Burness Paull

National Security and Investment Act

BRIEFING NOTE

Corporate Finance

Introduction of NSI Act

Up until now, the UK has had very little in the way of control over foreign direct investment (FDI), particularly when compared to other economies such as the US. However, the introduction of the National Security and Investment Act which came into force on 4th January 2022 signifies a key change in this area of law and could impact almost all types of business and investment.

This increase in screening of investment by the UK Government (with the overall aim of protecting national security) follows a global trend towards more regulation in relation to foreign investment. The regime is similar to CFIUS in the US and the FDI rules in France and Germany, and follows a more recent FDI regime imposed at EU level.

The breadth and depth of the Act go much further than was anticipated and given it is now fully in force, it needs to be considered on all deals. The purpose of this note is to help clients understand the key changes and the types of transaction caught by the requirements.

The general consensus is that the Act as passed is extremely wide, particularly in relation to the 'sensitive sectors' discussed below. Other than within the sector definitions, there are no minimum turnover, market share or size of transaction thresholds, so generally the net is cast extremely widely.

There are two key parts to the compliance requirements – a **mandatory notification regime** for certain key sensitive sectors where there is a 'trigger event'; and a **voluntary notification regime**, where there is a risk to national security and, again, where there is a trigger event. Overriding these is the right of the Secretary of State to **'call-in'** transactions, where required. To understand how this applies to transactions and investments, we need to consider these three elements in more detail.

Mandatory notification and pre-transaction clearance

Mergers and acquisitions which:

- fall within one of the 17 key 'sensitive' sectors identified (see below); and
- meet the 'trigger event' criteria,

require notification **before** a transaction takes place.

Any such transaction which goes ahead in breach of this **will be null and void**.

The 17 key sensitive sectors identified are:

- advanced materials;
- advanced robotics;
- artificial intelligence;
- civil nuclear;
- communications;
- computing hardware;
- critical suppliers to the Government;
- cryptographic authentication;
- data infrastructure;
- defence;
- energy;
- military and dual-use technologies;
- quantum technologies;
- satellite and space technologies;

- suppliers to the emergency services;
- synthetic biology; and
- transport.

We would have expected to see many of these, such as defence and military technology covered. However some go much further than may have been expected and could be very wide. Consultation on the sector definitions has been undertaken and an up to date list has been published.

The Government will also have the ability to amend the sector definitions – to respond to any changes in national security risk – so we can expect that these will change over time.

If a matter falls within one of these sectors, then it will be notifiable if the acquisition also meets one of the following trigger events:

- where the percentage of shares or voting rights in the qualifying entity held by the acquirer increases to more than 25%, 50% or 75%; or
- the acquisition of voting rights that enable the acquirer to secure or prevent the passage of any class of resolution governing the affairs of the entity.

A 'qualifying entity' is an entity which carries on activities in the UK or supplies goods or services to the UK. The provisions have wide application and can apply to an acquisition where there is a UK subsidiary or where foreign entities supply goods or services to the UK.

It is worth noting that the obligation is imposed on the acquirer to notify and receive clearance, rather than the target company.

The mandatory notification part of the rules only applies to mergers and acquisitions – it does not generally apply to the purchase of assets or land (but the voluntary regime does - see below).

It is not intended that the regime will cover loans to entities, however enforcement of security over shares may be caught where an acquisition of control is taking place, so lenders and investors need to be aware of this.

Voluntary reporting

In addition to the mandatory reporting regime covering the key sectors, there is also a voluntary reporting regime included in the Act. A transaction should be notified under this section if there is a 'trigger event' and there is a national security element to it. The acquirer, target or seller can notify under this section.

Importantly, this part of the regime applies to the purchase of a wide range of assets including: intellectual property; any ideas, information or technique with industrial, commercial or other economic value; and land. So the new requirements are not just restricted to M&A deals.

Land is generally only expected to be an asset of national security interest where it is, or is proximate to, a sensitive site, examples of which include critical national infrastructure sites or Government buildings. It is likely that this will occur rarely in practice, but will need to be considered for property transactions.

Trigger events are generally determined in the same way as for the mandatory regime but also includes acquiring 'material influence' over a qualifying entity's policy – so is potentially wider than the mandatory regime and could catch acquisitions where less than 25% of an entity is being acquired.

We must keep in mind that it is not always apparent that something can cause a national security concern – it could be a different application of technology that is not directly relevant to the deal or perhaps currently intended.

The advantage of notifying voluntarily is that the Government then has a set timeline to respond on the transaction (see below). If a matter is not notified but should have been, it can be called-in by the Secretary of State for up to five years from the completion date (or from the commencement date of the Act if it has completed before then), or six months from the date upon which the Government becomes aware of the matter. As such, voluntary notification may be useful even if it is felt that the risk of call-in is low, as it will give certainty to the parties to the deal.

Government response timescales

When either mandatory or voluntary notification is made, the Secretary of State has 30 working days to decide whether or not to call-in the matter. If the matter is called-in there is then a further 30 working day period where any conditions will be determined. This second 30 working day period can be extended by a further 45 working days, if further investigation is needed (and again further, if agreed).

Whether or not the parties have given a voluntary notification, the Secretary of State has the power to call-in a transaction which has taken place up to 6 months after becoming aware of the matter (for example, through press coverage of a deal) so long as it is done within 5 years of the trigger event occurring (or from the commencement date, if completion is prior to that). Importantly, where the acquisition should have been subject to mandatory notification, the 5 year time limit does not apply, so there is no time limit on the call-in power in that instance.

'Call-in' power

In addition to the mandatory and voluntary notification requirements, The Secretary of State will have an overriding power to 'call-in' non-notified transactions (for national security purposes) where a trigger event has taken place or is in contemplation. This covers both the acquisition of entities and also assets.

As set out in the Statement of policy intent three areas will be considered when deciding whether or not to call-in a transaction:

Target risk – the nature and business of the target and whether that could result in a national security risk;

Trigger event risk – the control being acquired and how that could be used in practice; and

Acquirer risk – the extent to which the acquirer raises national security concerns.

In addition to the call-in powers, the Act gives the Government extensive information gathering powers – so it can effectively request information at any given time. Presumably this will be focused on key risk sectors, but the Act does not restrict the powers to these alone.

Foreign investment? Who is caught by the regime?

Although investment from foreign entities may result in more national security concerns, the Act is not limited to investment from outwith the UK, and can catch both foreign and domestic investors in any entity which carries on business in the UK (or supplies goods or services to the UK). This means that the relevant sector in a deal and the trigger event thresholds need to be considered on all deals, even if the acquirer is entirely a UK entity.

Sanctions for non-compliance and remedies

The sanctions for non-compliance are severe:

- if a transaction should have been notified under the mandatory notification requirements and it wasn't, then it is deemed null and void (although the Secretary of State can retrospectively validate a transaction);
- there are criminal sanctions for individuals involved in a breach including up to 5 years in prison, and a director can also be disqualified for up to 15 years; and
- fines of 5% of worldwide turnover of the relevant entity (and any business owned or controlled by it) or £10m (whichever is higher) can be brought against the entity in breach.

Outcomes post-notification

The actions the Government can take once a matter has been notified are:

- block a deal entirely (although this is likely to be rare in practice);

- allow a deal to proceed but impose conditions (such as limiting the transfer of sensitive IP); or
- give clearance for the deal to proceed.

Interaction with current law

The provisions in relation to national security run alongside the current UK merger control regime so both regimes need to be considered. However the Competition and Markets Authority no longer has a role in dealing with matters of national security, it is now all dealt with by the Secretary of State through a new Government unit – the Investment Security Unit – which is tasked with implementing these new requirements and will be the single point of contact for notifications and enquiries. Notifications and applications for clearance are being made online.

Key practical points

Overall – although the Act is extremely wide – the Statement of policy intent makes clear that the purpose of these new rules is to facilitate investment into the UK rather than limit it. Over time we will be able to see how the Government intends to enforce this legislation in practice, but in the meantime these are the key practical points to consider:

- The regime creates some uncertainty. Uncertainty creates risk and this needs to be managed;
- We are likely to see more conditional deals as they will need to be conditional upon notification and clearance. Conditional deals inevitably bring an extra layer of complexity to a deal;
- If in doubt it is likely best to notify – this will give more certainty to a transaction;
- More due diligence or information on the ultimate owner and affiliates of an acquirer or investors may be required and sellers will want comfort from purchasers that all relevant information has been provided;
- More diligence on the sector that is being dealt with and whether or not it may cause a national security concern will be required;

- These requirements will impact on transaction timescales and costs, so factor this in;
- Keep in mind this is not just applicable to mergers & acquisitions – it is relevant for investments in assets (including IP) and property transactions so it touches on many sectors and practice areas (some perhaps unexpected).

For more information including our useful flowchart see – flowchart and National Security and Investment Act.

We hope that this provides you with a helpful summary of the position. This guide is not legal advice, but should you require any further advice or assistance, please do not hesitate to get in touch with your usual Burness Paull contact.

Get in touch

Catriona Macallan

Direct Dial: +44 (0)131 473 6134

Mobile: +44 (0)7885 298 409

Email: Catriona.Macallan@burnesspaull.com

Aberdeen

2 Marischal Square
Broad Street
Aberdeen
AB10 1DQ
T +44 (0)1224 621621

Edinburgh

50 Lothian Road
Festival Square
Edinburgh
EH3 9WJ
T +44 (0)131 473 6000

Glasgow

2 Atlantic Square
31 York Street
Glasgow
G2 8AS
T +44 (0)141 248 4933