A&O SHEARMAN

U.K. National Security and Investment Act

2024

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Introduction

The National Security and Investment Act 2021 (NSI Act) introduced a new standalone regime which drastically expanded the U.K. government's powers to scrutinize investment on national security grounds.

THE REGIME IN BRIEF

The NSI Act came into force on January 4, 2022. The new regime replaced the national security public interest intervention regime which, like U.K. merger control rules, was not a mandatory notification system.

The NSI Act introduced a mandatory and suspensory notification regime (i.e., approval is required before closing can occur) for certain acquisitions of "qualifying entities" that carry out activities in the U.K. specified in one or more of 17 sensitive sectors of the economy.

The NSI Act also introduced a new power enabling the U.K. government to "call in" transactions (including the acquisition of assets and other commercial agreements such as license or R&D agreements) in the wider economy that may raise national security concerns. This call-in power potentially applies for up to five years after completion of the relevant transaction.

Transactions may be voluntarily notified to the government in order to avoid the uncertainty of whether they might be called in for screening by the government on its own initiative.

Ultimately, the government can impose remedies to address any national security concerns raised by a transaction, including unwinding or prohibiting the transaction.

Civil and criminal penalties can be imposed for a breach of the NSI Act. It is a criminal offense to complete a transaction that triggers the mandatory notification requirement. A transaction that is completed without being notified and approved will be legally void.

A SIGNIFICANT IMPACT IN PRACTICE

The government is clear that the U.K. remains open to foreign investment and that the NSI Act has not changed this position. It states that the regime is "light-touch" and "proportionate" and that most transactions will be cleared without any intervention and in a short timeframe (the initial review period, within which the overwhelming majority of notifications are approved, is 30 working days).

However, the far-reaching scope of the regime and the resulting administrative burden and transaction risk inevitably has a significant impact on investors looking to invest directly or indirectly in the U.K.

Parties to transactions falling in the scope of the NSI Act should ensure that they:

- build into the transaction timetable the time to assess and, if necessary, to notify and obtain any approvals
- are conscious of national security risk when dealing with counterparties
- include appropriate contractual protections in the deal documentation

Mandatory notification

The NSI Act provides for a mandatory and suspensory notification regime for certain acquisitions of entities that carry out activities in the U.K. specified in one or more 17 sensitive areas of the economy. Any notifiable acquisition that is completed without first notifying and gaining government approval is legally void and civil and criminal penalties could be imposed.

ACQUISITIONS IN SCOPE

The mandatory notification regime applies to certain acquisitions of "qualifying entities" that carry out activities in the U.K. specified in one or more of 17 sensitive areas of the economy (see below).

The definition of "qualifying entities" is broad. It includes companies, partnerships, LLPs, unincorporated associations and trusts. Individuals are not caught. A foreign entity can be a qualifying entity if it carries on activities in the U.K. or supplies goods or services to persons in the U.K. (see the section on extraterritorial effect below).

Only acquisitions that amount to "trigger events" are caught by the regime. For the purposes of the mandatory notification requirement, these are:

- transactions resulting in the increase of shares/voting rights held in the qualifying entity to more than 25%, more than 50% or to 75% or above
- acquisitions of voting rights which enable the acquirer to pass or block any class of resolution governing the affairs of the qualifying entity

Significantly, corporate restructures and reorganizations can also qualify as notifiable acquisitions. This means that purely internal reorganizations with no change to the ultimate controlling entities may require notification and prior approval.

Acquisitions of assets do not require mandatory notification. However, the government has the power under the NSI Act to bring assets in the scope of the mandatory regime. To date there are no indications that it plans to do so.

THE 17 DESIGNATED SECTORS

The 17 sensitive sectors are set out in detailed regulations. The government has published guidance to help determine which activities fall within the scope of the specified sectors.

Broadly, the sectors are:

- advanced materials
- advanced robotics
- artificial intelligence
- civil nuclear
- communications
- computing hardware
- critical suppliers to the government
- cryptographic authentication
- data infrastructure
- defense
- energy
- military and dual use
- quantum technologies
- satellite and space technology
- suppliers to emergency services
- synthetic biology
- transport

SEVERE CONSEQUENCES OF NOT NOTIFYING

For the acquirer, completing an acquisition that falls within the mandatory notification regime without notifying and receiving approval risks significant civil and criminal penalties (see further below).

However, of relevance to all parties, the transaction will also be rendered automatically legally void.

It is possible to apply to the government for retrospective validation of a transaction that has been completed without notifying and obtaining approval. However, this does not 'cure' the civil and criminal liability for the missed notification.

Call-in power

Even if mandatory notification is not required, the government has a broad call-in power review transactions that it reasonably suspects have given rise to, or may give rise to, a risk to national security. Transactions can be called in up to five years post-completion (or six months where the government is aware of them).

TRANSACTIONS IN SCOPE

The government's call-in power relates to the wider economy, i.e., it goes beyond the 17 sensitive sectors which are subject to the mandatory notification regime. There are no turnover or other materiality thresholds, and the call-in power can apply to a broader range of transactions than the mandatory notification regime.

Acquisitions of **qualifying entities** (as described above) which amount to a trigger event are in scope. The relevant trigger events are broader than under the mandatory notification regime:

- transactions resulting in the increase of shares/voting rights held in the qualifying entity to more than 25%, more than 50% or to 75% or above
- acquisitions of voting rights which enable the acquirer to pass or block any class of resolution governing the affairs of the qualifying entity
- acquisitions which enable the acquirer to materially influence the policy of a qualifying entity (here, material influence is interpreted in a similar way as under the U.K. merger control rules, e.g., the right to appoint members of the board enabling influence of the entity's strategic direction).

Acquisitions of **qualifying assets** which amount to a trigger event are also in scope. Qualifying assets include:

- land
- tangible moveable property
- ideas, information or techniques which have industrial, commercial or other economic value (i.e., intellectual property—examples given include trade secrets, databases, source code, algorithms, formulae, designs, plans, drawings and specifications, and software).

Assets situated outside the U.K. may also be in scope—see the extraterritorial section below for more details.

The trigger events relating to asset acquisitions are acquisitions of rights or interests in (or in relation to) the asset which enable the acquirer to:

- use the asset, or use it to a greater extent than before the acquisition, or
- direct or control how the asset is used, or direct or control how it is used to a greater extent than before the acquisition

VOLUNTARY NOTIFICATION

A party to a completed or planned transaction that is not covered by the mandatory notification regime may choose to submit a voluntary notification.

The main benefit of submitting a voluntary notification is legal certainty as to whether or not the government will call in the transaction. This must be balanced against the time and cost of making a notification and waiting for approval (and how this may impact the transaction timetable).

There are risks to deciding not to voluntarily notify a transaction that potentially raises national security concerns. The government could call it in (and issue orders, including imposing conditions and even unwinding the transaction) up to five years after the transaction has taken place. Parties should consider the likelihood of third-party complaints as part of their assessment of whether to voluntarily notify.

It is possible to complete a transaction before submitting a voluntary notification. If a voluntary notification is submitted prior to closing and the transaction is called in, the government has the power to prevent completion (see the section on interim orders below for more on this power).

LIKELIHOOD OF CALL IN

The government can only call in transactions that it reasonably suspects give rise to or may give rise to a risk to national security.

The government has published guidance on how it expects to use its call-in power. It will consider three risk factors to assess the likelihood of the acquisition giving rise to a risk to national security.

1. Target risk

The government will consider what the target does, and what it is used for or could be used for.

In particular, the following transactions are more likely to be called in:

- acquisitions of control through material influence over qualifying entities in the 17 designated sensitive sectors
- acquisitions of entities which carry out activities closely linked to the activities in the 17 sensitive sectors
- where the target holds a sensitive supply relationship to the government in the 17 sensitive sectors or related areas
- acquisitions of assets that are, or could be, used in connection with the activities in the 17 sensitive sectors, or closely linked activities
- acquisitions of land which is, or is proximate to, a sensitive site (e.g., critical national infrastructure sites or government buildings), potentially taking into account the intended use of the land

The government expects that it will be rare to call in acquisitions of assets which do not fall into the above categories. While government guidance is that call in of asset acquisitions will be rare compared to call in of acquisitions of entities, in practice asset deals have been subject to intervention and final orders (i.e., remedies and prohibition).

The government may also consider whether there are national security risks presented by cumulative acquisitions across different or related sectors, or within the same sector or supply chains.

2. Acquirer risk

The government will consider the characteristics of the acquirer. This can include past behavior, the intent of the acquisition and the acquirer's existing capabilities. The past behavior and intent of linked parties may also be relevant.

The government will not make judgements based solely on the acquirer's country of origin, and does not regard all state-owned entities, sovereign wealth funds or other entities affiliated with foreign states as being inherently more

likely to pose a national security risk. But it will consider an acquirer's ties or allegiances to states or organizations hostile to the U.K.

In some cases, a target will be so sensitive that it will need to be investigated regardless of the acquirer. The government will consider each acquisition on a case-by-case basis even if the acquirer has previously notified the government of an acquisition and that acquisition has been cleared.

3. Control risk

The government will consider the amount of control the acquirer will gain over the target's activities, policy or strategy.

For example, a greater degree of control may increase the possibility of a target being used to harm national security and may mean a call in is more likely. A history of passive or long-term investments, or voting rights being held by passive investors compared to direct owners, may indicate less risk.

The government may consider whether the amount of control gives the acquirer the ability to influence the policy of the target, e.g., through access to board seats.

It may also consider the amount of control an acquirer could gain through exercising financial instruments such as loans, conditional acquisitions, futures, and options.

Extraterritorial effect

The NSI Act primarily concerns U.K. companies and U.K.-based assets, but the wide scope of the regime means that acquisitions of many foreign entities/assets will also fall in scope.

FOREIGN ENTITIES

As noted above, a foreign entity may be in scope if it:

- carries on activities in the U.K., or
- supplies goods or services to people in the U.K.

Examples of when this is likely to be the case include where the foreign entity carries out research and development in the U.K., has a U.K. office from which it does business, or supplies goods to a U.K. hub which then sends them onto other countries.

On the other hand, a foreign entity is unlikely to be in scope just because it, e.g., has staff based in the U.K. who work remotely for a non-U.K. office, has owners/investors based in the U.K., buys goods/services from U.K.-based suppliers, or lists securities on a regulated market in the U.K..

FOREIGN ASSETS

Land or tangible moveable property situated outside the U.K. may be in scope if it is used in connection with:

- activities carried on in the U.K., or
- the supply of goods or services to people in the U.K.

This could cover, for example, machinery located overseas used to produce equipment that is used in the U.K.

OUTWARD DIRECT INVESTMENT

Outward Direct Investment may also be scrutinized under the NSI Act. This includes the transfer of technology, intellectual property and expertise as part of the investment or when forming joint ventures overseas.

USE OF CALL-IN POWER FOR FOREIGN ENTITIES/ASSETS

The call-in power for foreign entities and assets is more likely to be used for acquisitions connected with the 17 sensitive sectors or closely linked activities.

The government will consider how strongly the entity or asset is connected to the U.K. and to what extent people in the U.K. rely on those entities or assets.

Process and timing

Notifications are made online to the Investment Security Unit. The Secretary of State for the Cabinet Office will decide within certain time limits whether to call in a transaction for further assessment and whether or not to approve it.

MAKING THE NOTIFICATION

Notifications are made via an online portal to the Investment Security Unit, which sits within the Cabinet Office.

There are separate forms for mandatory, voluntary and retrospective validation notifications.

Parties need to disclose details of the ownership/structure of the acquirer and the qualifying entity (or asset), the sectors involved, and activities of the qualifying entity.

TIMING

The Secretary of State for the Cabinet Office is the ultimate decision-maker and must reach decisions under the regime within certain time limits.

Where a mandatory or voluntary notification is made and accepted as complete (which typically takes around a week), the Secretary of State then has a 30 working day "review period" to decide whether to approve or call in an acquisition for further investigation of the national security risk.

If the Secretary of State decides to call in the transaction, there is a further 30 working day "assessment period". This assessment period can be extended by the Secretary of State by 45 working days. An additional "voluntary period" can also be agreed with the acquirer.

Notably, it is only during the in-depth assessment period—but not the initial review period—that requests for information and attendance notices (which require individuals to attend interviews) stop the clock on the timelines.

At the end of the assessment period the Secretary of State will make a final decision on whether or not to approve the transaction, with or without conditions.

INTERIM ORDERS

During the assessment period the government may issue interim orders. These are designed to prevent action that could undermine any conditions that might ultimately be put in place to address national security concerns.

The government has indicated that interim orders may be used to prevent the exchange of confidential information and/or access to sensitive sites or assets. They may also prevent the progress (or completion) of an acquisition.

Interim orders can be imposed on persons outside the U.K. in certain circumstances.

CONFIDENTIALITY

The government will not routinely make public that it has called in an acquisition for national security assessment or that it has issued an interim order. It will inform the acquirer if it intends to do so.

The final decision

The Secretary of State will decide whether the transaction will give rise to a risk to national security and, if so, whether to impose certain conditions or to block the deal.

NATIONAL SECURITY IS NOT DEFINED

Under the NSI Act, transactions can only be assessed on national security grounds. The government cannot use its powers to intervene on broader economic or public policy grounds.

The NSI Act does not set out the circumstances in which national security is, or may be, considered at risk. The government says that this reflects its longstanding policy to ensure that national security powers are sufficiently flexible.

However, government guidance highlights some areas which may amount to harm to U.K. national security. These include whether an acquisition:

- may lead to disruption, erosion or degradation to critical national infrastructure, or present risks to governmental and defense assets (including risks relating to supply chains and ensuring that the acquisition does not create a dependency that could lead to a national security risk)
- may lead to disruption or erosion of the UK's military, intelligence, security or technological capabilities
- enables actors with hostile intentions to build defense, intelligence, security or technological capabilities which may present a national security threat to the UK now or in the future (e.g., by acquiring goods, technology, sensitive information (including data), intellectual property, know-how or expertise

REMEDIES AND PROHIBITION

The Secretary of State can impose a final order to address any national security concerns. Before making a final order, the Secretary of State must consider any representations from the parties.

The final order can prohibit the transaction (or require it to be unwound where it has already been completed).

It can also impose remedies. Examples of possible remedies include:

- limits on the level of shareholding that can be acquired or excluding certain parts of an entity or certain assets from the acquisition
- requiring government approval of proposed business locations or disposals/transfers of significant assets
- maintenance of strategic capabilities in the U.K. and continuity of supply to the U.K. government
- restricting access to commercial information or IP
- restrictions on the target's board membership and/or management and staff
- controlling access to certain sites or works
- requiring regular on-site security inspections, staff interviews and reports on compliance

Final orders can apply to persons outside the U.K. in certain circumstances (e.g., if the person is carrying on business in the U.K.).

A publication notice containing information about the final order (such as to whom it applies, the start date and a summary) will be published, but not the order itself.

Final (as well as interim) orders can be reviewed, varied and revoked by the Secretary of State. The parties can request a review of any order in certain circumstances.

Parties can challenge the Secretary of State's decision in court.

RELATIONSHIP WITH THE U.K. MERGER CONTROL REGIME

A transaction may undergo parallel reviews in the U.K.—on both antitrust grounds (by the Competition and Markets Authority (CMA)) and on national security grounds (by the government).

The NSI Act gives the Secretary of State the power to direct the CMA to take, or not take, action under the merger control regime in relation to the transaction. This effectively means that the national security issues can "trump" antitrust concerns.

Sanctions and enforcement

There are severe sanctions for breaching the NSI Act. These can be both civil and criminal and include significant fines and even prison sentences.

A RANGE OF PENALTIES

The NSI Act sets out a variety of civil and criminal penalties for non-compliance with the regime.

For example, failing to notify a transaction which falls in the scope of the mandatory notification regime is an offense subject to fines and up to five years in prison. Civil penalties can also be imposed—maximum fines of 5% of total global turnover or GBP10 million (whichever is higher).

The same penalties apply for failure to comply with an interim or final order.

Remember also that where a transaction is not notified as required under the mandatory regime, it will automatically be void.

Other breaches, such as failing to comply with information requests or attendance notices, supplying false or misleading information, or destroying/altering information, could also lead to fines and prison sentences.

ENFORCEMENT IN PRACTICE

The government is keen to point out that its aim is to support acquirers to meet their obligations under the regime. It may provide advice, reminders and warning letters, require implementation of an improvement plan or agree actions with parties before applying for civil injunctions, imposing civil penalties or instituting criminal proceedings.

This suggests that the government does not intend to automatically impose sanctions in all cases of non-compliance.

Interestingly, despite receiving a number of applications for retrospective validation, the government has not yet issued any penalties or concluded any criminal prosecutions.

As the regime continues to mature, it remains to be seen if the government will take a tougher approach to non-compliance, in particular missed filings.

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