UK FINANCE

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The UK National Security and Investment Act 2021: its impact on M&A

The mergers and acquisitions (**M&A**) landscape in the UK changed on 4 January 2022 when the National Security and Investment Act 2021 (the **Act**) came fully into force. The following article has been published in collaboration with UK Finance and its Corporate Finance Committee.

The Act creates a new screening regime that allows the Government to review certain transactions that may give rise to a risk to national security and potentially prevent or unwind them. Certain transactions falling within 17 "sensitive" sectors of the UK economy now require the Government's clearance prior to completion, otherwise they will be void.

In addition, under the Act, the Government has an expanded call-in power in respect of certain transactions that occurred on or after 12 November 2020. Transactions may be voluntarily notified to the Government in order to avoid the risk that they are subsequently called-in for screening. The Act has the potential to impact significantly on affected M&A transactions. We explore some of the issues below.

Summary

- From 4 January 2022, certain M&A transactions within 17 “sensitive” sectors of the UK economy must be notified prior to completion or they will be legally void and civil and criminal liability may be incurred.
- Many M&A transactions in the wider economy, including asset acquisitions, will be subject to an expanded call-in power. The Government will be able to scrutinise transactions (and order that they are unwound) for up to 5 years after they have completed. To create certainty, parties can voluntarily notify transactions to the Government.
- Most transactions are expected to be cleared by the Government within 30 working days of a notification being accepted.
- The Act needs to be considered on M&A transactions being negotiated going forward and its application is a key due diligence point.
- The Act’s impact will need to be considered when settling deal timelines and when negotiating transaction documents.

The Act at a glance

The Act creates two separate, but related, regimes: a mandatory notification regime and a voluntary notification regime backed up by a broad call-in power exercisable by the Secretary of State (a senior minister in the Government) (the **SoS**).

The mandatory notification regime

The mandatory notification regime obligates acquirers to notify and obtain approval from the SoS before a notifiable acquisition takes place in 17 “sensitive” sectors of the UK economy. Notifiable acquisitions take place when a party acquires: a holding of votes/shares in an entity that increases its votes/shares to more than 25%, more than 50% or to 75% or more; or voting rights that allow the acquirer to enable or prevent the passage of any class of resolution governing the affairs of the entity being acquired.

The relevant sectors are as follows: 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 technology, suppliers to emergency services, synthetic biology and transport.

Importantly, for the purposes of the mandatory notification regime, the votes/shares must be acquired in an entity that “carries on activities in the UK” – so overseas incorporated entities can fall within its scope if their activities qualify (eg they undertake research into or produce a specified category of sensitive product in the UK).

The voluntary notification regime

Outside the mandatory notification regime, there is the possibility for sellers, acquirers or the entities concerned to voluntarily notify transactions in any sector of the economy which qualify as “trigger events”. This could cover a wide range of transactions, including asset acquisitions involving land and intellectual property.

Specifically, the relevant trigger events are the acquisition of: an increase in a holding of votes/shares to more than 25%, more than 50% or to 75% or more; “material influence” over the policy of an entity; voting rights that enable or prevent the passage of any class of resolution governing the affairs of an entity; or a right or an interest in an asset, or in relation to an asset, enabling the use of an asset or the control of an asset to a greater extent than prior to the acquisition.

A trigger event can occur in relation to an entity which is formed or recognised outside the UK, but only if it "carries on activities" in the UK or "supplies goods or services to persons" in the UK. Certain acquisitions of assets overseas will also fall within the scope of the call-in power.

Under the voluntary notification regime, where a transaction is notified, completion of a transaction could take place before a clearance is received. However, the Government has the power to impose interim orders to halt or reverse any acquisition and, in anticipated transactions, to order that completion does not take place.

The call-in power

The call-in power gives the Government the power to scrutinise transactions which were not notified to it, but which may raise national security concerns. Importantly, the call-in power extends to transactions which completed on or after 12 November 2020. In general terms, once the Government becomes aware of a trigger event it will have six months to call in the transaction, subject to an overall five-year limitation period from the date of the trigger.

The Government has set out in a statement how it expects to exercise its call-in power (the **Statement**). In short, the SoS will consider: the "target risk" which concerns whether the entity or asset being acquired is being used, or could be used, in a way that poses a risk to national security; the "acquirer risk" which concerns whether the acquirer has characteristics that suggest there is, or may be, a risk to national security from the acquirer having control of the target; and the "control risk" which concerns whether the amount of control that has been, or will be, acquired through the qualifying acquisition poses a risk to national security.

The clearance process

Notifications must be made via an online portal to a new Investment Security Unit (**ISU**), which sits within the Department for Business, Energy and Industrial Strategy (**BEIS**), and the ultimate decision-maker will be the SoS for BEIS. The notification forms require detailed disclosure regarding the transaction and the relevant parties. Upon acceptance of a notification, the SoS has a maximum of 30 working days to decide whether to clear a transaction or to call it in for a more detailed review. The Government has stated that most transactions will be cleared at this stage. If the SoS reasonably suspects that there is – or may be – a risk to national security, they will conduct a detailed review. They will have up to another 30 working days to do this, extendable by 45 working days in exceptional circumstances. Any further extensions must be agreed with the acquirer.

In order to address any national security concerns found, the Government can impose remedies and even prohibit or unwind transactions. Additionally, the Government has wide powers to request information in order to inform its assessment, including through interviews. These powers extend to requiring information from acquirers outside the UK. To avoid parties running down the time by delaying responses, the clock stops when such requests are made, so the overall timeframe may be extended.

Consequences of breach

The Act sets out civil and criminal sanctions for non-compliance with the regime. For example, fines of up to 5% of global turnover or GBP 10 million (whichever is greater) can be imposed on an acquirer where they complete a notifiable acquisition without approval, and individuals face imprisonment for up to five years.

Where a completed transaction is subject to mandatory notification, it is automatically legally void in the absence of an approval from the SoS.

Impact on M&A

In practical terms, some key considerations for M&A transactions in relation to the Act are as follows:

- When to consider the Act: the Act needs to be considered at the outset and on all transactions falling within its scope going forward.
- Due diligence: the Act's application is now a key due diligence point on all transactions where a target entity "carries on activities" or "supplies goods or services to persons" in the UK. It is vital to determine if the transaction is caught by the mandatory regime at an early stage.
- Impact on the deal timeline: while most transactions should be cleared within 30 working days of notification to the Government, deal timetables will need to build in the time necessary to perform due diligence on the Act's application, draft and file any required notifications, answer any questions raised by the Government and await the Government's response.
- Managing uncertainty: despite the extensive guidance issued by the Government, aspects of the regime remain uncertain and the Government's powers are very broad. For example, it may be unclear if a transaction falls within the mandatory notification sectors as certain sectoral definitions and the extraterritorial application of the Act can be difficult to apply in practice. Since "national security" is undefined in the Act and the Statement is broadly drafted, the Government will also have considerable discretion in how it uses its powers. We expect parties to adopt a conservative approach to the Act with transactions being voluntarily notified until market practice settles and the Government's approach to exercising its extensive powers becomes clearer. We also expect that, now the Act is fully in force, there will be constraints on the ISU's ability or willingness to provide informal guidance before notification as to whether a transaction may be considered to give rise to national security issues.
- Contractual terms: the contracts relating to transactions that fall within the scope of the mandatory regime should explicitly address the issues and contain provisions such as:
  - a condition precedent to completion that the required clearance has been obtained from the UK Government;
  - a longstop date for completion that accommodates the timeline associated with a mandatory notification being made;
  - where appropriate, contractual terms agreed between the parties in relation to the clearance application process, information sharing and co-operation.

If the transaction falls outside of the scope of the mandatory regime, the extent of any tailored contractual terms will depend on whether it is decided to make a voluntary notification, as well as the call-in risk associated with the transaction more generally.

- Interaction with other screening regimes: where a transaction is notified to governments allied to the UK, particularly those in the "Five Eyes" community of Australia, Canada, New Zealand, the UK, and the United States, there is a greater likelihood that the UK Government will also want to scrutinise the transaction.
- Intra-group reorganisations: there is no carve-out for intra-group reorganisations. Where they are caught by the mandatory regime, they must be notified.
- Impact on lenders: parties to M&A transactions should be aware that lenders will also be focused on the application of the Act to the transactions that they are financing.

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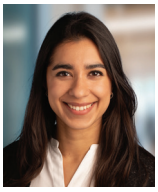

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