Inward Foreign Investment – House of Commons International Trade Committee

Taylor Wessing LLP submission

1. Introduction

1.1 We are pleased to submit our response to the inquiry into inward Foreign Direct Investment (FDI) led by the House of Commons International Trade Committee (the "**Committee**") in respect of the National Security and Investment Bill (the "**Bill**").

1.2 We welcome the Committee's decision to consult on the proposal by the UK Government (the "**Government**") for legal and regulatory changes to this rapidly evolving area of investment and international commerce.

1.3 As a global law firm with specialist practices advising UK and international clients on venture capital investment, mergers and acquisitions, private equity and capital markets transactions, Taylor Wessing LLP has a specialist vantage point which enables us to assess the provisions of the Bill and the wider implications this new regime will have on inward investment. Further, having an established office in Menlo Park, California, in the heart of Silicon Valley, has enabled us to form a network of international clients looking for investment and venture capital opportunities in the UK. Taylor Wessing LLP also has a market leading inward investment practice, is widely recognised as a leading venture capital law firm[1] and has a highly regarded mid-market practice advising on domestic and international mergers and acquisitions[2]. We are also particularly well-known for advising investors and companies in the Technology and Life Science sectors, which may be significantly affected by the implementation of the Bill.

1.4 As mentioned in our submission to the Joint Parliamentary Committee for the Bill dated 10 December 2020 (the "**First Submission**"), a copy of which is enclosed at Appendix 2 and our submission relating to the Sector Definition Consultation for the Bill dated 6 January 2021 (the "**Second Submission**"), a copy of which is enclosed at Appendix 3, we are fully supportive of the intention behind the Bill to enable the Government to scrutinise foreign investments that may pose a threat to national security. We also endorse the commitment by the Government to provide "certainty, transparency and predictability of the regime to businesses and investors and… [ensure] that the UK is a good place to invest"[3]. However, we have deep reservations about the implications of the proposed Bill, which will reduce the attractiveness of the UK for inward investors and have a negative impact on innovation and growth opportunities for domestic companies, particularly those in the early stage of their growth.

1.5 The support for continued FDI 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, there needs to be a clear and workable legislative

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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 in 2020 as a response to the outbreak of the Coronavirus pandemic

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

[3] BEIS, *National Security and Investment White Paper: Government response*, 11 November 2020, page 7/52 (accessed on 28 December 2020); and BEIS, *National Security and Investment: Sectors in Scope of the Mandatory Regime*, 11 November 2020, page 11/71 (accessed on 28 December 2020)

framework that allows investments to be made into the UK's most promising companies without being too burdensome. As an international, sector-focused firm, we see the opportunities for companies in the Technology and Life Sciences industries to relocate to other, more favourable regimes, including across the European continent, Ireland and, of course, the US.

1.6 This submission focuses on highlighting key concerns that we have with the Bill and the new regime which the government is proposing to implement regarding inward investment. It will be imperative that the Government strikes the right balance between mitigating national security threats, while also maintaining its global reputation as a stable, transparent and predictable jurisdiction for international investors.

2. Inquiry – terms of reference

2.1 This section focuses on the following terms of reference that were set out in the Call for Evidence:

I. What advice, support and assistance should the Government be providing to inward investors and how can it most effectively communicate with investors?

II. What effects would the provisions of the National Security and Investment Bill have on UK inward investment and how well does it balance national security against promoting and facilitating inward investment?

We will leave it to others to comment on the remaining terms of reference but offer our considerations on these two below.

I. What advice, support and assistance should the Government be providing to inward investors and how can it most effectively communicate with investors?

2.2 The UK has an enviable position when it comes to innovation and the Government has made clear that the knowledge economy is a clear driver of the UK's economic strategy going forward. Further, and in preparation for Brexit, the Government has also made clear its intention to forge and maintain trade relations with as many countries as possible, evidenced by the Government firming up continued trade deals with 63 of the 70 countries it held trade deals with as part of the EU; forging four new trade deals with Canada, Mexico, Albania and Jordan; and currently holding trade talks with a further five countries.[4]

2.3 The Government appears to have a strong mandate to expand its international trade relationships and to continue to foster the right conditions to ensure the UK to promote new opportunities for inward investment. Continued strong messaging reflecting the message that the UK is "open for business", pushed out via knowledge networks (more on this below) will be crucial.

4 See Edington, Tom "Brexit: What trade deals has the UK done so far?" *BBC News*. 8 February 2021. <https://www.bbc.co.uk/news/uk-47213842> (accessed on 26 February 2021)

2.4 In order to achieve the above mandate, the international investors and industry experts we have spoken with have indicated to us that they would welcome advice, support and guidance relating to the following topics:

Raising the profile of the value of investing in UK companies

2.5 The UK has an excellent reputation for stability, transparency and professionalisation of investment, as well as offering abundant opportunities for investors and companies. For example, a report by the Institute for Public Policy Research found that the city of London continues to be an "international digital powerhouse" and remains ahead of European cities in terms of capital investment5 , and the Coalition for a Digital Economy has described London as a city where there is access capital and opportunities to scale a business6.

2.6 We recommend that the Government communicate the value of remaining headquartered in the UK to founders and investors of UK companies. They can become advocates of the UK investment ecosystem.

2.7 We also recommend compiling profiles of UK companies which have attracted international investment and become successful, to be used abroad to showcase the considerable opportunities for global investors. This material could be distributed through not only UK and international networks and organisations, but also diplomatic missions, such as consulates and embassies, in the UK and abroad.

Tailored support offered by the Government

2.8 We have also seen a strong desire for international investors to be supported as they set up and expand their investments into the UK. The Department of International Trade's ("**DIT**") launch of the UK Investment Support Directory tool is a helpful7; however, global investors want to see more of these resources available. DIT could continue to work with other departments, such as HMRC and the Foreign, Commonwealth & Development Office ("**FCDO**") to communicate the resources available to global investors.

Streamlined and or self-service/self-certification process

2.9 A key way to communicate with investors and demonstrate the UK's commitment to being open for business is to ensure that the touch points those investors have with Government are streamlined and as unburdensome as possible. To the extent that it is possible to have clear and simple format requirements for any NSI notifications, template forms and/or example submissions and a clear process and timeline for submission it will be warmly welcomed. Prior, or better still, one time only certification, for parties who can pass a clearance process would also provide certainty and help drive investment.

5 Longlands, Sarah et al. Charting a Course for the Future: How London's Startup Scene Can Survive and Thrive in the Age of Brexit. *Institute for Public Policy Research.* June 2018 <https://www.ippr.org/files/2018-05/charting-a-course-for-the-future.pdf> (accessed on 26 February 2021)

6 Lloyd, David. "Why Having a U.K. Base Can Be a Competitive Advantage, Despite Brexit". *Entrepreneur Europe*, 27 June 2019, page 11. <https://www.entrepreneur.com/article/334908> (accessed on 26 February 2021)

7 Invest in Great: Britain & Northern Ireland. *UK Government* <https://www.great.gov.uk/international/investment-support-directory/> (accessed on 26 February 2021)

Sharing knowledge and networking

2.10 In other jurisdictions, such as the United States, and in particular in Silicon Valley, knowledge networks are in our view often more significant than raw capital, in terms of producing fruitful long-term growth for both the investor and the entrepreneur. It is therefore strongly recommended that the Government take the opportunity to play a significant role in connecting American and other international venture capitalists, operators and angel investors with UK-based companies in order to facilitate the sharing of that knowledge and those soft resources.

2.11 A further consideration, which we have encountered in the US, could be to establish a similar network to the Defense Investor Network, which allows the United States Department of Defense to work with private investors, to identify companies of strategic value (due to actual national security risks) which should have local investment, rather than global investment from outside countries. This could assist with the issue we raised in the Second Submission regarding definitions being so wide for the Bill as to catch any business active in a sector, rather than the sensitive part of the sector.

Finally, we have encountered a consensus that the Bill has not been considered for an adequate amount of time in order to properly address the serious concerns industry professionals hold and the impact it will have on global investors and UK companies. Therefore, there remains a strong argument to delay the implementation of the Bill to allow for such further consideration.

II. What effects would the provisions of the National Security and Investment Bill have on UK inward investment and how well does it balance national security against promoting and facilitating inward investment?

2.12 The Bill, as it is drafted, has created a lot of uncertainty for investors and companies with whom we have consulted. The principal concerns stem from the following:

(a) the trigger for notification has been set at a very low bar of 15%[8] ownership 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[9] (subject to a validation notice for those "materially affected"[10] if the Secretary of State accepts a validation application within the relevant review period)[11];

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

[8] Clause 6(2)(b)

[9] Clause 13(1)

[10] Clause 16(1)

[11] Clause 16(7)(b)(ii)

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

Disproportionate impact on very early stage companies

2.13 To expand on points (a) and (b) above, early stage companies are critical to the UK's future economy. However, in our experience, initial investment rounds for early stage companies typically involve at least one party taking an equity stake of 15% or more. 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. Typically, later stage growth companies attract larger valuations and the stakes 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 and will likely diminish the appetite for DFI by global investors. While the question of the balance of national security against promotion of inward investment is one for others to answer, the imbalance that we see is one where the burden and pressure rests with the smaller and more early stage companies raising capital.

Lack of clarity and focus with Sector definitions

2.14 Expanding on point (e) above, the proposed definitions are, in many places, vague and unclear. Further, many technical experts in these sectors have found it difficult to propose revised definitions that would be considered "fit for the purpose" for providing investors and businesses with a clear "bright-line" test between products and technologies on the one hand where national security implications could potentially arise from a trigger event, and hence where it would be reasonable and proportionate to apply a mandatory notification, and those where no such implications could conceivably arise.

2.15 Additionally, in some cases, these definitions will have the impact of catching any business active in a sector, rather than sensitive parts of the sector, which may pose a national security threat, which we believe is an objective of the Bill. The definitions cover businesses with products and technologies where it is difficult to conceive of any national security implications arising from a change in control, let alone the acquisition of a 15% equity stake. Again, we consider there is an imbalance here that will disproportionately affect smaller, earlier stage companies looking for investment.

Uncertainty, additional costs and unnecessary burdens

2.16 Taken together, these points mean that it will be very difficult for investors and businesses to conclude confidently that they fall outside the scope of the proposed definitions.

2.17 We therefore anticipate that this would lead to over-notification of transactions, even where there is no risk to national security, especially as the consequences for non-notification would be severe. This is likely to lead to a substantial increase in the number of transactions which will be subject to government review. Under the Enterprise Act 2020, just twelve (12) transactions have been called in for review by the UK Government in the 18 years since the legislation was adopted. In contrast, the Government's own impact assessment suggests that there will be 1000-1800 mandatory notifications per year if the Sectors are implemented as proposed in the Consultation Document.

2.18 From our view of the market and given the number of venture financings and mergers and acquisitions (both domestic and international) that we work on, together with data available from sources such as Pitchbook, we anticipate this number to be a significant underestimate. In fact, we would expect mandatory notifications to be required in almost every investment round for early stage companies, as it is common for at least one party to take a 15% equity stake.

2.19 Not only will this place a potentially unnecessary burden on the Government in reviewing notified transactions, but we expect there to be an increased cost for business (both industry and investors), more deal uncertainty and extended time periods required to conclude routine transactions, some of which have critical financing timeframes for the smooth running of the businesses concerned.

2.20 Our experience in working on transactions of this nature suggests that this would, at a minimum, cause friction and frustration in the short term and appears to us to have the potential to have a negative impact on the attractiveness of the UK for investment in the more medium to long term.

Thank you for taking our submission into consideration. We remain at your disposal.

Taylor Wessing LLP
2 March 2021