

Webinar: The UK's New National Security Investment Bill – Key points for sell-side and buy-side investors

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Agenda

1. The new National Security and Investment (**NSI**) regime
 - i. Overview
 - ii. Designated sectors for 'mandatory filings'
 - iii. 'UK nexus'
 - iv. Interplay with UK merger regime
 - v. Quick reference summary
2. Comments from a CFIUS Perspective
3. Buy and Sell-Side Observations

Overview of the NSI Regime

- On 11 November 2020, the UK Government published the National Security Investment Bill (**NSI Bill**) which introduces the most significant overhaul of the takeover regime in the UK in 20 years
- It comes on the eve of the Brexit transitional period; after that UK merger control will be entirely divorced from the EU's 'one-stop-shop' merger control process under the EU Merger Regulation
- The proposed changes effectively create **three complementary systems of review** for investments / transactions with a UK nexus:
 - Competition issues
 - Only Competition & Markets Authority (**CMA**)
 - Public interest issues
 - Media plurality, stability of the UK financial system, public health emergencies
 - CMA and UK Government through Secretary of State for BEIS (**SoS**)
 - National security
 - Only SoS

Overview of the NSI Regime (2)

- The NSI Bill amends the existing procedures in a number of ways and introduces a new system of review
 - It removes national security from the current review regime for ‘public interest’ issues – all national security issues will now be reviewed only under the NSI regime
 - It removes the lowered merger control thresholds for transactions related to: (i) military/dual-use goods, (ii) computer processing units, (iii) quantum technology, (iv) AI, (v) cryptographic authentication technologies and (vi) advanced materials
 - It creates a new review regime which:
 - Introduces a mandatory pre-closing notification obligation for certain investments (not subject to any materiality or control thresholds!)
 - Creates the option for voluntary notifications
 - Creates wide ‘call-in’ powers for the UK Government: if a ‘trigger event’ has occurred / in progress / in contemplation + the ‘trigger event’ may give rise to national security concerns
 - The UK Government expects around 1-1.8k NSI notifications, c.80 call-ins and 10 remedy cases per year (cf. 12 national security reviews since 2002 to date)

Overview of the NSI Regime (3)

- **Not limited to foreign acquirers – the NSI review will consider:**
 - ‘Target’ risk – significance for national security interests
 - ‘Trigger event’ risk – how much control / influence is being acquired
 - ‘Acquirer’ risk – issues with the identity of the acquirer (e.g. ‘hostile actor’?)
- **Wide powers to intervene in specified investments (“**trigger events**”) which adversely affect the UK’s national security interests, with significant intervention rights**
 - Interim remedies (e.g. prohibition completion or integration until review is complete)
 - Final orders to prevent, remedy or mitigate risks (must be proportionate), e.g. imposition of conditions or prohibition
 - In rare cases, can include offer of ‘financial assistance’
 - Civil and criminal sanctions for breaches of these orders
 - Subject to judicial review, if appealed within 28 days

Overview of the NSI Regime (4)

- **Mandatory pre-closing notification requirement for “notifiable acquisition”**
 - Investment in a ‘legal entity’ (not a mere asset)
 - Target active in a designated sector in the UK (‘UK nexus’)
 - Specified ‘trigger event’
 - Leading to shareholding of 15% or more (or ability to secure or prevent passage of any ‘class of resolution’ governing affairs of the entity)
 - Increases from 25% or less to more than 25%
 - Increases from 50% or less to more than 50%
 - Increases from less than 75% to more than 75%
 - Shareholding thresholds can also be applied to:
 - Percentage of voting rights
 - If no share capital, percentage of capital or profits of the target entity
 - For LLPs, right to a share of that percentage of any surplus assets on winding up
 - “Trigger event” must not be completed before NSI clearance has been obtained.

Overview of the NSI Regime (5)

- **Effects of a failure to make mandatory notification**
 - Investment is automatically voided
 - Fines of up to 5% of total worldwide group turnover of the acquirer or £10M, whichever is the higher
 - Criminal fines and/or imprisonment of up to five years
 - Subject to a future 'call-in notice' (no time limit)
 - *But* can be 'cured' ...
- **Beware personal criminal liability!**
 - The NSI Bill stipulates that where a legal entity commits an offence, an officer of the entity will be guilty of the offence if it is attributable to their consent or connivance, or to their *neglect*

Overview of the NSI Regime (6)

- **Government power to issue 'call-in notice'**
 - Transaction 'may' give rise to national security issue (low threshold) and trigger event has occurred, is in progress or in contemplation
 - Not limited to designated sectors
 - Not limited to legal entities; can cover assets
 - Additional 'trigger events': (i) 'material influence' over entities; or (ii) control over assets (e.g. access rights or control over use)
 - Note **retrospective effect** for trigger events from 12 November 2020 onwards (can be called in for six months from commencement date where SoS had knowledge before the commencement date or, otherwise, for five years from commencement date)
 - Trigger events **after the commencement date** can be called in for six months from the SoS having notice of the trigger event or five years from the trigger event, whichever is the earlier
- **Option of making a voluntary notification**
 - Applies to all situations where a 'call-in' right exists
 - Removes risk / uncertainty of future 'call-in' issues

Overview of the NSI Regime (7)

- **Same broad procedures apply to Government (BEIS) review**
 - Option of early informal guidance
 - Notification must be assessed as 'complete' (form to be published)
 - Phase 1: 'Screening period' of up to 30 working days
 - Phase 2: 'National security assessment' of 30 working days
 - Extension of 45 working days possible
 - Plus extension by consent in exceptional cases
 - **Beware** 'stop-the-clock' rules, i.e. RFIs interrupt the timetable
- **Powers of investigation**
 - Require production of documents and information
 - Require attendance of individuals
 - Civil and criminal sanctions for breaches
- **Impact on 'closing'**
 - Transactions subject to mandatory notification regime cannot be closed until cleared
 - Other transactions can close, pending outcome of a review unless interim order prohibits completion

Proposed 'Designated' Sensitive Sectors

- Current proposal for 17 sectors, deemed particularly sensitive from a national security perspective

1. Advanced materials
2. Advanced robotics
3. Artificial intelligence
4. Civil nuclear
5. Communications
6. Computing hardware
7. Critical suppliers to Government
8. Critical suppliers to emergency services
9. Cryptographic authentication
10. Data infrastructure
11. Defence
12. Energy
13. Engineering biology
14. Military and dual-use
15. Quantum technologies
16. Satellite and space technologies
17. Transport

- The list can be amended from time to time (and likely will be!)
- Secondary legislation will set out detailed definitions; the draft text is open to consultation at the moment until [6 January 2021](#) (e.g. AI in chess computing software?)

‘UK Nexus’ Test

- The NSI can apply to investments/transactions where neither the acquirer nor the seller has a direct link with the UK, provided:
 - For legal entities, the non-UK target entity carries on activities in the UK or supplies goods and services to persons in the UK; or
 - For assets, the overseas asset is used in connection with activities taking place in the UK or in connection with the supply of goods and services to persons in the UK
- Please note the mandatory notification regime only applies to investments into legal entities, not assets, e.g. a Spanish telecoms company which provides services to persons in the UK
- As regards assets, the guidance refers to investments into ‘deep-sea cables’ and the acquisition of ‘intellectual property’
 - ‘Call-in notices’ are only intended to be issued in relation to activities on which the UK “fundamentally relies”
 - Voluntary notifications can remove uncertainty in relation to such transactions

Interplay with UK Merger Control Regime

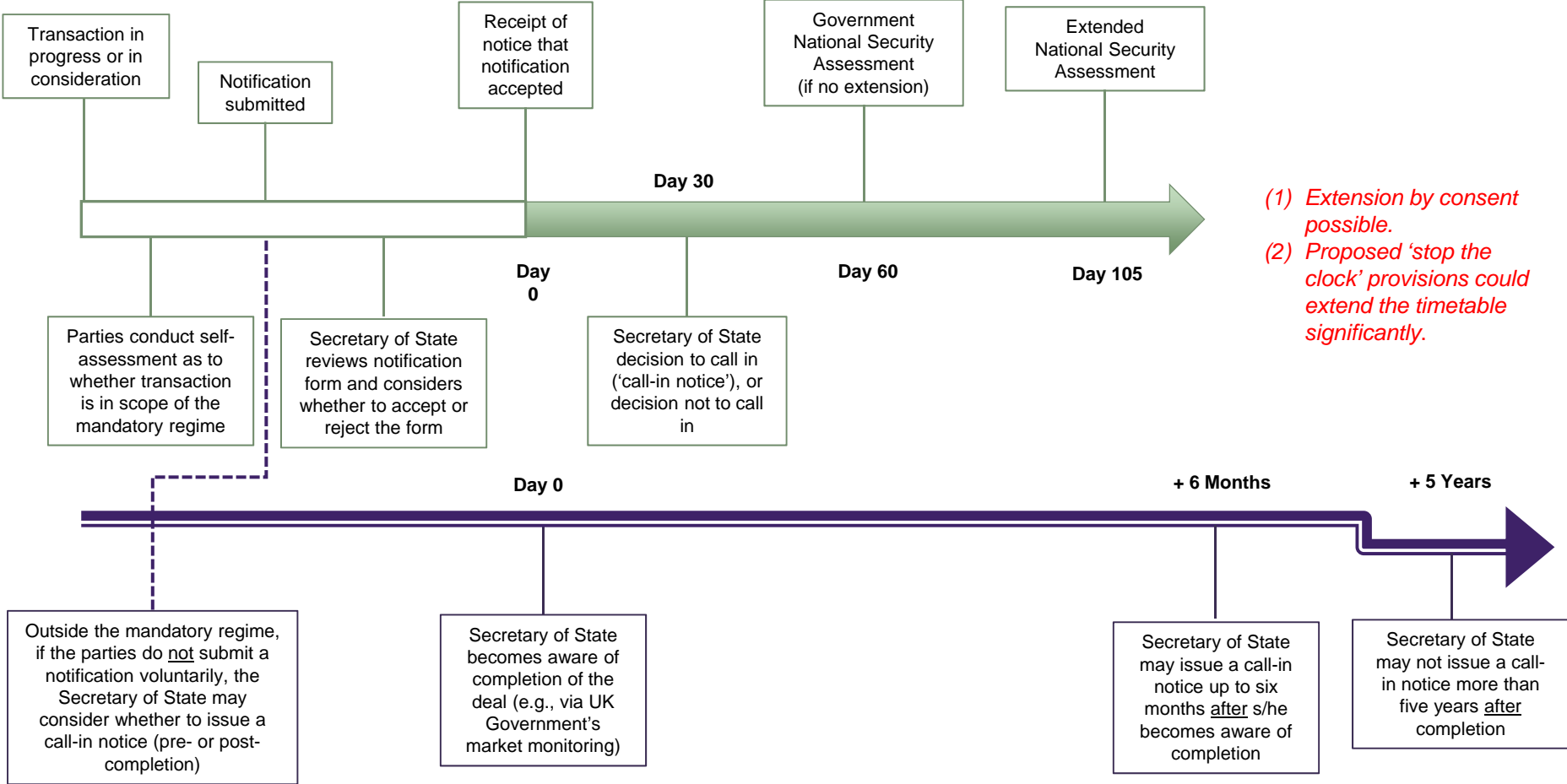
- The NSI regime is entirely separate from the UK's merger control regime under the Enterprise Act 2002 (EA02) conducted by the CMA
- The UK merger regime under the EA02 establishes a voluntary and non-suspensory merger control regime for transactions which:
 - Involve the acquisition of 'control'; and
 - Exceed certain transaction-size thresholds (i.e. £70M 'UK turnover' test or 25%+ 'share of supply' test)
- In contrast, the NSI regime captures acquisitions of 'potential control' (i.e. shareholdings as low as 15%) and applies no transaction-size thresholds
- In the UK, CMA and BEIS can conduct their reviews in parallel and are committed to coordinating on possible remedies / interventions
- The 'public interest' review regime under the EA02 (e.g. media plurality) involves both the CMA and BEIS

Summary of Mandatory and Voluntary Regime

	Mandatory notification regime	Voluntary notification regime
Target	<u>'Legal entities' only</u> (e.g. company, LLP, unincorporated association, trust)	<u>Entities and assets</u> (e.g. land, tangible moveable property, ideas, information or techniques which have industrial, commercial or other economic value)
Sector	Nexus to 'specified' sectors in the UK = (can be amended)	Whole economy
Type of Investment	1) Acquisitions of shareholding or voting rights crossing 15% threshold; <u>or</u> 1) <u>'Trigger Events'</u> under 2a) and 2b) for legal entities (see next column)	<u>Any of these 'Trigger Events':</u> 1) Assets: acquisitions of the ability to use, or direct or control how they are used, or to do so to a greater extent than prior to the acquisition 2) Entities: acquisitions of: a. Shareholding, right to profits/capital/assets, or voting rights crossing 25%, 50% or 75% thresholds; b. Ability to secure or prevent passage of any 'class of resolution' governing affairs of the entity; <u>or</u> c. Ability to 'materially influence' the policy of the entity (see UK CMA merger guidance definition)
Obligation to notify	Mandatory, pre-closing obligation to notify	No obligation to notify but subject to call-in
Sanctions for not notifying	<ul style="list-style-type: none"> - Automatically void, unless retroactively validated - May be called in up to six months after the SoS becomes aware of the Trigger Event (no time limit) - Sanctions of up to 5% worldwide turnover / £10 million for businesses, and up to £10 million or imprisonment for individuals 	May be called in up to six months after the SoS becomes aware of the Trigger Event, up to five years after the Trigger Event took place

Summary of NSI Process Timeline

Notifiable and non-notifiable acquisitions (references are to working days)





Comparison of UK and US Regimes



	NSI	CFIUS
Jurisdiction over equity sales	'Trigger event', including ability to 'materially influence' the policy of the entity	(1) 'Control' of the US business based on CFIUS control factors; or (2) covered investment in technology, infrastructure, or data (TID) business
Application to business investments	The non-UK target entity carries on activities in the UK or supplies goods and services to persons in the UK	Must have US 'business operations'. Sales alone are not sufficient
Application to asset purchases	The overseas asset is used in connection with activities taking place in the UK or in connection with the supply of goods and services to persons in the UK	Only applies to purchase of real estate within proximity to sensitive government facilities and giving buyer certain access rights
Mandatory filings	In designated sectors, acquisitions crossing 15% threshold or trigger event in sensitive industry	(1) Covered investment in critical technology business, or (2) TID investment with substantial government interest

CFIUS – Covered Control Transactions and FIRRMA Update



Covered Control Transactions

- CFIUS' core jurisdiction includes 'covered control transactions' which are defined as transactions by or with any foreign person that could result in the foreign control of any US business. This jurisdiction includes transactions carried out through a joint venture which would lead to foreign ownership or control of a US business.

Covered Investments

- FIRRMA expanded CFIUS' jurisdiction to include non-controlling investments in US businesses involved in (1) critical technologies, (2) critical infrastructure, and (3) sensitive personal data on US citizens.
- FIRRMA also introduced mandatory filings for (1) investments in critical technology businesses, and (2) investments where a foreign government holds a substantial interest in the foreign investor.

Covered Non-Controlling Investments

The jurisdiction extends to any investment by a foreign person that affords the foreign person:

- Access to any material non-public technical information;
- Membership or observer rights on the board of directors; or
- involvement in substantive decision-making of the US business regarding critical technologies, critical infrastructure, or sensitive personal data of US citizens.

Investment must be in a US business in:

- Critical Technologies
- Critical Infrastructure
- Sensitive Personal Data



Mandatory Filing Requirements

FIRRTA introduced a mandatory filing requirement that requires the filing of a Declaration for:

1. Foreign, non-controlling investments in a US business that designs, manufactures, tests, produces, fabricates or develops critical technologies that would require a license in order to be exported to certain persons in the new ownership chain;
2. A TID investment where a foreign government obtains a 'substantial interest' (25%) in a US TID business or where a foreign government in turn holds a substantial interest (49%) in the foreign person investing in a US TID business.

Excepted Investors

Excepted investors are not subject to CFIUS jurisdiction over non-controlling investments in TID US businesses and are exempted from mandatory filing requirements for investments in US businesses producing or developing critical technologies.

Excepted Foreign States

- The list of excepted foreign states is currently limited to **Australia, Canada, and the United Kingdom**. The list remains open and more foreign states may be added.

Excepted Investor

In order to qualify as an “excepted investor,” the foreign investor must:

- Be organized under the laws of an excepted foreign state or the United States;
- Have its principal place of business in an excepted foreign state or the United States;
- Have 75% or more of its board members or observers be US nationals or nationals of an excepted foreign state; **and**
- Ensure that any foreign person who, individually or as part of a group of foreign persons, holds more than 10% of its voting interest be a national of an excepted foreign state or the United States.

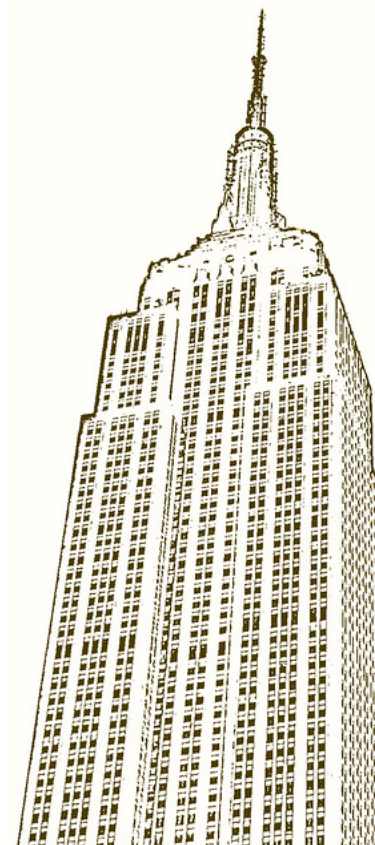
Exception does not apply to control transactions.

Covered Real Estate Transactions

Generally covers real estate purchases in locations where it may be possible to gather information on or from sensitive US Government facilities.

Covered real estate is property within or part of airports and seaports, or real estate that is within one mile or 100 miles of certain specified US military installations. Locations are listed in Appendix A to Part 802.

Transactions that involve the purchase, lease, or concession that affords the foreign person three or more of the following property rights: (1) physical access; (2) ability to exclude; (3) improve or develop; and (4) affix structures or objects.



Key Considerations

- **Growing Issues with Russia and China**
 - Deals involving companies or investors from Russia and China continue to pose a significant challenge of approval in the current political environment, even if Russian or Chinese persons involved pose no visible threat
- **Extensive Monitoring of Transactions**
 - CFIUS is trolling news sites for information on recent M&A activity, particularly with its expanded resources under FIRRMA. CFIUS will not hesitate to intervene and does not care about financial loss resulting from its actions
- **Expansive View of National Security**
 - CFIUS will use any connection between a foreign entity and a US business controlled by the foreign entity to pursue broader business objectives outside the United States under the broadly interpreted term of 'US national security'
 - Enhanced focus in recent years on access to mass data or expertise in financial services as potential security risks
- **No Information is Off Limits**
 - When parties do not notify CFIUS, and CFIUS discovers the transaction and sees a possible threat, the information requests will be expansive with little room for negotiation
 - Clients could be expected to divulge extensive, private information about their operations, strategy, and personnel

Buy-Side/M&A Considerations

- **Put in place UK NSI ‘screening’ now on current deals**
 - Note retrospective effect
 - For all transactions which may fall into ‘mandatory notification regime’
 - Consider ‘call-in’ risks
- **Going Forward – early assessment of risk**
- **Conditionality**
 - Mandatory vs Voluntary
 - Expected trends for Voluntary notifications
 - Timing
 - Competitive Tension
 - ‘Hell or High Water’?
 - Break Fees?
- **Funding**
 - Impact on potential consortium parties/direct co-investors

Buy-Side/M&A Considerations (2)

- **Acquisition of debt**
 - Not covered by mandatory regime if not connected to voting rights
 - May be subject to the 'call-in' right where the investment confers 'material influence'
- **Conversion of debt to equity**
 - May be a 'trigger event' for a mandatory notification if 15%+ shareholding or voting rights are being acquired or subject to the 'call-in' right where 'material influence' is being acquired
- **Restructuring**
 - Impediment to lenders enforcing security?

Sell-Side Considerations

- **Reduced scope of 'exit' options?**
 - NSI scope may put off certain bidders
 - Uncertainty not just of execution risk but also regarding the materiality of any possible conditions
- **Early stage DD regarding NSI risks of potential acquirers**
- **Consider timing implications if potential NSI issues exist**
 - Timeline of 30+30+45 plus extension by 'mutual agreement'
 - Consider 'stop-the-clock' risks

Speaker Contacts (1)

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Philipp Girardet heads the European Antitrust & Competition Practice Group and is based in the London office. He advises on complex mergers, investigations and competition litigation matters across a wide range of sectors, including industrials, transport, finance, pharma and online platforms. From 2005 to 2007, Philipp was the Deputy Director of the UK competition authority's Cartels and Leniency unit.

Philipp has been shortlisted for "Competition Team of the Year 2020" by both *Legal Business* and *The Lawyer* for two different matters. Highly ranked in *Chambers* and *The Legal 500*, clients note that he "provides excellent strategic advice and is extremely thoughtful" (*Chambers* 2021) and is a "truly outstanding practitioner" and "is first class - his advice is sharp, pragmatic, commercial and cuts to the heart of the issue" (*The Legal 500* 2021).

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David Mortlock is Chair of Willkie's Global Trade & Investment Practice Group and Managing Partner of the Washington office. He advises clients on international trade and government regulation of cross-border transactions, particularly the intersection of economic regulation and national security. *Chambers USA* (2020) ranks David among the leading individuals nationally practicing in the area of International Trade: Export Controls & Export Sanctions.

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Gavin Gordon is a partner in the Corporate & Financial Services Department and the Private Equity Practice Group. He focuses his practice on leveraged buy-outs, mergers and acquisitions, and infrastructure transactions. Gavin has advised private equity funds and corporate clients on cross-border mergers and acquisitions and corporate finance transactions.

Gavin is rated among the leading private equity practitioners by *Chambers UK* (2020), *The Legal 500* (2021), *IFLR1000* (2020) and *Super Lawyers*. *Chambers* has described him as "excellent" and "very commercial" highlighting that "he is praised by sources for his depth of knowledge in the private equity space" and is "commercial, responsive and extremely knowledgeable".

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Jeffrey Poss is a partner in the Corporate & Financial Services Department, Co-Chair of the Private Equity Practice Group and a member of the firm's Executive Committee. He focuses on private equity and venture capital transactions, and mergers and acquisitions transactions involving public and private companies, in each case across multiple industries, but with a particular focus on the financial services, fintech and technology/media/ telecom sectors. Jeff regularly advises senior management and boards of directors of both public and privately held entities on strategic and corporate governance matters. Jeff practiced in the firm's London office for several years handling cross-border transactions and remains very active in the firm's global private equity and M&A practice.

Chambers USA (2020) ranks Jeff among the leading individuals practicing in the area of Private Equity: Buyouts in the United States, and *Chambers FinTech* (2020) recognizes him as a notable practitioner in the FinTech space. He was named "private Equity Adviser of the Year" at The Deal Middle Market Awards in 2020, and shortlisted for the same honor at The Deal Awards US in 2019 and 2020.

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Annexes

Annex 1: Public Interest Interventions on National Security Grounds (2002-2020)

Deal	Acquirer	Sector	Remedies Accepted
Aerostar / Mettis	China	Supply of design, manufacturing, and assembly of forged and machined components for the aerospace industry in the UK	Transaction abandoned
Gardner Aerospace / Impcross	China	Supply of construction services for commercial aerospace and defence industry (rotating parts and aerospace assemblies)	Transaction abandoned
Connect Bidco / Inmarsat	North American consortium	Supply of two-way fixed satellite communication services by satellite service providers (SSPs)	Controls to protect sensitive information Board composition requirement (together, the Standard Remedies) + Must continue to provide capabilities
Advent / Cobham (*EUMR)	US	Supply of defence, aerospace, and space markets and advanced electronic communications	Board composition requirements
Gardner Aerospace / Northern Aerospace	China	Supply of aircraft wing spars and fuselage frames worldwide	No remedies imposed
Hytera / Sepura	China	Supply of digital mobile radio terminals and tetra radio terminals in the UK	Standard Remedies + Continue to provide services as a UK company
Atlas / Qinetiq	Germany	Supply of research, technology and support for British armed forces	Standard Remedies + Maintain a UK company for defence contracts
GE / Smiths Aerospace	US	Supply of components for military weapons platforms	Standard Remedies + Maintain a UK company for defence contracts
Lockheed Martin / Insys	US	Supply of specialist defence engineering and R&D services	Standard Remedies + Maintain a UK company for defence contracts
Finmeccanica / BAE	Italy	Supply of avionics and communications	Standard Remedies + Maintain a UK company for defence contracts
Finmeccanica / AgustaWestland	Italy	Design of armed forces helicopters	Standard Remedies + Maintain a UK company for defence contracts
General Dynamics / Alvis	US	Design of armoured fighting vehicles	Standard Remedies + Maintain a UK company for defence contracts + Continuation of supply requirement

Annex 2: Resources

- UK Government publications of NSI Bill materials
 - NSI Bill Documents: <https://www.gov.uk/government/publications/national-security-and-investment-bill-2020>
 - NSI Bill Factsheets: <https://www.gov.uk/government/publications/national-security-and-investment-bill-2020-factsheets>
 - Consultation on mandatory notification sectors: <https://www.gov.uk/government/consultations/national-security-and-investment-mandatory-notification-sectors>
 - Government response to White Paper consultation: <https://www.gov.uk/government/consultations/national-security-and-investment-proposed-reforms>
- US Government publications on CFIUS matters
 - General overview: <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-overview>