

The UK National Security and Investment Act 2021: A New Regime For Acquisition and Investment Transactions: Update

by Mark Taylor

GENERAL

There have been a number of key developments in the evolution of the UK's national security regime since our e-bulletin earlier this year ([UK to Adopt New Powers Over M&A Activity To Protect National Security](#)). First and foremost, the National Security and Investment Bill has now taken its place on the UK Statute Book as the National Security and Investment Act 2021 (the "**Act**"). The new legislation is set to come into force on the **4th January 2022**.

The Act and its associated secondary legislation will confer powers on the Secretary of State for Business, Energy and Industrial Strategy ("**BEIS**"), acting through the newly established Investment Security Unit (the "**ISU**"), to "call-in" transactions involving the acquisition of control or material influence over entities and assets where those transactions involve national security considerations. The Act will also mandate the prior notification and clearance of any acquisitions of material influence over entities which are active in one or more of 17 prescribed "sensitive" sectors. Those prescribed sectors are considered in more detail below but we would highlight at the outset that (in addition to defence, civil nuclear and military and dual use technologies) they include advanced materials, artificial intelligence, communications, data infrastructure, suppliers to the emergency services and transport. The new notification and clearance regime will therefore have application to a broad range of acquisitions and investments.

Significantly, once the Act comes into force, the call-in powers referred to above will apply to any qualifying transaction completed from the **12th November 2020** onwards. We discuss the implications of this for current investment and M&A activity later in this note.

WHICH ACQUISITIONS AND INVESTMENTS ARE CAUGHT BY THE ACT?

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It is notable that whilst a principal objective of the Act is to retain domestic control over sensitive assets, information and technology, the new regime does not specifically target overseas purchasers and investors. Instead, the Act will apply to any transaction which results in either an individual, or a UK or overseas entity, acquiring control over a qualifying entity or qualifying asset. Any such acquisition is defined in the Act as a **“Trigger Event”**, and the same definition has been adopted within this e-bulletin.

For this purpose, a **“qualifying entity”** includes any company, partnership, unincorporated association or trust which provides goods or services within or to the UK, regardless of its geographical base. A **“qualifying asset”** includes intangible assets such as trade secrets, designs and other intellectual property which are either used in connection with activities carried on in the UK or in the supply of goods or services to persons in the UK.

Since the Act focuses on the nature of the underlying activities or assets being acquired, no monetary thresholds apply.

The Act defines **“control”** in the broadest terms. With regards to qualifying entities, the definition captures any situation in which a buyer or investor is able to exercise material influence over the activities of that qualifying entity. In the case of qualifying assets, the term **“control”** means the ability to use, or direct or control the use of, that asset (or the ability to do so to a greater extent than before the acquisition).

More specifically, the Act provides that control over qualifying entities will be acquired where:

- the acquirer’s percentage interest in the shares or voting rights exercisable in the qualifying entity increases: (i) from 25% or less to over 25%; or (ii) from less than 50% to over 50%; or (iii) from less than 75% to over 75%. In the case of a partnership or other business medium which does not have shares, these thresholds relate to rights in the percentage shares of the surplus assets on a winding up; or
- the acquirer gains the ability to control sufficient voting rights in the qualifying entity with the power to pass or block resolutions governing the entity’s affairs; or
- the acquirer gains the ability to exercise material influence over the policy of the qualifying entity, such as by acquiring the right to appoint members of the board to influence its strategic direction. Notably, a holding of 15% or less of shares or voting rights may suffice here when considered alongside other material factors such as the acquirer’s status and sector expertise.

Control may therefore be acquired through a broad range of transactions including share transfers, share allotments, share buybacks and joint venture arrangements.

The Act specifically addresses numerous types of interests in qualifying entities, including joint holdings, holdings by connected persons, persons who share a common purpose, acquisitions of shares in holding companies in which a chain of control exists down to the qualifying entity and acquisitions of interests in nominees and in controllers of rights and interests over qualifying entities.

Importantly, an interest will not generally arise from the granting of security over shares

unless the terms of the security allow the holder to direct how the rights attaching to those shares are exercised prior to the occurrence of an event of default. The Act also contains a general exemption for rights exercised by administrators and creditors.

APPLICATION OF THE ACT TO OVERSEAS ENTITIES AND ASSETS

The Act applies to entities which carry on activities or supply goods or services to persons in the UK, regardless of their geographical base.

BEIS-issued guidance makes it clear that the Act also captures overseas entities which carry out research and development activities in the UK, have UK-based offices or branches or whose supervisory functions are performed in the UK, as well as those which supply goods to a UK hub (unless such hub only places orders to be sent elsewhere). The same guidance also explains that an overseas target will not be treated as a qualifying entity where its only nexus with the UK is one or more of the following:

- it has staff based in the UK who are working remotely from a non-UK office; or
- it has owners or investors based in the UK; or
- it buys goods or services from UK-based suppliers; or
- it has a parent with other subsidiaries that carry on activities in the UK; or
- its securities are listed on a regulated or exchange-regulated market in the UK.

If a qualifying asset is based outside the UK, it remains a qualifying asset if it is either used in connection with activities carried on in the UK or in the supply of goods or services to persons in the UK.

CONSEQUENCES OF ACQUIRING CONTROL OVER A QUALIFYING ENTITY OR A QUALIFYING ASSET

Categorisation of Transactions

Having established that a transaction constitutes or will constitute a Trigger Event, the next step is to determine:

- whether the transaction must be **notified** to, and thereafter cleared by, the ISU under the **mandatory notification regime** once this comes into force on the 4th January 2022 (the Act defines such transactions as “**notifiable acquisitions**”). The mandatory notification regime and its application is discussed later in this e-bulletin;
- whether the transaction, whilst not falling within one of the sensitive sectors, is one which might reasonably be regarded as having implications for national security and which may therefore be susceptible to the issue of a call-in notice if (and when) it comes to the attention of the ISU; or
- whether the transaction is neither a notifiable acquisition nor one which may be susceptible to the issue of a call-in notice.

In the last of these three cases, no action is required under the Act. However, where it is concluded that the transaction may be susceptible to the issue of a call-in notice, consideration should be given to the making of a **voluntary notification**.

We discuss the impending mandatory notification regime, the new call-in powers and the concept of notifiable transactions below.

Mandatory Notification Regime

When the Act and attendant regulations (which are currently in draft form and can be found [here](#)) come into force, acquisitions of qualifying entities which operate in one or more of 17 designated sensitive sectors must be notified and given advance clearance before proceeding to completion.

The 17 sensitive sectors are as follows:

Advanced materials	Critical suppliers to government	Quantum technologies
Advanced robotics	Cryptographic authentication	Satellite and space technologies
Artificial intelligence	Data infrastructure	Suppliers to the emergency services
Civil nuclear	Defence	Synthetic biology
Communications	Energy	Transport
Computing hardware	Military and dual-use	

On the 15th November 2021, the Government issued a [Guidance Note on notifiable acquisitions](#). This provides essential information on each of the above sectors and should be consulted in all cases where there is a concern that the target's activities may bring it within the mandatory notification regime.

After receiving notification of a transaction or proposed transaction in the prescribed online form, the ISU will have an initial review period of 30 working days to either clear the transaction or call it in for a full national security assessment. The ISU can also make requests for further information or ask to hold meetings with a party's representatives within this period.

If a call-in notice is served, a further 30 working days is allotted for the ISU to carry out a full risk assessment of the transaction. This assessment period is subject to an extension of up to a further 45 working days. Further extensions are possible, but will require the acquirer's agreement.

Notifiable acquisitions must not be completed until they have been notified and cleared. As such, a notifiable transaction which is completed without clearance will be **void**. Given the severity of this sanction, the Act provides for a retrospective validation process

which, in appropriate cases, will alleviate the consequences of an initial failure to notify and obtain clearance. However, sanctions for non-compliance may still be levied.

Exercise of Call-In Powers

The Act will confer power on the Secretary of State to issue call-in notices in respect of any transactions completed on or after the 12th November 2020, where he or she reasonably suspects that either a Trigger Event has taken place (being an acquisition of control over a qualifying entity or a qualifying asset, as above) or where arrangements are in progress which, if carried into effect, would give rise to a Trigger Event taking place. In either case, the acquisition must be considered to pose an actual or potential risk to national security.

A call-in notice may be issued at any time prior to the fifth anniversary of a transaction and must, in any event, be issued no later than 6 months after the Secretary of State (acting through the ISU) becomes aware of the deal. The call-in power cannot be exercised where the deal was previously approved following the making of either a mandatory or voluntary notification.

On the 2nd November 2021, the Government issued a statement providing information on how the Secretary of State expects to utilise the call-in power. The statement makes it clear that the Secretary of State will primarily (but not exclusively) focus on acquisitions involving one or more of the 17 sensitive sectors, and that the following three principal risk factors will be applied in making an assessment of risk to national security:

- Target risk: whether the target of the qualifying acquisition (the entity or asset being acquired) is being used, or could be used, in such a way that poses a risk to national security;
- Acquirer risk: whether the acquirer possesses characteristics which suggest that there is, or may be, a risk to national security as a result of the acquirer having control of the target; and
- Control risk: assessing the amount of control that has been, or will be, acquired through the qualifying acquisition, it being assumed that a higher level of control may increase the level of national security risk.

Sanctions and Penalties

Where national security risks are identified, the ultimate sanction available to the Secretary of State will be to unwind the transaction or otherwise block it from proceeding to completion. In practice, it is more likely that sanctions such as limiting the number of target shares that an investor can acquire or exercise voting rights over, restricting access to operational works or particular sites or forbidding access to certain commercial information will be utilised.

It is worth noting that failure to comply with the requirements of the Act could lead to fines of the greater of £10 million or up to 5% of worldwide turnover, a maximum 5 year prison sentence and director disqualification for up to 15 years.

Voluntary Notification

Whilst the Act does not require parties to notify or seek clearance for transactions which fall outside the scope of the mandatory notification regime, it does contain provisions which enable an acquirer to voluntarily notify acquisitions of qualifying entities or qualifying assets to the ISU. The same time periods apply here as for assessments made under the mandatory notification regime.

We believe that voluntary notification and clearance will become a useful tool for managing transaction risk. In particular, it has the potential to enable parties to create certainty around closing conditions and to dispense with, or at least limit, indemnification and escrow arrangements which might otherwise prove to be a stumbling block in negotiations.

PLANNING AHEAD

Despite the likelihood that only a fraction of deals will present real national security risks and thereby become subject to the full weight of the new regime, the Act will have a significant impact on the planning and implementation of transactions.

Clients contemplating any acquisition or investment (including transactions projected to complete before the 4th January 2022) should review the activities undertaken by the target and, where appropriate, seek guidance as to whether those activities might make the deal susceptible to being called-in once the Act comes into force or, if the timetable projects beyond 4th January 2022, require it to be notified and cleared as a condition to closing. We can assist clients with this analysis and will also advise on matters such as closing conditions and on the process for seeking informal guidance from the ISU on the likelihood of the deal being called-in.

As no formal notification procedure is currently in place, discussions with the ISU conducted prior to the 4th January 2022 will, at best, result in a non-binding indication from the ISU as to whether the proposed transaction is potentially at risk of being called in. However, such discussions carry the incidental benefit of limiting the period for serving a call-in notice to 6 months from the 4th January 2022, once the Act is in force.

We have advised numerous clients on the implications of the new regime and we will be happy to discuss any concerns that you may have around the application or potential application of the Act to any proposed or concluded transactions.

Please call Tim Maloney or Mark Taylor for further information.

This e-bulletin is issued to provide general guidance on the above topic. It is not comprehensive or exhaustive and does not constitute legal advice given by this Firm.