relation to national security to include a wider range of investments into which Government could intervene?

8. Restrictions on foreign investment and ownership should be a last resort, and should only apply to areas of clear national security interest which cannot be alleviated by appropriate operational controls and residuary powers (such as the powers identified in Annex A to the Green Paper).

9. The scope of any expanded regime must be precisely and narrowly defined to ensure that parties to potential investment/acquisition activities are clear from the outset whether a particular activity is "in scope".

10. In addition, the regime should make clear that unwinding or blocking transactions is the very last resort used in extremis. In most cases that may give rise to national security concerns, those concerns should often be capable of being adequately addressed by operational undertakings, restrictions on disclosure of information or restrictions on transfer/sharing certain assets or IP.

11. We are strongly in favour of a voluntary regime as referred to in our response to question 15. Please see further our response to question 16 below.

Question 9. Do you agree that the definitions for those investments into which the Government can intervene should be (1) more than 25% of shares or voting rights and/or (2) other means of significant influence or control?

12. 25% of shares or voting rights seems to us to be an appropriate test as a minimum threshold. This level of shareholding gives rise to certain statutory vetoes that may be indicative of control or material influence. Any other means of "significant influence or control" should be aimed at indicia of control over strategic decision-making rather than be focussed on economic interests. For example, many of our members manage or advise funds which are typically constituted as limited partnerships. These are controlled by a general partner, which will often delegate the management function to a manager. The majority of economic interests are held by limited partners, who are passive investors. They have no day-to-day control rights over the limited partnership, and no control or voting rights over the underlying portfolio companies. Limited partners usually have limited contractual rights to receive certain information in respect of portfolio investments of the fund; such rights are usually restricted to high level performance information (such as consolidated financial information) and do not extend to a right to receive detailed operational information. Accordingly, we do not believe that the identity of limited partners is relevant, given their lack of day-to-day control and limited access to information. Such passive investors should be excluded clearly from the scope (as would be the case under the Enterprise Act 2002).

13. We recommend using the established test of "material influence" as set out in the Enterprise Act 2002 as the relevant test for the new regime.

Question 10. What do you think should constitute significant influence or control in this regime? Can you give examples to support this view?

14. Please see our response to question 9 above. An ability to control a majority of the board of the company or a majority of the shareholder votes or to veto the business plan, budget or senior management should constitute significant influence or control, in line with the Enterprise Act 2002.

15. We consider it wholly inappropriate and disproportionate to extend significant influence or control to lesser vetoes that provide minority protection. In particular the statutory guidance for "significant influence or control" for the purposes of the PSC regime is not sufficiently clear in this context and has given rise to confusion and uncertainty already amongst market participants. Some of the indicia of "significant influence or control" in the statutory guidance (such as making additional borrowing or changing the nature of the business or establishing or amending any profit-sharing, bonus or other incentive scheme) denote isolated instances of minority protection against a particular risk. They do not denote control, the ability to have any material influence over day-to-day operations, or control or influence over the strategy of the

business.

Question 11. Do you agree that, if it pursued an expanded 'call-in' power, the Government should retain the ability to intervene in an investment after the event for national security reasons? Is three months an appropriate period for this?

16. We agree that an ability to intervene after the event is necessary in the context of a voluntary regime. Limiting that power to a short period of time is essential to reduce business uncertainty – three months at the maximum (and preferably shorter).

Question 12. What are your views about any 'call-in' power being expanded to new projects?

17. We understand the logic of extending a 'call-in' power to new projects. However, in practice, so long as the scope of the new regime is strictly limited to critical national infrastructure then the Government will likely have considerable involvement from the outset of such a project. Therefore, it seems to us that the circumstances in which Government would need to revert to a new 'call-in' power relating to new projects will be limited. If such a power were to be introduced, it would be necessary for it to be very clearly, and restrictively, defined.

Question 13. What are your views about any 'call-in' power being expanded to bare asset sales?

18. We do not believe that it is necessary or advisable to expand a 'call-in' power in this way for the following reasons:

- The existing export control regime provides protection in relation to the export of bare assets and intellectual property that may give rise to national security concerns.
- So long as the operation of a business relating to critical national infrastructure is "in scope" then we do not see what additional benefits would accrue from making ownership of bare assets used in such a business also subject to the regime.
- Industrial assets are frequently financed under finance leases, pursuant to which the bank or other lessor is the legal owner of the relevant assets. We believe that the imposition of ownership restrictions would potentially impede the free functioning of this capital market.

Question 14. How could the Government best ensure that the expanded call-in power is exercised in a proportionate way and to provide sufficient transparency and clarity to businesses?

19. To ensure proportionate exercise of an expanded power, we consider that the legislation should impose restrictions on Government in the exercise of its powers. Specifically:

- The Government should not exercise a power to block a transaction unless it is reasonably satisfied that it is in the national interest to do so (based solely on national security concerns) and that its concerns cannot reasonably be addressed by other means (such as behavioural undertakings).
- As suggested in the Green Paper, affected parties should be able to seek judicial review of

decisions.

- We believe it would be inappropriate for responsibility for exercising any call-in power to lie with ministers. Impartial and as far as possible consistent application of the regime depends on any such power lying in the hands of an independent and apolitical authority with access to the relevant expertise in national security issues.

20. In order to improve transparency and clarity, the Government should publish guidance on areas of concern and how such concerns may be addressed.

21. We understand that it may be difficult for Government to publish its concerns relating to particular investors or countries. Therefore, we believe that it is essential that the Government is able (and is adequately resourced) to provide informal prior guidance in the form of confidential advice in relation to any particular transaction. Many of our members have global or pan-European investment mandates and determine how and in which jurisdictions their resources are allocated. A lack of clarity and transparency in the regime is likely to make the UK a less attractive location for investment by our members, particularly during the first three to five years following its implementation.

Question 15. What are your views on the merits of a mandatory notification regime? What are your views on the potential benefits and costs of a mandatory regime?

22. We do not consider that a mandatory notification regime is either necessary or proportionate. The only benefit of imposing a mandatory regime would be to seek to ensure that transactions do not "slip through the net". However, with a post-transaction 'call-in' power then it is very likely that transaction parties and their advisers will be cautious in their approach and will make voluntary filings where there is any doubt. We also consider that the establishment of an intelligence unit (similar to that within the CMA) should ensure that transactions that are not notified but are of concern are considered through the 'call-in' procedure.

23. It is difficult to estimate the cost of imposing a mandatory notification regime. However, the operation of a mandatory notification regime will inevitably be materially more expensive for both Government and market participants and will require significantly more resource than operating a voluntary regime. In addition to the costs of making a notification itself, a mandatory clearance process will (absent other extensive clearance requirements) inevitably delay completion of transactions which, in turn, will increase the cost of funding an acquisition and create additional risks and uncertainty in corporate transactions. Such risks are not just as to whether the transactions will be cleared, but include operational risks for the parties in the period between exchanging contracts on a transaction and its completion following clearance or the expiry of any mandatory suspensory period imposed by a mandatory filing regime. All of this will make the UK a materially less attractive jurisdiction for foreign investment.

24. A number of our members have considerable experience of the voluntary CFIUS regime in the United States. The main way in which transactions come before CFIUS is through the submission of joint voluntary notices. That is, when parties consider that a transaction is one that CFIUS is likely to consider (a) a "covered transaction" (in that it could result in a foreign party's acquisition of control of a U.S. business), and (b) having a connection to U.S. national security, they often submit a joint voluntary notice to CFIUS and await confirmation from CFIUS that there are no outstanding national security concerns with respect to the transaction before

closing. This practice is beneficial to both the parties and the U.S. government. For the parties, the advantage of submitting a joint voluntary notice and waiting for CFIUS to "clear" before closing is the "safe harbour" that results from having gone through this voluntary process. That is, having "cleared" CFIUS, the transaction is insulated against later compulsory unwinding on national security grounds. For CFIUS, the advantage of the voluntary process is that it has the effect of enlisting parties and their CFIUS legal counsel as a preliminary "screen" for purposes of identifying the transactions that are likely to be of greatest interest from a national security standpoint. In contrast to a mandatory filing regime, the voluntary approach helps ensure against CFIUS being overwhelmed with filings the vast majority of which involve deals with no possible concerns for U.S. national security. Under a mandatory system, the burden would fall to CFIUS to wade through all of those filings and identify the ones of genuine national security interest.

25. Of course, under a voluntary system there is a risk that parties will refrain from notifying CFIUS even when a transaction likely would have an impact on national security. However, the U.S. system has a backstop to deal with this risk. In particular, even where parties have not submitted a joint voluntary notice to CFIUS, there is authority for CFIUS to request a notice (even post-closing) or to self-initiate a review based on a so-called "agency notice" (similar to the Government's proposed 'call-in' power for a voluntary regime). The existence of this backstop – and knowledge of its existence within the deal-making community and the CFIUS legal community – means that most deals that warrant CFIUS review in fact receive that review pursuant to the submission of a joint voluntary notice. In addition, in close calls, where parties opt to refrain from submitting a formal notice, they often give CFIUS an informal indication of their plans. In other words, the cooperative working relationship between CFIUS and private parties and the legal advisers works well.

Question 16. Do you have views about the draft definitions of essential functions in Annex C? Would they be appropriate for the scope of any future mandatory regime?

26. As noted above, we do not consider that a mandatory regime is necessary or proportionate.

27. We consider that any voluntary regime should be strictly limited in scope to essential functions. In general, we note that the proposed definitions are relatively wide and imprecise, and will need to be refined to provide clear guidance if the regime is to function efficiently and provide a degree of legal certainty for potential investors.

28. In relation to Annex C, we consider that the sectors listed in Part 1 seem broadly appropriate for inclusion, although some of the definitions need to be made more precise and narrower to ensure maximum certainty. For example, paragraph 2 of "Energy" is vague – it should define precisely what energy networks are to be included (compare, for example, with paragraph 4, which limits power generation to a minimum size). In addition where thresholds are stated (e.g. one million users / 20 million barrels / 5% of UK traffic), the time period for measurement should be clarified – i.e. is this in the last accounting period, average over a number of years etc.

29. In relation to Part 2 of Annex C, "Emergency services" are Government-controlled and so we would expect that the Government's procurement processes, and any operational restrictions to be imposed by Government, should be sufficient to protect the national interest. The draft essential function "Government" is vague and it is not clear what it would encompass. Again,

we would expect that anything Government-related should be adequately addressed through procurement procedures and operational restrictions.

30. We agree with the Government's view that the sectors listed in Part 3 of Annex C should not be within scope of a mandatory regime and should be exempt from a voluntary regime in circumstances where another regulator has approved the new controller or transfer in a particular transaction.

31. Please see our response to the Chapter 7 proposals for our views on the inclusion of the manufacture of military and dual-use items and advanced technology.

Question 17. Do you have views on whether certain parts of the Government and Emergency services sectors should be covered by a mandatory regime?

32. See above.

Question 18. Are there other sectors to which any mandatory notification regime (if introduced) should apply?

33. No.

Question 19. What are your views about the potential power for Government specifying to which businesses or assets a mandatory regime should apply? How could this power best be designed?

34. As noted above, we do not consider that a mandatory regime is necessary or proportionate.

35. The scope of any new national security ownership regime should be strictly defined by reference to particular industry sectors set out in primary legislation, and any additions should require further primary legislation. There should be no need for Government to specify individual businesses or assets. We are concerned that to allow the Government to do so would give the Government excessive powers to widen the regime's scope without proper scrutiny and consultation.

36. We are also concerned about the suggestion that the names of such businesses and assets might not be published. Potentially, that could mean that a transaction might be required to be unwound in circumstances in which the parties to the transaction were not aware that the business / asset was within the scope of the regime.

Question 20. What are your views about the potential power for Government to bring specific plots of land into scope of a mandatory regime?

37. In the absence of a known list of such plots, it will be impossible for investors to have any certainty as to whether the acquisition of any site or business owning property is potentially subject to a mandatory regime. Such uncertainty would be a significant deterrent to foreign investment in the UK. We therefore consider it essential that a register of such plots be available or that a quick low cost online advance search procedure be available for confirmation that any such plot is not in scope of the mandatory regime.

Question 21. Do you have any views about how sanctions for non-compliance with a mandatory regime should operate, including how compliance could best be incentivised?

38. As noted above, we do not consider that a mandatory regime is necessary or proportionate.

39. If a mandatory regime were to be introduced, given the potential for uncertainty as to whether a business or assets are in scope, there should not be penalties for non-filing. Rather, remedies should be limited to those that are appropriate to mitigate or overcome the security concern.

Question 22. What are your views on the relative merits of introducing either an expanded call-in power or a mandatory notification regime for specific businesses or assets, or both an expanded call-in power and a mandatory notification regime?

40. As noted above, we believe that a mandatory notification regime would be disproportionate and unnecessary. Notifications should be voluntary, and any 'call-in' power should be restricted to the sectors referred to in our response to question 16.

Question 23. Do you have any views about the introduction of an information-related power?

41. No.

Question 24. Would public guidance about the assessment process be useful? If so, what issues could it most usefully cover?

42. Yes. The Government should publish guidance on what activities may give cause for concern in each of the "in scope" sectors and how such concerns may be typically addressed by remedial action, such as behavioural undertakings. In addition, we believe that it is essential that the Government is able (and is adequately resourced) to provide confidential advice in relation to any particular transaction.

Question 25. Do you consider the proposed approach to Government intervention to be appropriate for a wholly national security-related regime?

43. We agree. There should be a requirement (as there is under the Enterprise Act 2002) that any remedies imposed are reasonable and proportionate to address a national security concern, and that the parties involved are consulted on the scope of any such remedies, so as to minimise interference with the operations of the business. We also consider it appropriate for the parties to have a right to seek judicial review of the remedy decision.

Question 26. Do you have any views about how any new reforms can best be designed to interact effectively and in an administratively efficient manner alongside any competition assessment being conducted by the CMA, the existing public interest regime and other corporate reporting requirements?

44. We expect the new regime to operate independently of the competition regime and the public interest regimes relating to media plurality and financial stability. We would also expect the existing public interest regime relating to national security to be replaced in its entirety by the new regime, otherwise there is scope for overlap and confusion.

Question 27. Do you have any views about how the reforms can be designed to be as transparent as possible for investors and companies given the national security focus?

45. See our comments above, in relation to a clear and narrow scope for the regime, public guidance and informal guidance.

Question 28. If you have experience investing in countries with foreign investment regimes, could you describe the costs and benefits involved, including familiarisation, administrative and legal costs and the costs of any delays?

46. See our comments in the response to question 15, in relation to the United States.

Question 29. What impact, if any, do you anticipate these proposals having on the capital market or UK infrastructure businesses' ability to raise financing?

47. Bank financing is typically secured against assets (including shares in companies) by way of a pledge or similar charge, and it is critical to banks that there are no impediments to enforcing their security in the event of default. Any limitation on the ability of a bank to enforce its security or dispose of assets following such enforcement may affect a bank's appetite to lend.

48. See also our comments in the response to question 13, in relation to finance leases.

Question 30. Are there any other important costs and benefits you haven't already discussed from adopting these reforms that could inform the Government's analysis?

49. No.

We would be very happy to discuss the contents of this letter further with you. Please contact Tom Taylor (ttaylor@bvca.co.uk) at the BVCA if you would like to arrange a meeting.

Yours faithfully

Amy Mahon
Chair, BVCA Legal & Accounting Committee