Simpson Thacher

Antitrust and Foreign Investment Alert

The Countdown Is Over: UK's National Security and Investment Act Launches Today

4 January 2022

The UK's new investment screening regime is now operative, introducing a mandatory notification regime for certain transactions and giving the UK Government call-in powers for evaluating national security risk for a broad range of transactions.

Introduction

The UK's National Security and Investment Act 2021 (the "**NSI Act**") comes into force today, bringing in a new national screening regime which will afford the UK Government greater oversight and control over transactions that may give rise to a national security risk.

A good understanding of the applicable rules and how they could impact potential transactions is crucial in order to minimise deal risks and potential delays to deal timetables

The new regime applies to all investors, regardless of nationality and (i) requires investors to obtain prior clearance from the UK Secretary of State for Business, Energy & Industrial Strategy ("**BEIS**") for transactions involving targets with activities in one of 17 strategic sectors in the UK under the mandatory notification regime ("**Notifiable Acquisitions**") as well as (ii) creating a strong incentive for acquirers to voluntarily notify transactions involving targets with activities outside of the listed strategic sectors, but where potential national security issues could arise.

The UK Government's introduction of the NSI Act is taking place in the context of a recent tectonic shift in foreign direct investment ("**FDI**") rules, which is seeing countries around the world introducing or expanding national FDI regimes. For investors, a good understanding of the applicable rules and how they could impact potential transactions is crucial in order to minimise deal risks and potential delays to deal timetables.

Mandatory Notification Regime

The UK's mandatory notification regime applies to "**Notifiable Acquisitions**", which consist of certain "**trigger events**" concerning "**qualifying entities**" with activities in one of **17 strategic sectors** in the UK.

Trigger Events

No change of control is required to trip the notification obligation

Trigger events comprise investments which result (directly or indirectly) in the crossing of certain thresholds for either shares or voting rights (25%, 50% or 75%) **or** the acquisition of voting rights that enable or prevent the passing of resolutions governing the affairs of an entity. Notifiable Acquisitions are therefore share acquisitions, not asset acquisitions, and the Investment Security Unit ("ISU", a branch of BEIS which is tasked with scrutinising transactions for potential national security concerns) has made it clear that no change of control is required to trip the notification obligation, with internal restructurings of qualifying entities in the 17 sectors potentially also within scope.

Qualifying Entities

Potential filings under the NSI Act may be required in the context of global transactions where the target has only a remote UK nexus

A qualifying entity is a target that (i) is incorporated in the UK, (ii) carries on activities in the UK or (iii) supplies goods or services to persons in the UK. There are no de minimis exceptions or financial thresholds applicable to the definition of a qualifying entity, although sector-specific thresholds may apply. In this respect, the scope of the NSI Act goes further than many other global FDI regimes, which generally require a local subsidiary, assets or at least branch office to be triggered. The UK regime can be triggered by employees undertaking research and development activity or sales to UK customers alone, meaning potential filings under the NSI Act may be required in the context of global transactions where the target has only a remote UK nexus.

Strategic Sectors

The 17 strategic sectors broadly fall within three categories:

- **Government and Military**: suppliers to the emergency services, critical suppliers to government, defence and military and dual-use. In our experience, diligence here is particularly target-led: the target's government contracts and the applicability of export controls to its goods, software and technologies are key.
- **Advanced Technologies**: advanced materials, advanced robotics, artificial intelligence, computing hardware, cryptographic authentication, data infrastructure, quantum technologies, satellite and space technologies and synthetic biology. Sectors

such as advanced materials and artificial intelligence are potentially applicable to a broad range of transactions involving manufacturers and software, whilst other sectors are more confined (*e.g.*, cryptographic authentication).

- **Key Infrastructure**: civil nuclear, communications, energy and transport. In contrast with the other sectors, de minimis thresholds may apply to certain activities within these sectors, which can exclude smaller infrastructure transactions from mandatory notification.

Notifiable Acquisitions Must Be Notified

Notifiable Acquisitions closed without the approval of BEIS will be automatically void and unenforceable

It is now unlawful to complete any Notifiable Acquisition without prior approval from BEIS. Notifiable Acquisitions closed without the approval of BEIS will be automatically void and unenforceable. Monetary and criminal penalties, such as a fine of up to 5% of total worldwide turnover and sentences of imprisonment for up to five years (applicable to officers of a company when the failure to notify occurs with their consent or as a result of their neglect) may be imposed.

Call-in Power and Voluntary Notification Regime

BEIS now also has the power to call-in trigger events involving qualifying entities or qualifying assets involved in activities in any economic sector, where it reasonably suspects the transaction gives rise to a risk to national security. This power is retrospective and applies to all transactions that closed on or after 12 November 2020.

In addition to trigger events which apply in relation to Notifiable Acquisitions, the call-in power applies to the acquisition of "material influence" over a qualifying entity or the acquisition of control over qualifying assets. This renders it considerably broader in scope than the mandatory notification regime:

- Material influence can capture shareholdings as low as 15% (or in rare cases, even lower than 15%), rights to board representation or even contractual relationships. The same concept is applied broadly under the UK's merger control regime.
- Qualifying assets are defined widely as any asset used in connection with activities carried on in the UK or the supply of goods or services to the UK, encompassing land, moveable property (*e.g.*, machinery) and IP across the full supply chain, regardless of the country where the actual asset is located.

The UK Government opted not to define "national security" to give itself maximum flexibility

Assessing Whether a Transaction May Be Called In

Where BEIS considers three key risks (target risk, acquirer risk or control risk) are individually or collectively high enough to create a potential risk to national security, it will issue a call-in notice. The UK Government opted not to define "national security" to give itself maximum flexibility, meaning investors will need to rely on its guidance on the three risk types:

Acquirer risk […] *will encompass the acquirer's investment and/or criminal track record, pre-existing holdings and links to entities that pose a risk to the UK's national security*

- **Target risk** will be highest where the target company operates in the 17 sectors or in areas "closely linked" to those sectors; however, in practice call-in notices should not be ruled out in relation to other sectors, such as water supply, food security and even real estate assets, as BEIS has identified risk where real estate is located in close proximity to sensitive sites (*e.g.*, government buildings or national infrastructure).
- **Acquirer risk** (including the risk posed by the acquirer's ultimate controllers) will encompass the acquirer's investment and/or criminal track record, pre-existing holdings and links to entities that pose a risk to the UK's national security.
- **Control risk** will assess how the acquirer can exercise their control over the target, likely to be assessed on a spectrum with the highest risk resulting from 100% ownership of the target and the lowest risk resulting from a passive investor with a minority stake.

Voluntary Notifications

An important route for investors to obtain confirmation their transaction will not be called-in is the **voluntary notification regime**. Notifying voluntarily does not create any standstill obligation, allowing transactions not subject to the mandatory regime to close without prior approval from BEIS. However, if the call-in power is exercised over the transaction (whether notified under the mandatory or voluntary regime or not notified at all), the ISU may impose interim orders on the parties, including hold-separate obligations and restrictions on access to sensitive data and facilities. Breaching an interim order may lead to the same monetary and criminal penalties as for failing to notify a mandatory notification, in addition to daily monetary penalties for the period of non-compliance.

Investors will need to consider the risks of not notifying the ISU of deals outside the mandatory regime. Public interest in the transaction, outspoken complainants in the press, the target's contracts with certain public authorities and potential sensitive activities could all potentially lead to a call-in notice being issued.

Time limits on the call-in power also turn on when the Secretary of State to BEIS **became aware** of the transaction: the call-in power can be exercised up to six months after the Secretary of State became aware of the trigger event, provided that date is within a long-stop of five years after closing.

The new screening procedures brought in by the NSI Act have the potential to impact deal timetables

Impact on Transaction Timetable

The new screening procedures brought in by the NSI Act have the potential to impact deal timetables and careful planning is therefore recommended from the outset. The review periods comprise:

- **Initial Review**: 30 working days for the ISU to assess whether the transaction should be subject to a call-in notice for an in-depth review.[1]
- **Assessment Period**: once a call-in notice is issued, another 30 working days (unilaterally extendable by BEIS for a further 45 working days). Requests for information could have the effect of stopping the statutory review period.
- **Voluntary Period**: an additional **indefinite period**, agreed between the parties and BEIS, for particularly sensitive transactions. "Voluntary Period" is likely a misnomer in this context; parties will in practice have little choice but to continue with the process until BEIS is satisfied.

Key Takeaways

The NSI Act is now effective and the new screening procedures will have potential material implications for investors looking to acquire interests in targets with a UK nexus. Each transaction will need to be considered based on its own fact pattern, but some key points to consider on transactions involving a target with a UK nexus include:

- consider whether the target's activities could fall within one of the 17 strategic sectors subject to a mandatory notification and be mindful of the material consequences of failing to make a mandatory notification;

[1] Note that the initial review period is only triggered when a notification is accepted by the ISU as complete, meaning the length of any pre-notification is at the ISU's discretion. There is currently no indication as to the length of this period (which could take multiple weeks).

- if the transaction falls outside the scope of the 17 strategic sectors, consider whether the transaction could nevertheless raise potential national security issues (*e.g.*, is it closely linked to a sensitive sector); if so, a voluntary notification could reduce the risk of a call-in notice and possibly far-reaching interim orders based on potentially inaccurate public information the ISU may have seen;
- if there is uncertainty as to how the NSI Act's framework applies to the fact pattern of the transaction, consider informally approaching the ISU to obtain guidance, however, be mindful that this process can itself take time;

Ensure the transaction documents allocate risk appropriately

- ensure the transaction documents allocate risk appropriately and ensure the necessary information is made available for any filings and/or interactions with BEIS;

Be aware of the implications a review under the NSI Act could have for the deal timetable

- be aware of the implications a review under the NSI Act could have for the deal timetable: a 30 working day review for notifications raising limited concerns and 105 working day (extendable) review for transactions involving substantive concerns (these periods are in addition to the time to prepare the filing, any pre-notification engagement with the ISU, stop-clocks and/or other extensions); and
- consider potential remedies and undertakings early in sensitive cases, alongside a communications strategy to keep key stakeholders onside. BEIS has indicated remedies will reflect other global FDI regimes: limits on the amount of shares or voting rights acquired, ring-fencing sensitive information, technology and/or operational sites, restricting IP transfer and obligations to maintain strategic UK capabilities. In global transactions involving multiple FDI filings, coordinating remedies and undertakings to satisfy the concerns of different national governments will be key.

A sea-change in the UK's approach to national security concerns

Annually, the UK Government expects up to 1,830 notifications (more than the entirety of the EU in 2020) and to issue a call-in notice for 90 non-notified transactions, with approximately 10 transactions requiring remedies. This represents a sea-change in the UK's approach to national security concerns and investors should expect far greater scrutiny going forwards.

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