Simpson Thacher

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International Trade Alert

Reflective of Broader Global Trends Towards Increased Foreign Direct Investment Scrutiny, Parliament in United Kingdom Introduces Legislation to Modernize National Review Procedures for Transactions

November 12, 2020

On November 11, 2020, the Parliament of the United Kingdom ("U.K.") introduced the National Security and Investment Bill of 2020 (the "NSI Bill") to modernize the U.K.'s foreign direct investment ("FDI") screening process and strengthen its ability to investigate and intervene in transactions targeting U.K. businesses. The NSI Bill imposes mandatory notification requirements to the U.K. Department of Business, Energy and Industrial Strategy ("BEIS") for transactions involving investments in U.K. businesses operating in certain strategic sectors, a regime that will apply to investors from any foreign country.

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In the broader context, the NSI Bill is reflective of a global trend of tightening FDI screening in many major economies, including the United States, European Union member states, and Australia, among others. Particularly in the era of COVID-19, numerous countries around the world have implemented or expanded national security-focused FDI regimes designed to protect domestic businesses involved in sectors affecting national security and public order. International investors, including private equity sponsors and multi-national corporations engaged in cross-border transactions, should consider and analyze as part of their routine transaction diligence the plethora of new obligations arising pursuant to these changes, and in particular, the forthcoming rules in the United Kingdom.

Background

Under the U.K.'s current Enterprise Act 2002, the government has the power to scrutinise transactions and, where a transaction meets certain jurisdictional thresholds (including turnover or market share thresholds), issue a Public Interest Intervention Notice ("PIIN") (or a European Intervention Notice ("EIN") where the merger is notified under the EU Merger Regulation) on strictly defined public interest considerations. Under this existing regime,

only 12 PIINs/EINs have been issued on national security grounds since 2003, with no transactions ever being blocked.

Over the past three years, the U.K. government has made clear its intention to modernize the current regime. A series of interim reforms have recently been passed expanding the current regime, with a particular focus on ensuring the regime appropriately captures the technology sector (including multi-purpose computing hardware, advanced materials, AI and cryptographic sectors) as well as critical sectors involved in combatting public health emergencies (in response to the COVID-19 pandemic).

The NSI Bill now introduces a new U.K. FDI regime, to be administered by a new 100 person "Investment Security Unit" within BEIS. In contrast to the existing regime, which is largely focused on a limited number of high risk transactions and applied on a case-by-case basis, the new regime will result in the U.K. government being formally notified of all transactions in a broader scope of sectors, with the ability to take action to assess and address any national security risks. The U.K. government estimates the new regime will result in 1,000-1,830 transactions being notified per year.

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The NSI Bill will be subject to Parliamentary debate and possible amendment before being enacted.

New Investment Restrictions in the U.K.

The NSI Bill provides the U.K. Secretary of State of Business, Energy and Industrial Strategy (the "Secretary of State") with the authority to screen certain investments in the U.K. and address national security risks they involve, including the power to "call in" acquisitions of control[1] over entities, land, tangible assets, and ideas, information or techniques which have industrial, commercial, or other economic value (covering intellectual property), called "trigger events," that could pose a risk to the national security of the U.K.

The jurisdictional scope of the proposed regime is broad and will apply to investors from any country. The scope covers controlling investments in any entity that is either: (i) organized under the laws of the U.K.; or (ii) a non-U.K. entity if it carries on activities in or supplies goods or services to persons in the U.K. Moreover, an interest or right in a U.K. entity held

[1] For purposes of the NSI Legislation, a person gains "control" of an entity if (i) the percentage of shares or voting rights that the person holds in the entity increases from (a) from 25 percent or less to more than 25 percent; (b) from 50 percent or less to more than 50 percent; or (c) from 75 percent or less to more than 75 percent; (ii) a transaction enables the person to secure or prevent the passage of any class of resolution governing the affairs of the entity; or (iii) a transaction enables the person to materially influence the policy of the entity. Additionally, a person gains "control" of an asset if a transaction allows the person to (i) use the asset; or (ii) direct or control how the asset is used.

indirectly by a person (such as through a chain of entities) is treated under the NSI Bill as being held by that person, the implication of which is that a transaction involving a foreign target with a U.K. subsidiary could also fall within the scope of the NSI Bill's regime.

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Notification Procedure

As drafted, the NSI Bill contemplates both mandatory and voluntary notification procedures. Although the list is not exhaustive, BEIS has identified the following 17 sectors as being sensitive from a national security perspective, and certain investments in these industries will be subject to mandatory filing requirements under the new regime: **civil nuclear, communications, data infrastructure, defense, energy, transport, artificial intelligence, autonomous robotics, computing hardware, cryptographic authentication, advanced materials, quantum technologies, engineering biology, critical suppliers to government, critical suppliers to emergency services, military or dual-use technologies, and satellite and space technologies**. BEIS is currently consulting on which parts of these sectors should be included within the scope of the mandatory regime, to be precisely defined via secondary legislation.

Even if a transaction does not involve a listed sector, BEIS has indicated that certain transactions should be voluntarily notified if they may "raise a national security concern" or involve "the acquisition and control of certain assets, such as security software code and blueprints for sensitive equipment." Transaction parties may also contact BEIS for informal discussions to determine whether a proposed transaction falls within the scope of the new regime.

Assessment of National Security Risk

Once a mandatory or voluntary notification has been made, BEIS has 30 working days to determine whether there may be national security concerns raised by the transaction and issue a "call-in" notice. Where a "call-in notice" is issued, it has up to 30 working days to perform a detailed national security assessment (which in some instances can be extended by a further 45 working days) and to determine whether to impose remedies or take no further action. When making its assessment, the Secretary of State must consider (i) the target risk, including the nature of the target and whether it is in an area of the economy where risks are

likely to arise; (ii) the trigger event risk, including the type and level of control being acquired; and (iii) the acquirer risk, including the extent to which the acquirer and those in ultimate control of the acquirer raise national security concerns.

The prescribed time limits for review and assessment periods, together with the avenues of appeal, provide investors with helpful procedural clarity (contrasted with the informal processes currently adopted on a case-by-case basis).

As part of this review process, the U.K. government may require that the transaction parties provide additional information relevant to the transaction and may issue an interim order limiting the parties' actions until a final decision is made. BEIS may also impose conditions on the transaction, including "altering the amount of shares an investor is allowed to acquire, restricting access to commercial information, or controlling access to certain operational sites or works." In extreme circumstances, the U.K. government may also issue orders forbidding the transaction's consummation, or unwinding completed transactions. Once BEIS concludes its assessment (including any conditions imposed), it cannot revisit its decision, although its orders may be amended. The NSI Bill includes a safeguarding mechanism for parties to appeal orders where necessary.

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Other Considerations

The NSI Bill creates a number of civil and criminal sanctions that would apply in the event of non-compliance. Civil sanctions include fines of up to five percent of worldwide turnover for transaction parties or £10 million, whichever is greater. Criminal penalties could include imprisonment of up to five years. The criminal penalties can apply to officers of the company such as directors (broadly defined to include shadow directors and those whose interests or rights in the company enable them to materially influence its policy) and managers. Moreover, transactions covered by the mandatory notification requirement which close prior to receipt of BEIS clearance will be deemed void.

Finally, the NSI Bill grants BEIS with a five-year retroactive power (reduced to 6 months once BEIS is made aware of the transaction) to call in transactions that were not previously notified but which may raise national security concerns. To grant businesses and investors certainty regarding historical deals, this retrospective authority will only apply to transactions that take place after the NSI Bill's introduction to Parliament, *i.e.*, those that take place on or after November 12, 2020. For transactions that are currently in progress, BEIS encourages parties to informally engage with the U.K. government to provide some

level of certainty as to the application of the existing regime and the new NSI Bill to their transaction, ahead of its expected enactment.

Key Takeaways

The NSI Bill establishes a new FDI regime in the U.K. that will result in increased government screening of transactions for national security risks. Given the absence of any safe harbours and the broad jurisdiction set out in the NSI Bill, the new regime will play a much bigger role than the existing U.K. regime in M&A considerations going forward. Cross-border mergers, acquisitions, and investments where the target maintains relevant touchpoints in the U.K. should be analysed early to determine whether a mandatory notification is required, or if a voluntary notice would otherwise be advisable.

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While the NSI Bill is still under review in Parliament, these rules should be considered for any transaction that is expected to be consummated on or after November 12, 2020 given the retrospective language included in the proposal. The introduction of a mandatory notification requirement, coupled with the potential for the retroactive review of non-notified transactions, will require much more attention during transaction diligence to determine the applicability of this new regime and its potential impact on deal timing and certainty.

While the scope and level of transactional diligence is often determined on a case-by-case basis taking into consideration the facts and circumstances of a proposed investment, international investors are increasingly focused on global FDI regimes and often call on counsel to identify and assess the universe of jurisdictions triggered by the investment. Simpson Thacher & Bartlett offers deep experience navigating the complexities of foreign direct investment screening regimes, regularly coordinates and oversees the worldwide activities of local counsel on behalf of clients engaging in major international transactions, and continues to monitor regulatory developments in this space.

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