

UK To Adopt New Powers Over M&A Activity To Protect National Security

by Mark Taylor

Background

Draft legislation, which is currently being debated in the UK Parliament, will introduce a new regime granting the UK Secretary of State robust powers to review, vary or block acquisitions which may pose a risk to the national security of the UK. The proposed legislation is intended to provide the Secretary of State with powers similar to that of the Committee on Foreign Investment in the United States (“**CFIUS**”) while maintaining the UK’s position as an attractive forum for business and an openness to foreign investment.

The new legislation, known in its draft form as the National Security and Investment Bill and to be enacted as the National Security and Investment Act (“**NSIA**”), will not come into effect until later this year. However, when it becomes law it will have retroactive effect from 12 November 2020. It is therefore important that clients contemplating any transaction which has a UK element and is likely to come within the ambit of the new law obtain advice now to assess whether that transaction may be at risk of challenge once the Act becomes law. Note that notwithstanding that NSIA is not yet in force, the Secretary of State has implemented some procedures to assist clients and advisers in determining whether a deal completed prior to the Act coming into force may be at risk of challenge once the new law comes into effect (see below under “Current Application of NSIA”).

Summary

The new law will empower the Secretary of State to call-in for review a broad range of transactions involving a change of control of a UK entity or asset where it considers that they may have the effect of jeopardising UK national security interests.

In addition, NSIA will require any purchaser proposing to acquire a “qualifying entity” in one or more of 17 specified “sensitive sectors” to make a mandatory notification of that

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transaction to the Secretary of State in advance of the deal closing. A purchaser may not complete a transaction in this category until clearance has been given. As presently envisaged (and assuming that no amendments are made during the current parliamentary debates), a notifiable transaction which completes without prior notification will be void.

Where a transaction is not in a “sensitive sector” and so does not fall into the mandatory notification regime described above, the parties may still avail themselves of a voluntary notification regime. This might be considered to be prudent where the parties consider that, whilst not within one of the “sensitive sectors”, the transaction may none-the-less be considered by the Secretary of State as having the potential to jeopardise UK national security and is therefore susceptible to being called-in for review (and potentially, made the subject of remedial action under the new powers).

Finally, the new law will empower the Secretary of State to address risks to national security by imposing remedies which may range from the imposition of conditions to requiring offending transactions to be unwound to protect national security.

Application of the new law

The new law will apply to any acquisition of control of a qualifying entity or a qualifying asset at any time from and after 12 November 2020.

As is to be expected, the expression “**control**” is widely drawn. It will include, an acquisition: (i) of more than 15% of economic ownership or voting rights; (ii) the increase of economic ownership or voting rights from 25% or less to more than 25%; the increase of economic ownership or voting rights from 50% or less to more than 50%; or the increase of economic ownership or voting rights from 75% or less to more than 75%. It also includes securing the ability to exercise or control the exercise of voting rights sufficient to pass or block resolutions of the entity or otherwise becoming able to exert material influence on the policy of the qualifying entity.

A “**qualifying entity**” is any entity, including a company, a limited liability partnership, or any other body corporate. If the qualifying entity is based outside of the UK it is still a qualifying entity if it carries on activities or supplies goods or services to persons in the UK.

A “**qualifying asset**” is any asset, including land, tangible property, and ideas, information or techniques. If the qualifying asset is based outside of the UK it remains a qualifying asset if it is used in connection with activities carried on in the UK or the supply of goods or services to persons in the UK.

Of particular note is that fact that there are no materiality thresholds for transactions to which the new law will apply, whether monetary, market share related or otherwise and, as previously noted, the new law will apply equally to entirely UK domestic transactions and to cross-border transactions. As currently proposed, the new law will not contain a specific definition of “national security” for fear of facilitating loopholes.

Notification under the NSIA

Mandatory Notification Required for “Sensitive Sectors”

As mentioned earlier, where the proposed acquisition of control relates to a qualifying entity in a sensitive sector there is a mandatory obligation on a purchaser to notify the Secretary of State prior to that change of control so as to enable it to exercise its power of review to the extent that, following notification, it determines that the proposed transaction justifies review. A notifiable acquisition that completes without the prior approval of the Secretary of State will be deemed void and of no legal effect. It is however unclear how this will apply in practice to non-UK assets or transactions.

Under the legislation currently before Parliament, there are 17 “sensitive sectors”. These are: (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 the 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; and (17) Transport.

The wide ranging definition of “notifiable acquisition” in the draft legislation means that mandatory notification may be required for a broad range of transactions. For example, if a US-head-quartered group of companies that is being acquired includes a 15% minority ownership of an English transportation company, an acquisition of that group is likely to be a notifiable acquisition. Similarly, an investment round where a US venture capital fund increases its shareholding from 10% to 26% of an English AI start-up is also likely to be a notifiable acquisition.

It is expected that in the short, medium and, indeed, longer term, refinements will be made to the definitions of these sectors in the interests of clarity and workability.

Voluntary Notification Facility for other sectors

The NSIA will also provide a voluntary notification facility for acquisitions which are not in sensitive sectors but may none-the-less be susceptible to call-in because they may be regarded by the Secretary of State as jeopardising UK national security interests.

Effect of Notification

Notification and approval, whether made and obtained under the voluntary regime or the mandatory regime for sensitive sectors, will provide certainty to the buyer and the seller that the deal will not be at risk of being unwound or made subject to other sanctions at the instance of the Secretary for State in the future provided that the approval was granted on the basis of accurate disclosure of all material facts.

The “Call-In” Power

Issue of “call-in notice” following notification of an impending deal

After receiving a mandatory or voluntary notification of a transaction or proposed transaction, the Secretary of State has 30 working days to decide whether to issue a “call-in notice” or (where the notification is made in advance) to decide whether the proposed acquisition can proceed without further action. A call-in notice may only be issued where the Secretary of State reasonably suspects that the transaction or proposed transaction may pose a risk to national security. After a call-in notice has been issued, the transaction cannot be completed without the approval of the Secretary of State. Some initial guidance has already been issued on this aspect of the proposed new law (and it is likely that this will be subject to further refinement in the future).

The issue of a call-in notice will begin an initial 30 working day “**assessment period**” to allow the Secretary of State to consider whether the transaction poses a risk to national security. The assessment period may be extended by a further 45 working days and there is also scope for the purchaser and Secretary of State to agree a further voluntary extension to the assessment period. Following its review, the Secretary of State will determine either that remedies are required or that no further action is to be taken.

Issue of “call-in notice” at election of Secretary of State

Save where the Secretary of State has approved a deal after receiving a mandatory or voluntary notice, the Secretary of State may, on the grounds of national security, issue a call-in notice for any transaction to which the new law applies within 6 months of it becoming aware of that deal, for up to 5 years after the closing of the deal. The assessment period available to the Secretary of State following the issue of that call-in notice and the rights to extend that period, are as described in the paragraph above. If a notifiable acquisition was not approved, or if false information was provided to the Secretary of State with respect to any transaction, then the Secretary of State may issue a call-in notice. In the case of false information, the Secretary of State has 6 months from the day the information was found to be false to issue a call-in notice. However, in the case of the non-notification of a notifiable transaction no time limit applies.

The Secretary of State must, within 6 months of becoming aware of a notifiable transaction which has completed without having made a mandatory notification, or at the request of an interested party, either issue a call-in notice to review the transaction, or issue a validation notice, which confirms that no further action will be taken with respect to the transaction and, must importantly, that it is not void. Note that, in the absence of a validation notice, such transactions will be and remain void. This could have severe ramifications for third parties dealing with the affected entity. In the case of smaller technology companies which do not necessarily have the time or resource to evaluate whether the new law applies and which may be reluctant to incur advisors’ fees, we predict that there will be numerous instances of transactions completing without having made the required notification and that such companies and/or interested parties having dealings with them, will account for a high number of post transaction “validation” applications.

Powers and Sanctions

The Secretary of State will have wide-ranging powers to impose conditions and/or order the unwinding of transactions and/or the divestment of certain assets or operations where it considers this to be necessary to protect national security and, pending its final determination, may issue interim orders as it considers fit. Decisions of the Secretary of State may be challenged by way of judicial review.

A natural person who fails to comply with an order under the new provisions or who completes a notifiable acquisition without approval from the Secretary of State may incur imprisonment of up to 5 years or a fine of up to £10 million. If the offence is committed by a business, the fine may be anything up to the greater of £10 million or 5% of global turnover (including subsidiaries).

Current Application of NSIA

As NSIA is not yet law in the UK, there is currently no formal process for businesses to make notifications to, or to receive clearance from, the Secretary of State and buyers and sellers may conclude deals without regard to the notification provisions referred to above. However, once NSIA is enacted, deals concluded after 12 November 2020 which may have national security implications in the UK may be at risk of being called-in for review and possible sanction. This creates unwelcome uncertainty for buyers and sellers at the present time.

To assist in alleviating some of this uncertainty, the UK government is encouraging parties to engage in informal discussions with the incoming review body known as the “Investment Screening Unit” (“**ISU**”) to consider the prospective application of the NSIA to transactions which are likely to close during this interim period. If sufficient information is provided, the ISU has indicated that it is prepared to conduct a preliminary review and, where appropriate, provide a non-binding assurance as to whether a given transaction is likely to be called in for review when the new law comes into effect. At best, the obtaining of such non-binding assurance provides comfort to the parties. We also think it likely that the fact that information has been provided and reviewed prior to NSIA coming into force would mean that the 6 month call-in period allowed to the Secretary of State once it becomes aware of a transaction having occurred will commence on the date on which the new law comes into effect. Finally, the ISU has indicated that, while it will review all transactions which are notified to it, it is unlikely to issue call-in notices with respect to transactions which clearly are not at risk of jeopardising the national security of the UK.

Ask Dorsey London

Dorsey’s London Office can provide support and assistance to prospective buyers and sellers within and outside the UK who may be affected by the new law. Our experienced lawyers will provide advice on the potential impact of the new provisions to particular transactions and, where appropriate, will arrange and conduct discussions with the ISU to assist in assessing the risk for transactions conducted in the interim period.

