Burness Paull

National Security and Investment Act

BRIEFING NOTE

Corporate Finance

Introduction of NSI Act

The introduction of the National Security and Investment Act, which came into force on 4th January 2022, signifies a key change in the UK's regime of control over foreign direct investment (FDI) and has the potential to 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 is significant – other than within the sector definitions, there are no minimum turnover, market share or size of transaction thresholds – and therefore it needs to be considered on all deals, from property transactions to energy deals, private equity to intra-group transfers. The purpose of this note is to highlight the key features of the Act and the types of transaction caught by it.

There are two key regimes introduced by the Act – 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. In addition, there is an overarching right of the Chancellor of the Duchy of Lancaster (CDL) 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, acquisitions, and/or investments 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.

The Government has the ability to amend the sector definitions – to respond to any changes in national security risk – so we can expect that these may 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% (including acquisitions made pursuant to the creation or release of security over shares); 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).

The transfer of shares in a Scottish company to a lender to create security over those shares or the transfer of such shares by a lender to release the security may be caught by the Act. Enforcement of security over shares may also be caught where an acquisition of control is taking place and the lender is not already the registered shareholder. UK lenders and investors need to be aware of this in the context of putting in place financing packages as this will impact on timescales.

Voluntary reporting

A transaction should be notified under the voluntary regime if there is a 'trigger event' and there are potential national security considerations.

Importantly, this part of the regime does not just apply to the acquisition of shares in a company, it applies also 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.

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 Government blocked the proposed acquisition of a Welsh semi-conductor manufacturer citing national security concerns because the target company was a subsidiary of a partially state-owned Chinese company.

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 CDL 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. The acquirer, target or seller can make a notification under the voluntary regime.

Government response timescales

When either mandatory or voluntary notification is made, the CDL 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 CDL 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 CDL has an overriding power to 'call-in' non-notified transactions (for national security purposes) where a trigger event has taken place or is under contemplation. This power has retrospective effect back to 4 January 2020. This covers the acquisition of both entities and 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 identity or nature of 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.

Foreign investment? Who is caught by the regime?

Although investment from foreign entities may result in increased national security concerns, the Act's reach is not limited to investment from outside the UK, and catches 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 a UK entity which is entirely UK owned.

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 CDL 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 such that 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 CDL– 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 made online and we can assist with this.

Key practical points

Overall – although the Act is extremely wide – the Statement of policy intent makes it clear that the purpose of the Act is to facilitate investment into the UK rather than limit it. Key practical points to consider:

- Deals may be conditional upon notification and clearance. Conditional deals inevitably bring an extra layer of complexity to a deal – this can often be avoided by submitting a notification early on in a transaction, such that the CDL's period for response runs in parallel with the overall transaction timeline, and consent may be received in advance of signing;
- If in doubt it is likely best to notify the CDL – 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;
- The granting and release of security may also be covered by the Act and this will affect timescales for refinancing debt facilities and borrowing new money; and
- Keep in mind this is not just applicable to mergers & acquisitions – it is relevant for investments in assets (including IP), intra-group reorganisations 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

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