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Client Alert

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United Kingdom: New UK 'CFIUS' regime kicks in

Commencement of new regime and powers under the National Security and Investment Act 2021, bringing to life the UK's first dedicated foreign investment screening mechanism

In brief

On 4 January 2022, the new UK foreign investment review regime under the National Security and Investment Act ("**NSI Act**", available here) will come into force, completing the overhaul of the UK's foreign investment rules and commencing operation of a standalone foreign investment screening regime for the first time in the UK.

The new rules require businesses and investors to submit mandatory notifications for certain acquisitions of and investments in companies active in 17 key sectors of the economy. They also grant the UK Government extensive powers to investigate and impose conditions on a wide range of transactions (including both corporate investments and asset transactions) on national security grounds.

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Five key takeaways about the National Security and Investment Act

- From 4 January 2022, a **mandatory notification must be made for acquisitions and investments in companies that carry out activities in 17 key sectors of the UK economy.** It will also be possible to submit voluntary notifications outside these sectors and for a broader range of transactions. Notifications will be submitted to the UK Government's recently established Investment Security Unit via a new online portal.
- From 4 January, **the UK Government will also be able to "call in" transactions for in-depth review where it suspects they give rise to a national security risk**, including in respect of transactions that closed since 12 November 2020. At the end of an assessment period, the UK Government will either clear, impose conditions on, or unwind or block an acquisition.
- The jurisdictional criteria in the NSI Act are extremely broad, and **the new regime catches the acquisition of intangible assets such as IP, certain minority investments, non-UK transactions and even internal corporate reorganizations**.
- Businesses will need to self-assess whether they must submit a mandatory filing. **Non-compliance with the mandatory regime risks significant criminal and civil sanctions**, while mandatorily notifiable investments that complete without being cleared under the NSI Act will be **void**.
- Acquirers, sellers and parties providing finance should **carefully assess the risk profile of their transactions** and consider the possibility of review and any potential remedies or conditions that may be imposed, particularly where transactions involve: (1) businesses that supply or support **defence or security related services, critical infrastructure, or strategic or emerging technologies**, (2) **buyers with higher risk characteristics**, or (3) acquisitions providing a **high degree of control** over, or transfer of, a target's sensitive activities.

In more detail

We set out below the key features of the new regime and main considerations for businesses and investors following the introduction of the new rules, based on our analysis of the legislation and our extensive engagement with the UK Government over the last year. This includes our recent webinar discussion (available here) exploring the regime with the UK Government (for which we were pleased to be joined by Chris Blairs, Deputy Director for NSI Policy at the Department for Business, Energy & Industrial Strategy ("BEIS"), and Daniel McCarthy, Senior Policy Advisor for NSI at BEIS), and our in depth discussions with BEIS and other key UK Government departments on industry-specific activities, technologies and issues.

Our Foreign Investment Review team has substantial expertise in liaising with UK Government stakeholders in relation to issues of national security, critical infrastructure and strategic technologies and in advising clients on all aspects of the NSI Act. Follow our UK and global insights on investment review developments and trends on our Foreign Investment and National Security Blog and please do contact a member of our team directly if you have any questions regarding the implications of the NSI Act for your current and future transactions.

What has changed?

The new UK foreign investment regime has been several years in the making, and follows a consultation and a white paper on national security and infrastructure investment published in 2018. We have previously published blog posts and client alerts following the progress of the new regimes through the legislative process since the NSI Act was first introduced as a Bill before the UK Parliament on 11 November 2020 (find and follow UK foreign investment updates and developments our blog or see our alert following the announcement of the timetable for the new regime to be implemented).

Since the primarily legislation was finalised in April 2021, the UK Government has passed the secondary legislation needed to specify the scope and operational effect of the new regime and has published guidance providing further explanation of how many of the core elements will be implemented in practice. The UK Government has also consulted both formally and informally on various aspects of the regime. In particular, the definitions of the 17 mandatory notification sectors and the content of the notification form have been subject to an intense consultation process.

From 4 January 2022, the NSI Act regime will be in full effect, meaning that:

- The mandatory notification requirement will apply to certain corporate transactions. Criminal and civil sanctions can be applied where these transactions are completed without clearance and these non-notified transactions may be automatically void;
- The UK Government will be able to make use of its call-in powers, investigatory powers and an ability to block, unwind, or impose conditions on transactions (including doing so retrospectively for transactions that have closed since 12 November);
- The Investment Security Unit (ISU) within the Department for Business, Energy & Industrial Strategy (BEIS) will be operational and the online notification portal will be available.

Mandatory Screening for 17 key sectors of the economy

The mandatory notification regime under the NSI Act requires acquirers to notify the ISU in advance of transactions where they will acquire a right or interest in relation to any entity that carries on activity in the UK in one of 17 specified sectors of the economy, where this:

- results in them holding more than 25%, more than 50%, or 75% or more of the total shares or voting rights in the entity, or
- enables them to secure or prevent the passage of (any class of) resolutions governing the affairs of the entity.

(a "mandatory notification trigger event").

The requirement applies to indirectly held interests and rights, to non-UK entities that carry out activities in a specified sector in the UK and to intra-group transactions / reorganisations.

The 17 key sectors of the economy where the mandatory notification requirement will apply are defined in the Notifiable Acquisition Regulations. This list includes traditionally sensitive areas (such as defence, military and dual use, and critical suppliers to UK Government), critical infrastructure (such as energy, communications, and data infrastructure), and emerging technologies (such as artificial intelligence, advanced robotics, and synthetic biology).

Businesses will need to self-assess whether they must submit a mandatory filing. To assist with this, the UK Government has also released Guidance on Mandatory Sector definitions, which expands on many of the technical terms used in the Notifiable Acquisitions SI, and provides clarity on what the UK Government sees as being sensitive areas and drivers for national security risk for each sector. While the Guidance does not directly specify the activities within the Mandatory Sector that will be at greatest risk of being "called in" for a full review following notification, it does provide further insights beyond the legal definitions in the SI. This clarification is particularly useful given that the UK Government will have a degree of discretion around whether a transaction will be considered 'closely related' to one of the 17 sectors as we discussed with BEIS in our webinar.

Mandatory notification sectors

1. Advanced Materials
2. Advanced Robotics
3. Artificial Intelligence
4. Civil Nuclear
5. Communications
6. Computing Hardware
7. Critical Suppliers to Government
8. Cryptographic Authentication
9. Data Infrastructure
10. Defence
11. Energy
12. Military and Dual-Use
13. Quantum Technologies
14. Satellite and Space Technologies
15. Suppliers to the Emergency Services
16. Synthetic Biology
17. Transport

We have engaged in detail with BEIS and relevant UK Government departments on the scope and interpretation of a number of these sectors, both in relation to the proposed and final definitions and the accompanying guidance and this, coupled with our longstanding experience in advising on trade and national security matters, means that we are well placed to support businesses with assessment of whether target activities fall in scope of the 17 mandatory notification sectors.

Call-in powers

The NSI Act grants the UK Government the ability to review transactions (including acquisitions outside the mandatory notification sectors and share or asset transactions that are not subject to the notification requirement) where a trigger event occurs and the Secretary of State reasonably suspects that this may give rise to a risk to UK national security. This can apply to:

- Acquisitions of rights or interests relating to entities (including those outside the 17 mandatory notification sectors) that result in holdings of share or voting rights meeting the thresholds for the mandatory notification trigger events;
- Acquisitions of rights or interests that, alone or together with other interests or rights held, enables the acquirer to exert material influence over an entity;
- Acquisitions of rights or interests in relation to an asset that allow the acquirer to use the asset or to direct or control how the asset is used (or to do this to a greater extent than prior to the acquisition).

The call in power is only available where the UK Government reasonably suspects a transaction may give rise to a risk to national security. The UK Government has published a statutory statement on how the call-in power will be used. This explains the risk factors the Secretary of State will take into account and areas of the economy where a call-in is most likely to take place. The statement notes that a call-in is more likely happen where entities undertake activities in or "closely linked" to the mandatory notification sectors or where assets are or could be used in connection with such activities.

Broad Jurisdictional Scope

Unlike many foreign investment systems globally, the NSI Act does not apply any monetary or share of supply jurisdictional thresholds to identify qualifying transactions. Instead, the UK Government has jurisdiction to call-in any transaction that constitutes a "trigger event" (as described in the sections on mandatory screening and call in powers above) for an in-depth national security assessment under the new regime, regardless of its size or value.

A range of legal structures (including companies, limited liability partnerships, unincorporated partnerships, associations and trusts) can be the target of a trigger event.

Acquisitions of assets comprising land, tangible moveable property or any ideas, information or techniques which have industrial, commercial or economic value are also in scope, covering purchases of bare assets including IP, trade secrets, databases, source codes, algorithms, formulae, designs/plans and software. Acquisitions of assets by consumers are excluded, other than for land or sensitive items subject to export controls.

The new regime has an expansive geographic nexus, capturing acquisitions of non-UK entities and assets (e.g., foreign IP or infrastructure) as long as they are carry on activities in or supply of goods or services into the UK or are used for this purpose. For example, an acquisition of off-shore deep-sea cables which supplies energy to the UK could in principle satisfy the nexus requirements.

Although the political focus is likely to be on foreign inward investment, the rules apply to transactions by both UK and non-UK acquirers alike. The regime does not provide for any exemptions based on the country in which the investor is based (nor does it provide for an exemption for or pre-approval of investors or certain categories of investor).

The UK Government has issued guidance about the extraterritorial reach of the NSI Act to explain how the NSI Act could affect people or acquisitions outside the UK. This guidance explains that an overseas or IP/intangible asset is likely to be in scope of the regime if it is used (i) by someone in the UK, (ii) by someone outside the UK to supply goods or services to the UK, (iii) to generate energy or materials that are used in the UK. The guidance restates that there would always need to be either an activity carried on in the UK (and in the case of an asset, it needs to be used in connection with such an activity) or a supply of goods or services to people in the UK (and in the case of an asset, it must be used in connection with such supply).

Notification process - timeline and procedure

A UK national security filing will need to be accommodated in pre-closing timetables. Once a notification has been accepted by the ISU as complete during a period of pre-notification which could last several weeks, the UK Government will be required to complete its initial screening within 30 working days. The majority of transactions are unlikely to raise significant national security concerns requiring the deal to be called in for a longer in-depth review.

- **Initial screening period**: If a transaction is notified (voluntarily or as a result of a mandatory requirement) the UK Government will have a maximum of 30 working days from the moment the notification is declared complete to perform an initial screening. The aim of the screening stage is for the UK Government to decide whether to call in the deal for a more in-depth assessment.
- **Assessment period**: If required, a detailed national security assessment will start once the UK Government issues a call-in notice. This can occur following the screening period (for notified transactions) or when the UK Government decides to call-in a transaction which has not been notified to it. The detailed national security assessment comprises an initial review period of 30 working days, followed by a possible extension of an additional 45 working days. Thereafter, an additional extension must be mutually agreed. The UK Government has powers to require that businesses and investors provide any information that may be relevant to the transaction.
- Following the assessment period, the UK Government may impose any remedies it considers necessary and proportionate to prevent the identified national security risks. Remedies may include restricting the permitted share ownership levels, restricting access to commercial information or sensitive sites and (as a last resort) prohibition or unwinding of transactions.
- The call-in and assessment process will be largely opaque - the UK Government has referred to sensitivity around publicising where it believes national security risks could arise. The UK Government intends to publish call-in decisions and decisions in cases cleared without remedies only where this is necessary and appropriate (e.g., where one of the parties is a listed company with disclosure obligations) and to provide aggregated information in annual reports of activity to Parliament regarding timelines, efficiency and outcomes. Only information about decisions on cases resulting in remedies will be published.
- There is no opportunity to appeal the UK Government's substantive decision on the merits (though full appeals of any civil penalty decisions will be allowed). It will only be possible to seek judicial review of decisions on grounds such as irrationality, illegality or procedural impropriety. The UK Government considers that it is best placed to assess the national security risk which decisions in this proposed regime are intended to address and it would not be appropriate for courts to remake these decisions.
- The national security review timelines will run in parallel with any UK merger control process conducted by the CMA. However, the UK Government will have the power to override any competition remedies proposed by the CMA where following the national security assessment such remedies would be contrary to the UK Government's national security interests.

Notification forms are submitted to the ISU via an online portal. The format and details required for mandatory and voluntary notifications are set out in the Prescribed Form and Content of Notices Regulations. Broadly speaking, the notification forms require details of:

- the acquirer;
- the target and trigger event, including:
    - any relevant mandatory notification sectors,
    - UK Government security classifications and national security vetting clearances, UK regulatory licences (e.g., energy or communications), dual-use items (for which details required are notably wider than the mandatory notification sector definition), and UK Government supply relationships and R&D funding,
    - Pre- and post-acquisition ownership structure charts for the qualifying entity,
    - Non-UK Government roles in operation or decision making;
- arrangements between acquirer and other parties (e.g., other investors);
- any related approvals, notifications or submissions (including overseas);
- the anticipated timeline for the transaction.

Further formalities for procedure of service of documents on and by the UK Government are set out in the Procedure for Service Regulations.

Consequences of failure to notify

Penalties for failure to notify

The mandatory regime is suspensory, meaning that transactions cannot be completed until clearance has been received. If a transaction that is subject to mandatory notification completes prior to obtaining clearance, it will be legally void.

Furthermore, if an acquirer fails to submit a mandatory filing, they risk significant financial penalties (up to 5% of total worldwide turnover or £10 million whichever is higher) and criminal liability for directors. The methodology for calculating turnover for the purposes of penalties is set out in the Monetary Penalties SI.

Retrospective call-in risk

The UK Government believes that if it is not notified of a transaction that has national security risks, then it has the ability to step in retrospectively (including after completion) to address those risks. The UK Government has six months from "becoming aware" of a non-notified transaction in which to call the transaction in for review, subject to an overall deadline of five years from the "trigger event" of the transaction. However, the five year limit will not apply to deals requiring mandatory notification – this means that there is no definitive end date by which the UK Government must act. The UK Government could, in theory, become aware of the transaction many years after closing, call it in within six months of gaining that knowledge, and impose remedies (including, as a last resort, prohibiting the deal) if it raises national security concerns.

Further guidance on preparing for the new regime

The UK Government has also published a range of further guidance on issues arising in relation to the NSI Act, which includes:

- Guidance for acquirers and investors - intended as a brief practical guide to the new regime and provides an overview of the process of notifying the UK Government of transactions that fall within the scope of the 17 mandatory sectors.
- Guidance on the NSI Act regime alongside other UK regulatory requirements - covering the interaction between the foreign investment rules implemented by the ISU and the following regulators and codes: Enterprise Act 2002, Competition and Markets Authority, Export Control Joint Unit, The Takeover Code, Financial Conduct Authority, Prudential Regulation Authority.
- Guidance for higher education and research sectors - intended to help higher education institutions, other research organisations and investors to understand how the regime will apply in relation to these sectors and examining case studies relating to university research, development and formation of research centres (between research organisations and public and private partners), spin-outs, funding arrangements for employees and students, and academic donations.

The Enterprise Act 2002 (Public Interest) Regime

The NSI Act regime replaces powers allowing the UK Government to scrutinise transactions on national security grounds under the "public interest" regime linked to the UK's competition merger control regime, within the Enterprise Act 2002.

However, the other public interests grounds for review under the Enterprise Act 2002 have been retained and the Enterprise Act public interest regime applies separately and in addition to any requirements under the NSI Act for those public interest grounds. In particular, the retained public interest regime allows the UK Government to intervene in mergers (meeting the jurisdictional tests for the UK competition regime) where the Secretary of State believes raises the following public interest considerations :

- newspaper and broadcasting standards and media plurality,
- the stability of the UK financial system, and
- maintaining the capability to combat, and to mitigate the effects of, public health emergencies.

Practical insights and experience

The UK Government has been keen to stress throughout the passage of the NSI Act that the UK remains open for foreign investment. However, the risk remains of an expanding category of national security issues being conflated with industry policy factors in assessments carried out under the NSI Act.

While its intervention and assessment practice under the regime remains to be seen, it is to be hoped that the UK Government will call in for review only a very small proportion of deals genuinely harmful to national security, speedily clearing all other notified investments. In anticipation of commencement of the regime, it has been possible for businesses and their advisers to engage informally with the UK Government regarding whether specific transactions are likely to fall within the scope of and/or cause national security concerns under the Act.

Our experience to date of dealing with the ISU - whether clarifying elements of the regime or obtaining informal views on specific transactions - has been positive. We have found the ISU to be responsive, receptive to considered points made to it and committed to helping investors and companies adjust to the new regime. This bodes (cautiously) well for formal interactions with the ISU required by the NSI Act..

There has been a generally cautious approach taken by parties and advisers around the need to notify the ISU about transactions, given the Act's very broad jurisdictional criteria and draconian penalties and consequences of non-compliance. We expect this approach to continue, leading to a material volume of voluntary notifications being submitted as well as a conservative approach being taken to what is included in the mandatory notification sectors, particularly in the early stages of the regime.

We also saw approaches develop around NSI Act risk mitigation and conditions precedent in transaction documentation before commencement of the regime, given the potential retrospective application of the call-in power. We expect these strategies to develop further as it becomes clearer how the ISU will use the new powers over time and as investors build a relationship with the ISU.

We already see NSI Act risk becoming a key negotiation point in affected transactions in the same way that merger control has been for decades. For cross-border transactions involving multiple filings, it will also be crucial for parties and their advisers to coordinate NSI Act processes with other foreign investment approval procedures globally so that substance is consistent and timetables are aligned.

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