Written evidence submitted by Taylor Wessing LLP (NSIB06)

1. INTRODUCTION

1.1 We are pleased to submit our views on the National Security and Investment Bill (the "**Bill**") to the Joint Parliamentary Committee that is supporting the Bill's passage through Parliament.

1.2 Taylor Wessing is a global law firm which has specialist practices advising UK and international clients on venture capital investment, mergers and acquisitions, private equity and capital markets transactions. We are a leading venture capital law firm[1] and have a highly regarded mid-market practice advising on mergers and acquisitions[2]. We are particularly well-known for advising investors and companies in the Technology and Life Science sectors. As a result, we have a specialist vantage point enabling us to assess the provisions of the Bill and its likely impact on the UK's knowledge economy.

1.3 We are grateful for the opportunity to provide input into the Joint Committee and we will also be responding to the Government's consultation on the sectors subject to mandatory notification. We welcome the Government's stance on reviewing the framework around national security and are supportive of the intention behind the Bill to ensure that the Government is able to appropriately scrutinise foreign investments that may pose a risk to national security.

1.4 However, we have some deep reservations around the Bill and, in particular, the mandatory notification regime that it provides for. We have set these out below but based on our experience in the Technology and Life Sciences sectors, both internationally and within the UK, our view is that the Bill, as drafted, could provide some material impediments to the development and growth of the UK as a leader in innovation. If left as it currently stands, our view is that this could significantly and adversely affect the UK's competitive advantage in this space.

2. CONCERNS FOR UK GROWTH COMPANIES AND THE TECHNOLOGY AND LIFE SCIENCES SECTORS

2.1 The UK has an enviable position when it comes to innovation. For example, three of the top 10 universities in the world are based in the UK[3] and the UK sits in a group of six countries that are global innovation leaders[4]. This ecosystem is

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[1] See rankings in, Chambers & Partners 'Private Equity: Venture Capital Investment in UK-wide'; and the Legal500 'Venture capital'. We also helped the Government with the creation of the Future Fund scheme earlier this year.

[2] See rankings in Legal500 'M&A: Lower mid-market deals'; we are also ranked by Pitchbook as third 'Most Active in Europe'

[3] See The Times World University Rankings 2020: https://www.timeshighereducation.com/world-university-rankings/2020/world-ranking#!/page/0/length/25/sort_by/rank/sort_order/asc/cols/stats

[4] See the following Innovate UK blog www.innovate.blog.gov.uk: https://innovateuk.blog.gov.uk/2018/07/16/strengths-and-weaknesses-in-the-uk-innovation-system/#:~:text=The%20UK%20sits%20fifth%20in,well%20above%20the%20EU%20average.&text=

supported by a range of welcomed Government incentives and policies, including tax credits and grant funding, and in our experience the UK has a strong reputation across the international investment community for excellence. The Government has made clear that the knowledge economy is a clear driver of the UK's economic strategy going forward.

2.2 The support for continued foreign direct investment in the UK is well set out within the Government's consultation documents. However, for the UK to maintain that position as a leader in innovation and technology, a transparent, stable and predictable regime is vital (as recognised by the Government), and it is critical that there is a clear and workable legislative framework that allows investments to be made into the UK's most promising companies. It should also not be too burdensome. From our vantage point as an international, sector-focused firm, we see the opportunities for companies in the Technology and Life Sciences industries, in particular, to relocate to other, more favourable regimes, including across the European continent, Ireland and of course the US.

2.3 The mandatory notification regime, in the form proposed, poses various difficulties and threats to the future of the UK's start-up and growth companies and we mention some of these below. While we have some concerns over the scope of the voluntary regime and call-in power (such as the lack of a threshold, the trigger events being set too low, the long period of uncertainty created by a five-year call-in period, etc.), we are aware that similar points are being made by other interested parties. As such, this submission focuses primarily on our principal concerns as regards the proposed mandatory notification regime.

3. SPECIFIC CONCERNS REGARDING THE MANDATORY NOTIFICATION REGIME

3.1 The specific concerns that we have for the companies innovating and operating within the Technology and Life Sciences sphere are set out below. These concerns also apply to other sectors of the economy. The overarching concerns stem from the fact that:

(a) the trigger for notification has been set at a very low bar of 15%[5] and does not need any national security connotation;

(b) there is no *de minimis* level for notifications – companies could be caught from day one of their inception or spin-out;

(c) the ramifications for proceeding without notification are severe – the transaction will be void[6] (subject to a validation notice for those "materially

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Overall%2C%20our%20research%20system's%20performance,average%2C%20according%20to%20EIS%20indicators.

5 Clause 6(2)(b)

6 Clause 13(1)

affected"[7] if the Secretary of State accepts a validation application within the relevant review period)[8];

(d) there is no distinction between investments by UK investors and non-UK investors; and

(e) the list of 17 sectors subject to mandatory notification is extremely broad (albeit we note subject to consultation).

All of these factors will have the following implications.

Disproportionate impact on very early stage companies

3.2 Early stage companies are critical to the UK's future economy. However, in our experience, initial investment rounds for early stage companies typically include at least one party taking a 15% or more equity stake. We would expect a notification to be required in almost every investment round in an early stage UK company within these broad ranging sectors under the proposed regime.

3.3 Typically, later stage growth companies attract larger valuations and the stakes taken tend to be smaller as a proportion of the overall share capital. The burden of this regime will therefore be borne most heavily by earlier stage companies.

Increased complexity and delay for funding rounds

3.4 The Bill provides for a "review period", which is stated to be 30 working days (i.e. circa six weeks)[9]. However, the review period only starts to run once the mandatory notice is accepted[10] and the clock stops when the Secretary of State requests further information. This does not give the necessary certainty for investors or companies when planning for investment and brings considerable delays into the funding.

3.5 It is not uncommon, particularly for early stage companies, that funding needs to be injected into the company urgently, for example to meet the next month's payroll. This regime will make it significantly more difficult for many high growth companies to obtain funding if urgently required.

3.6 If a mandatory notification requirement is maintained, especially with the current 15% threshold, it is also likely that investment rounds will become more complex. This regime, as proposed, will likely see additional tranching of rounds in companies caught by the Bill within the notifiable sectors.

3.7 If the Government wishes to maintain such a wide-ranging mandatory notification regime, we would advocate that the Government provides for a two-tier

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7 Clause 16(1)
8 Clause 16(7)(b)(ii)
9 Clause 14(9)
10 Clause 14(8)

notification system, with faster timelines for investments involving smaller companies and/or those in financial need, particularly if in a lower-risk sector.

Implications for proceeding without BEIS approval

3.8 The Bill provides that notifiable acquisitions completed without approval are "void"[11], albeit subject to retrospective validation by the Secretary of State for those materially affected[12].

3.9 It is possible that a notifiable transaction might be completed without approval in certain instances; for example, if funds are urgently required or perhaps because of an oversight. In practice, we would expect the Secretary of State to receive a large number of notifications for rectification under clause 16.

3.10 Making a transaction "void" at law, as opposed to "voidable", is draconian. In an investment context, as well as money changing hands, there are typically also board seats taken by investors and changes made to the company's shareholders' agreement and articles of association as to how decisions are made. If a transaction is void, it is unclear what should happen to the steps taken by the company under its new shareholders' agreement and constitution pending the transaction being unwound (or retrospective validation received).

3.11 We would submit that it would be much clearer to specify that the transaction would be "voidable" in these circumstances.

Unmanageable numbers of notifications

3.12 The proposed mandatory notifications regime necessarily relies on the new Security Investigations Unit ("**SIU**") being fully staffed from the outset to deal with the likely influx of cases. We also anticipate that the Bill, in its current form, would result in a significant number of voluntary notifications being submitted.

3.13 We note the Government's assessment that it is likely to receive between 1,000 – 1,830 notifications per year. However, in our view, and based on the number of transactions we advise on each year, we expect this to be a significant under-estimate, unless the regime and associated sectors are narrowed significantly.

Disproportionate costs

3.14 We note that the Government's Impact Assessment does not consider the costs to investors or companies from the delays outlined in paragraphs 3.4 to 3.7.

3.15 Separately, the investors' professional advisor fees on a funding round are typically paid, at least in part, by the company receiving investment. This means there will likely be disproportionate additional costs to early stage companies in respect of

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11 Clause 13(1)

12 Clause 16

legal advice required to navigate the new regime (even if the advice ends up being that no notification is required).

Unworkability for publicly quoted companies

3.16 The mandatory notification regime in the Bill makes no distinction between privately held and publicly quoted companies, and as such the Bill will also apply to publicly listed shares. The issues regarding takeovers and practical difficulties of unwinding those (which we would echo) have been made elsewhere.

3.17 However, the mandatory notification regime will also have practical (and unworkable) connotations in the following areas:

- ***On IPO where an investor takes over 15% (or 25%)*** – imposing a six-week (or more) timeline in these circumstances is unworkable;
- ***Rights issues or placings taking any shareholder through the 15% (or 25%) threshold*** – these transactions are often done in condensed timelines of a few weeks (or sometimes less). Again, a mandatory notification in these circumstances is unworkable;
- **Tender offers resulting in one or more shareholders going through the 15% (or 25%) thresholds** – similarly, these should not be subject to mandatory approval.

3.18 More generally, it is unclear to us why investors in public companies would need to make a mandatory notification. UK companies listed on the Official List and quoted on AIM are already subject to Chapter 5 of the Disclosure Guidance and Transparency Rules, whereby major shareholdings (typically 3%+) need to be disclosed publicly through a Regulated News Service ("**RNS**"). It should be possible for the SIU to monitor the RNS for large positions in listed companies in sensitive sectors, rather than require a mandatory notification and approval for investments in publicly listed stock.

4. RECOMMENDATIONS

In order to mitigate the issues identified above, we recommend the following amendments to the Bill.

Consider dropping the mandatory notification regime

4.1 The mandatory regime as drafted would have a transformative impact on the way transactions are carried out in the impacted sectors. This burden and cost will bite disproportionately on earlier stage companies. We anticipate that it will capture an extremely large number of transactions that do not raise national security concerns.

4.2 We would strongly advocate that the Government reconsiders whether the regime is maintained as mandatory. The UK legislative framework already provides for some level of oversight as to ownership stakes in English companies; for example, share issuances need to be notified to Companies House[13], Persons with Significant Influence and Control need to be publicly disclosed[14], and investors with large positions in main market and AIM quoted companies need to be disclosed to an RNS. There are other ways that the new National Security Unit could gain oversight of ownership interests without imposing additional requirements onto the existing regime.

4.3 At the least we would recommend the Bill being amended so that if notification is mandatory, proceeding without approval does not automatically result in transactions being void.

4.4 If the aim is to prevent leakage of knowledge to a non-trusted party who does not notify, a mandatory regime will not prevent that. If the aim is instead to deny such a party ongoing control of rights, a retrospective call-in power should be sufficient.

Include a *de minimis* threshold under the mandatory regime

4.5 We note that the Government's previous consultation, which consulted on a *de minimis* threshold, was in the context of a voluntary regime only.

4.6 We anticipate that the Government will receive be significantly more than the 1,000 – 1,830 notifications estimated, particularly given the scope and breadth of the mandatory notification regime.

4.7 We would therefore strongly recommend some level of *de minimis* below which the mandatory regime does not bite. The threshold of £1,000,000 in revenue[15] that was introduced by The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 and The Enterprise Act 2002 (Share of Supply) (Amendment) Order 2020 would seem to be a logical starting point for this.

Be more targeted in the territorial application of the mandatory notification regime.

4.8 Both the mandatory notification regime and the call-in power would seem to apply to investments with no foreign element at all. It is clear from the Parliamentary debates and the Government's Impact Assessment that the main concern over risks to national security are in transactions involving foreign investors.

4.9 In light of the concerns raised above as to the breadth of the regime, we would therefore recommend that only transactions involving a non-UK acquiror or UK acquirors owned by non-UK entities are subject to the mandatory notification regime.

4.10 If the Bill was changed in this way, the Government will still be able to rely on the call-in power in the rare situation where there may be a risk to national security

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13 Section 555, Companies Act 2006

14 Part 21A, Companies Act 2006

15 Section 23(1)(b)(ii), Enterprise Act 2002

when only UK investors are involved. We note that this would bring the regime in line with each of the national security regimes reviewed by the Government as part of its Impact Assessment, all of which only apply when foreign investment is involved.

4.11 Conversely, and to limit notifications, the Government should also remove non-UK companies with activities in or who sell goods or services to the UK from the mandatory regime.

Restrict, at least in the outset, the mandatory notification regime to a limited number of core sectors related to national security

4.12 To limit the number of notifications and to make the Bill more proportionate, we would recommend that the regime starts more narrowly and, if later deemed to be required, builds out from there.

4.13 We suggest that the initial regime focuses on those that are already covered by the Enterprise Act 2002, being Military and Dual Use, Computer Hardware Technology, Quantum Technologies, AI, Cryptographic Authentication Technology and Advanced Materials, with the addition of National Infrastructure and Critical Supplies to Government and the Emergency Services.

4.14 The Bill provides that further sectors can be added via secondary legislation (as already permitted by clause 6(1)) once the BEIS team is fully operational and the process for reviewing notifications has been streamlined as much as possible. We would strongly recommend against this being done without prior consultation, and the Bill should provide for that.

5. OTHER AREAS FOR CLARIFICATION

Intellectual Property transactions

5.1 The framework around Intellectual Property rights needs clarification. Licensing of IP is an important part of the commercialisation of innovation and, for example, many early stage companies begin their journey by in-licensing Intellectual Property from universities or research institutes.

5.2 The Bill makes clear that Intellectual Property rights are intended to be within scope of the call-in powers (if there is an associated national security element)[16], albeit not (as yet) under the mandatory notification regime. The definition of "control of assets" also includes a hair trigger test (the ability to "use the asset, or use it to a greater extent than prior to the acquisition")[17].

5.3 This could catch any manner of Intellectual Property licensing, which we assume is not the intent. We would strongly advocate against the ability to be brought

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16 Clauses 1(1) and 7(5)

17 Clause 9(1)(a)

within the mandatory regime through secondary legislation[18], at least without prior consultation.

"Impossible" to notify

5.4 The Bill provides that mandatory notifications are not required where it would be "impossible" to comply[19]. Please could the Government give guidance on what instances are in contemplation here.

Third case of control of entities

5.5 The third limb where a person "gains control" of a "qualifying entity" is where an investor is given "voting rights" which enable them to prevent the passage of "any class of resolution governing the affairs of the entity"[20]. The Explanatory Notes make clear that this is intended to capture the scenario where the investee company is not subject to conventional voting thresholds under the Companies Act 2006.

5.6 In venture capital investments, investors are typically issued preferred shares and will often be able to prevent a resolution of that class of share (a "**Class Consent**") in order to protect their investment or minority rights (rather than to influence the policy of the target). We ask that the Government clarify that these forms of Class Consent are not intended to be caught by this legislation.

Company incorporation / set-up

5.7 The Bill does not include any carve-out for people incorporating a company. The Bill (or at the least its Explanatory Notes) should include an express acknowledgement that initial subscription for shares when incorporating a company is exempt.

10 December 2020

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18 Clause 6(6)
19 Clause 6(3)
20 Clause 8(6)