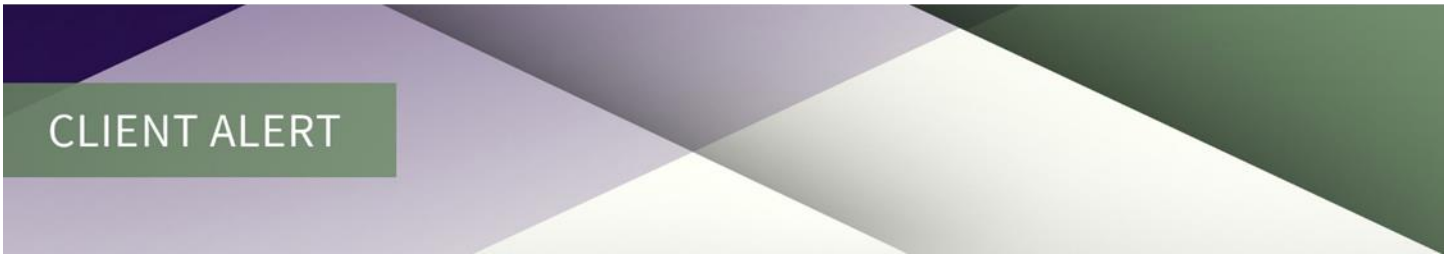

The UK's New Mandatory UK National Security Investment Filing Regime Goes Live Today

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On 21 July 2021 the UK Government announced that the mandatory notification regime of the UK National Security and Investment Act 2021 (NSI Act) will come into force on 4 January 2022.

A suite of guidance documents has also been published to help businesses prepare for the new rules, including a helpful checklist to assist businesses assessing whether the new screening regime will apply to an investment and examples of the activities which fall within scope.

The UK Government's announcement follows the recent adoption and/or strengthening of investment control rules globally, including across a number of EU member states, including in Germany, Italy, France and Spain. Following the adoption of Regulation (EU) 2019/452 of 19 March 2019, which established an EU-wide framework for screening foreign investments, further enhancement of investment controls may be expected in the EU.

In the remainder of this client alert we provide an overview of the regime followed by a number of practical considerations for deal makers. This client alert updates our client alert regarding the operation of the new NSI Act notification and review regime which we published on 22 July 2021.

The key points for deal makers and investors to note are as follows.

- **Mandatory pre-closing approval required in 17 sectors**: Pre-closing NSI approval is mandatory for investments closing on or after **4 January 2022** if the target entity is active in one or more of 17 designated sectors in the UK (***Notifiable Acquisition***).

Notifiable Acquisitions cannot close until approval is granted. Notifications must be made to a dedicated government unit – the Investment Security Unit (ISU) – through a digital portal. The UK Government has published a filing form detailing the required information.

The 17 designated sectors for the purpose of the mandatory notification regime are: advanced materials, advanced robotics, artificial intelligence, civil nuclear, communications, computing hardware, critical suppliers to government, cryptographic authentication, data infrastructure, defence, energy, military and dual-use, quantum technologies, satellite and space technologies, suppliers to the emergency services, synthetic biology and transport.

Some of these sectors are broadly defined and may cover investments in targets whose activities raise no obvious national security concerns. Indeed, where relevant shares or voting rights are acquired in a target which is active in a designated sector, the investment must be notified, and it is strongly advisable that closing be conditional on NSI approval even if it is clear that no national security concerns are likely to arise.

- **No UK subsidiary or physical presence required**: It is not necessary for the target to have a subsidiary, branch or assets in the UK in order for an investment to be notifiable. There is also no minimum turnover or deal size threshold. To trigger a mandatory filing, it is sufficient that the target makes any sales in any of the designated sectors to customers located in the UK (***Qualifying Entity***).

The mandatory regime is triggered by the acquisition of shares or voting rights in a Qualifying Entity exceeding 25%, 50%, or 75%; or voting rights enabling or preventing the passage of any class of resolution governing the affairs of the Qualifying Entity. The mandatory notification regime does not apply to the acquisition of bare assets.

- **Notifiable Acquisitions are void if completed without approval**: Notifiable Acquisitions are void under English law if completed without notifying and/or prior to obtaining approval. There are significant sanctions for failure to make a mandatory filing, including civil and criminal penalties, also for company officers.

Investors may seek retroactive approval for investments deemed void for failure to notify or obtain a required approval, but this "curing" procedure will not prevent the application of civil and criminal sanctions.

- **Impact on deal timeline**: Notifications are subject to an initial screening review of up to 30 working days (***Review Period***). Should the UK Government identify potential national security concerns during its initial screening, it can

initiate an in-depth assessment which can take up to a further 30 working days, extendable by a further 45 working days (***Assessment Period***), giving a total overall NSI review period from the time of notification of up to 105 working days.

- **Transactions not captured by the mandatory notification regime can be called in for up to five years if they raise national security concerns**: Relevant share acquisitions falling outside the 17 designated sectors are not subject to mandatory notification, but may be called in for an NSI review for up to five years from the acquisition if the UK Government has national security concerns.

This "call in" power is applicable to investments which closed on or after 12 November 2020, but not before.

The "call in" power can also be exercised in relation to acquisitions of assets, including an asset located outside the UK if it is used in connection with activities carried on in the UK or to supply goods or services to people in the UK.

In relation to shares, acquisitions of material influence may be called in, in addition to the trigger events set out above. Material influence is broadly defined as the ability to influence an entity's commercial policy, and the UK Government has stated that it will take into account the CMA's guidance concerning material influence in assessing that concept within the new NSI framework.

The UK Government notes that its "call in" power is expected to be used exceptionally, and that parties can mitigate this risk by making a voluntary notification. Voluntarily notified transactions may be progressed unless prohibited by interim order, but parties take the risk of an adverse outcome that requires the transaction to be unwound.

The Review Period and Assessment Period are the same for voluntary and mandatory notifications. Transactions that are called in for review will proceed directly to the Assessment Period.

Execution risk considerations

The NSI Act does not define "national security", and so in principle affords the UK Government a wide margin of discretion. However, the UK Government will consider the following three general factors in exercising its "call in" powers, which deal parties should self-assess when considering whether or not a voluntary filing may be prudent, even if a mandatory notification is not required, in a specific case:

(i) Target risk – the nature of the target and whether its activities are in an area of the economy where the UK Government considers risks more likely to arise;

(ii) Acquirer risk – the extent to which the acquirer has characteristics or links to entities that raise national security concerns; and

(iii) Control risk – the type and level of control being acquired and how this could be used in practice, e.g. to corrupt processes or systems, or gain unauthorised access to sensitive information.

With respect to the acquirer risk, although the UK Government has stated that it does not regard state-owned entities, sovereign wealth funds or other foreign state-affiliated entities as inherently more likely to pose a national security risk, in practice, foreign state affiliation will likely be an important consideration when assessing acquirer risk in sensitive sectors. The UK Government can also be expected to look at the ultimate controlling parties of an acquisition vehicle when assessing acquirer risks.

This means that deal parties will wish to carry out thorough due diligence on the controlling structure and ultimate controlling entity of the acquirer, their pre-existing holdings, criminal records and any negative media coverage to assess whether the acquirer may have links to hostile states, organisations, persons or other "entities which may seek to undermine or threaten the interests of the UK, including the integrity of the UK's democracy, the UK's public safety, the UK's military advantage and the UK's reputation or economic prosperity".

The UK Government has powers to compel deal parties as well as third-party individuals and businesses located in the UK to provide information or give evidence in relation to its screening and assessment functions under the NSI Act. Further guidance on how the UK Government expects to use its "call in" power is set out in its statement of intent.

Key considerations for investors

As a result of the potentially broad application of the rules, both with respect to the scope of the specified sectors and the meaning of "national security risk", the NSI regime should now be considered as a matter of course when evaluating any potential transactions and investments with a UK nexus.

From a sell-side perspective, the NSI regime may impact the pool of eligible investors in assets and businesses with a UK nexus. This may call for increased due diligence on the affiliations of investors to rule out national security concerns.

On auction processes, in the absence of a transaction clearly falling within the mandatory regime, consideration will need to be given by the parties and their advisors to the timing of any informal discussions with the UK Government as to whether the transaction is notifiable.

Parties may also wish to consider whether a voluntary notification may be prudent in order to obtain deal certainty where it is unclear whether a mandatory notification is required (and no firm guidance may be available on the issue from the UK Government in short order) or where there is a genuine risk that the UK Government may exercise its "call in" power which it can do up to five years after closing.

In cases where investments are notified, the cooperation and timing provisions of the transaction documents must be drafted to anticipate the UK Government's wide-ranging powers to require parties to produce information or to attend interviews, and to "stop the clock" during the Assessment Period.

Finally, internal restructurings are not exempt from the NSI regime and may constitute a Notifiable Acquisition even if the ultimate owner remains the same, provided that the transaction meets the conditions discussed further above. This is an important difference with the approach taken under the merger control regimes of most jurisdictions, including the UK.

Please refer to our previous client alerts for further detail on the NSI Act here and detailed mechanics of the NSI regime here.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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