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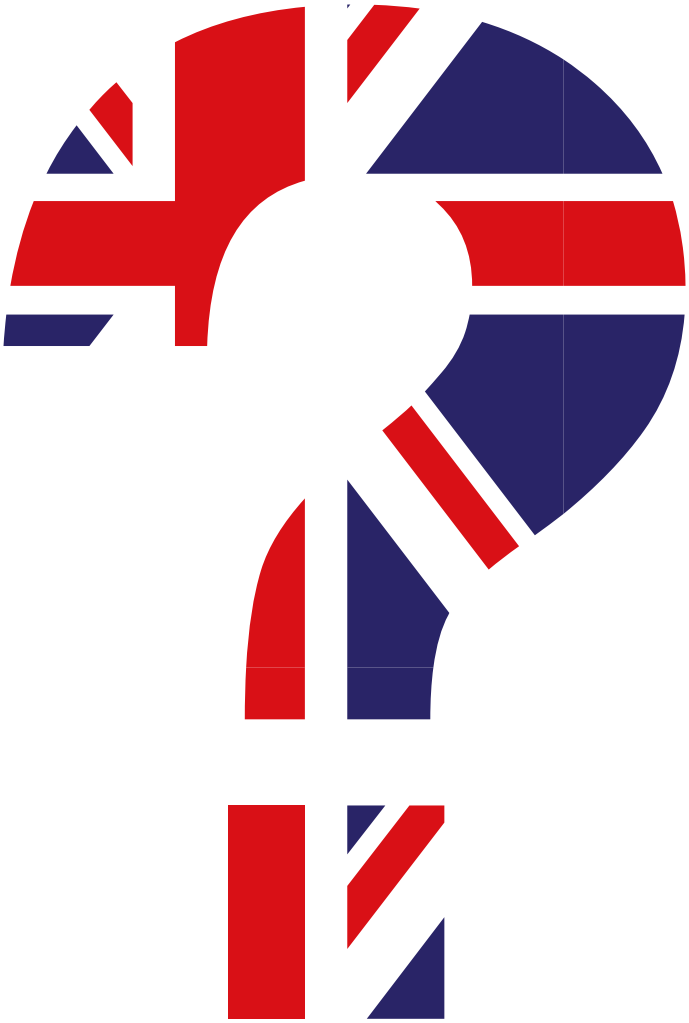

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IS IT STILL OK TO DO UK M&A? THE NATIONAL SECURITY AND INVESTMENT ACT 2021: THE FIRST FIVE MONTHS OF PRACTICAL EXPERIENCE

By Nicole Kar & Mark Daniel

Almost five months have passed since the UK's National Security and Investment Act 2021 ("NSIA") took effect, radically overhauling the UK's approach to foreign investment screening. Although hugely expansive in its scope and jurisdictional reach, generating a projected 1,000 - 1,830 filings per year, the UK Government's intention was to establish an efficient and proportionate screening regime to allow fast clearances of most non-problematic deals and thereby minimize the burden of the NSIA for business. We consider how effective the Investment Security Unit has been at delivering these goals, the key takeaways from our practical experience with the NSIA over the past five months, how transacting parties have been navigating the NSIA in practice, and highlights areas of uncertainty which could usefully benefit from market wide guidance. We also look at the Government's first calls ins under the new regime (namely China-backed Nexperia's acquisition of a stake in Newport Wafer Fab, and the increased stake in BT by Patrick Drahi, the French billionaire owner of Altice) and consider what light they can be expected to shed on the NSIA regime.

I. INTRODUCTION

It has now been almost five months since the UK's National Security and Investment Act 2021 ("NSIA") took effect, radically overhauling the UK's approach to foreign investment screening. The introduction of the NSIA regime represented a step-change in the UK's approach to screening investments, ushering in one of the most expansive investment screening regimes internationally with a mandatory notification review process for the 17 most sensitive areas of the economy coupled with a broad power for the Government to call in non-notified transactions.

The past five months has provided some welcome clarity on many practical aspects of the operation of the NSIA and the Investment Security Unit ("ISU") - the newly established unit within the Department for Business, Energy & Industrial Strategy ("BEIS") responsible for the administration of the new regime. However, the past five months has equally highlighted some teething issues associated with the new regime and shown that important areas of legal uncertainty remain for transacting parties.

This article: (i) sets out some key takeaways from our practical experience with the NSIA over the past five months; (ii) explains some of the ways in which transacting parties have been navigating the NSIA in practice; and (iii) highlights some of the continuing areas of legal uncertainty that we understand the ISU will helpfully clarify going forward in a series of market guidance notes. The article also comments on enforcement practice in the first five months and, in particular, the recent announcement by the Secretary of State for BEIS, Kwasi Kwarteng that he has issued two "call-in" notices under the NSIA – the first with respect to the high-profile China-backed acquisition of the UK's largest semiconductor component manufacturer, Newport Wafer Fab ("NWF"), and, more recently, in relation to the increase in Altice's ownership stake in BT by a further 6 percent to an 18 percent shareholding.

II. A RECAP OF THE NSIA REGIME

The NSIA introduced a hybrid investment screening regime, consisting of a mandatory regime for 17 of the most sensitive sectors of the economy and a voluntary regime for all other sectors. We use the term "investment screening" very deliberately: to the surprise of many, the regime is not limited to foreign acquirers but enables the ISU to consider acquisitions by British companies. To the authors' knowledge, there is no other regime which takes a similar approach[2].

Under the **mandatory regime**, parties must submit a notification to the newly established Investment Security Unit ("ISU") at the Department for Business, Energy & Industrial Strategy ("BEIS") if they acquire more than 25, 50 or 75 percent of shares or votes (or the ability to block or pass resolutions governing the affairs) of a target entity active within a specified sector in the UK. Due to the suspensory nature of the mandatory regime, a transaction cannot close until it receives clearance. The NSIA has an extremely expansive jurisdiction: there are no turnover, transaction value or market share safe harbors and the UK nexus requirements have been satisfied in most transactions we have considered.[3]

The 17 sectors to which the mandatory regime apply are: advanced materials, advanced robotics, artificial intelligence, civil nuclear, communications, computing hardware, critical suppliers to government, critical suppliers to the emergency services, cryptographic authentication, data infrastructure, defense, energy, military and dual-use, quantum technologies, satellite and space technologies, synthetic biology and transport.

The definitions of what specific activities fall within each mandatory sector are very technical and, in certain cases, can be difficult to interpret and apply in practice, so often require in-depth technical consideration and confirmation from the target as part of the due diligence process.

The **voluntary regime** applies to all sectors of the economy and parties are encouraged to voluntarily notify any "trigger events" which they consider may be of interest from a national security perspective. In addition to the thresholds under the mandatory regime, trigger events for the voluntary regime include the acquisition of "material influence" over a company (a well-established concept under UK merger control rules,[4] which may be deemed to exist in shareholdings as low as 10 or 15 percent) and acquisitions of a "right or interest" in a qualifying asset (such as land or intellectual property).

2 The Chinese NSR rules are sometimes said to enable review of Chinese domestic deals but if the direct acquirer and its ultimate controller are both Chinese, the NSR would not apply, whilst the NSIA could (at least in principle) to wholly domestic merger parties.

3 See BEIS Guidance on How the National Security and Investment Act could affect people or acquisitions outside the UK, January 2022. The Guidance states that a foreign entity can still be a qualifying entity for the purposes of the NSIA if it (i) carries on activities in the UK or (ii) supplies goods or services to people in the UK.

4 See CMA's Guidance on Jurisdiction and Procedure, January 2022, paras 4.17 – 4.32.

The UK Government also has extensive "call-in" powers to review qualifying transactions that have not been notified up to five years post-completion. However, if the Government has been made aware of the transaction, the call-in period is reduced to six months. This power is retroactive, enabling the Government to review transactions that closed as far back as November 12, 2020 (and has recently been exercised with respect to the NWF deal).

There are significant criminal and civil sanctions for non-compliance with a mandatory notification obligation. A fine of up to 5 percent of worldwide turnover – or £10 million – (whichever is higher) can be imposed on the acquirer and directors of the acquirer can also face up to five years' imprisonment. A transaction completed in contravention of the mandatory notification requirement will also be automatically void, which represents a shared risk for both buyer and seller.

III. PRACTICAL EXPERIENCE WITH THE NSIA TO DATE

A. There are Positive Signs that the ISU is Adopting a Proportionate Approach to Screening for Non-problematic Cases

The UK Government's intention was to establish an efficient and proportionate screening regime to quickly clear the majority of non-problematic deals and thereby minimize the burden of the NSIA for business.

Our experience to date is that the ISU has made positive steps in this direction. For transactions that do not raise substantive national security concerns, notifications have generally been "accepted" for review rapidly by the ISU (generally within a week). Similarly, information requests have generally been proportionate for no-issues cases. Our experience to date has been that non-problematic cases have ultimately been cleared comfortably within the initial 30-working-day NSIA review period. We have also seen willingness on the part of the ISU to engage with parties in advance of a signed transaction document, allowing parties to frontload the NSIA process in certain circumstances.

Both mandatory and voluntary NSIA filings must be submitted via an online portal, which requires parties to respond to a number of prescribed questions – principally relating to the transaction structure, the target company, and the acquirer. While the online portal itself can be difficult to navigate, and certain of these questions are geared towards simple corporate M&A and are not readily transferable to more complex fund structures, the scope of the information required is not as onerous as we have seen for certain foreign investment regimes internationally.

B. Second, the Expansive Scope of NSIA Jurisdiction has Driven Significant Numbers of Precautionary Notifications

It is also clear that the expansive scope of the NSIA regime, coupled with the breadth and ambiguity of certain of the mandatory notification sectors, has resulted in a considerable number of benign deals being notified (with associated costs for businesses).

In particular, it is notable that the mandatory notification requirement under the NSIA applies to internal re-organizations for in-scope companies, even where there is no change in the ultimate controlling entity. These filings have accounted for a material proportion of the filings that we have made to date, and we would expect this to be replicated across the market. Given that corporate restructurings do not, prima facie, raise any conceivable national security concerns, the requirement to make a mandatory notification in this scenario seems an unwarranted burden on both business and the ISU alike. Pending market guidance in this area is very welcome.

Some of the mandatory sector definitions (for example, communications, energy, AI, advanced materials, defense and synthetic biology) have also (despite some refinement during the consultation phase) been criticized for being too broad and difficult to interpret. This has led to a large number of benign deals being notified and transactions also being notified on a conservative basis (noting that the ISU is not always willing to provide guidance in advance of notification on whether a given target's activities fall within a mandatory sector). The definitions could benefit from more fulsome guidance to assist parties in identifying whether their transaction is one that should fall within the scope of the mandatory regime.

These may be areas where further guidance – or amendment of the NSIA – may be necessary. For example, additional safe harbors could be established to exclude internal group re-structuring and financing arrangements from the mandatory regime, and provide for those deals to be called in where appropriate.

C. Third, Concerns have been Raised Regarding the Opaque Nature of the ISU Review Process

In addition, the practical experience of the first five months of the NSIA's operation has led to some concerns about the transparency and accountability of the ISU process, especially during the initial review period.

Given the nature of the online portal through which filings are made, notifying parties are not allocated a named ISU case handler and the process is more anonymous than for example, CMA merger control reviews. Experience has also shown that the ISU can be reticent in providing the parties with information on either the status of the substantive appraisal of the case or the anticipated timing for the Secretary of State's clearance. While there are inevitably constraints on what can be disclosed when dealing with considerations of national security, the opaque nature of the ISU procedure has fostered concerns that the NSIA review is something of a "black box" and that transactions could be "called in" for a detailed review without the parties having had an adequate opportunity to exercise their rights of defense by responding to concerns.

IV. IMPORTANT AREAS OF LEGAL UNCERTAINTY REMAIN IN THE APPLICATION OF THE NSIA

There are a number of important areas where the application of the NSIA is not adequately clarified by existing guidance and where businesses and market participants could benefit from the market guidance anticipated from the ISU:

· **Financing transactions**. Financing arrangements (such as loan and security agreements, the issuing of some debt instruments or financing of underlying transactions) can also fall within the scope of the NSIA, including within the mandatory notification regime. This has led to considerable uncertainty among market participants regarding the application of the NSIA to the taking and enforcement of security and whether consequential changes are required to financing and security documents.

· **Contractual rights**. One of the trigger events for mandatory notification under the NSIA relates to the ability to block or pass a class of resolution regarding the affairs of an in-scope entity. Given that shareholders' agreements will typically contain minority protection rights or veto rights that cover many of the matters subject to a special resolution as a matter of English company law, the circumstances in which contractual rights could trigger a mandatory NSIA notification could be usefully clarified.

· **Minority acquisitions**. One of the trigger events for mandatory notification under the NSIA relates to acquisition of over 25 percent of shares or voting rights of an in-scope entity. While the application of this test is straightforward for the acquisition of a stake in excess of 25 percent in an in-scope entity directly, where the acquisition of an equivalent stake is structured via an intermediate holding company there has been uncertainty regarding whether this satisfies the "indirect" holding provisions at Schedule 1 of the NSIA.

V. HOW HAS THE NSIA BEEN REFLECTED IN DEAL TERMS?

Notwithstanding the uncertainty of dealing with a new and untested regime, investors have generally taken the NSIA in their stride, particularly for big ticket M&A deals. We have not, to date, (outside of investors from known high risk jurisdictions) witnessed any chilling effect on deal-making. We have seen several themes with respect to how transacting parties are navigating the NSIA in terms of deal conditionality:

· ***Transacting parties have a shared interest in ensuring that mandatory notification obligations are correctly identified***. If a transaction requires a mandatory NSIA notification, then the inclusion of a condition in the transaction documents allowing for such a filing is typically uncontroversial. Missing a mandatory NSIA filing results in transaction voidness, which represents a shared risk for buyer and seller (and finance parties). As such, it is in the mutual interest of transacting parties to correctly identify filing obligations and we have generally seen parties erring on the side of conservativism, especially where the mandatory notification definitions are less clear. Outside the mandatory regime, parties may consider including a voluntary notification condition to address the residual risk of the Secretary of State issuing a "call-in" notice to review the transaction; however, in auction processes this may well be resisted on the sell-side.

· ***Standard of performance and obligations with respect to remedies is often the main focus of negotiations***. In many cases, the main point of contention is the standard of performance to obtain NSIA clearance and, in particular, obligations with respect to remedies (mitigation in CFIUS parlance). A seller will typically want the buyer to take all steps necessary to obtain NSIA clearance (including offering whatever remedies are necessary to obtain clearance), whereas a buyer will generally want to limit the scope of this obligation. This tension is exacerbated in the case of the NSIA by the uncertainty over the nature of remedies that may be imposed by the ISU given that to date, no remedies decisions have been issued (although there are several in the pipeline). In the absence of NSIA decisional practice, expectations as to what remedies might be required are framed by pre-NSIA cases under the Enterprise Act 2002 (such as *Cobham/Advent* (2020) and *Bidco/Inmarsat* (2019)) which notably include "economic" commitments as well as remedies to address narrowly defined defense contractor related national security concerns. We can expect some further insight on what types of remedies and commitments the Government is likely to accept as more cases move through the national security review process – in particular in relation to Cobham Ltd.'s takeover of Ultra Electronics Holdings plc and Parker Hannifin's acquisition of Meggitt plc. While both cases are being

reviewed under the Enterprise Act 2002, media reports indicate that Cobham has recently agreed to a set of improved commitments to gain political backing for the transaction. Those commitments are likely to also inform future cases under the NSIA, and include granting the UK Government oversight of contracts, future asset sales and business relationships.

· ***Co-investments and risk allocation***. Where an acquisition is being made by a consortium of investors, there is a risk that some investors either directly (or via investors in funds they advise) may pose a greater risk from a national security perspective. Transacting parties (including consortium members themselves) are considering how consortium arrangements could be structured or re-negotiated to mitigate the risk posed by co-investors (e.g. by reducing governance rights or equity levels of particular co-investors in the event of national security concerns being identified). We have not, to date, seen UK assets or entities excluded from transaction perimeters (but carve outs are a feature in some other more established regimes).

VI. WHAT LESSONS CAN BE LEARNT FROM RECENT NSIA CALL-INS?

Last month, the Government publicly announced that two transactions would be called in under the NSIA, namely: (i) China-backed Nexperia's acquisition of a stake in NWF; and (ii) French billionaire, Patrick Drahi's increased stake in BT. The fact that the Government has chosen to publicly announce these "call-in" notices is enlightening in itself, as it was not previously apparent that "call-in" notices would be publicly announced. We have considered these two transactions, and the light that they shed on the NSIA regime, in further detail below.

A. Newport Wafer Fab

By way of background, the acquisition by China-backed Nexperia of the UK's largest silicon wafer manufacturer[5], NWF, was announced in July 2021. In response to concerns raised at that time, the UK Prime Minister announced a security review of the acquisition. However, nine months later, reports emerged that the Government had decided not to intervene. Despite Nexperia denying the accuracy of such reports, the reports nonetheless triggered a flurry of concerns and press coverage.

Soon after, a report on the takeover of NWF was published by the Foreign Affairs Committee, confirming that a review had not in fact been started, and expressing concerns about *"the Government's apparent lack of appetite to use the powers at its disposal to protect the British companies in this industry."*[6] Subsequently, BEIS confirmed that a review is, in fact, taking place and that the acquisition is *"being considered very closely."*[7]

The Government's decision to review NWF represents the first instance that we are aware of where the Government has used its retroactive powers under the NSIA to review a transaction that had closed before the NSIA took effect. It is also notable in that the Government publicized its intervention and that the "call in" of the Newport Wafer Fab transaction comes despite Stephen Lovegrove (the UK Government's national security adviser) previously concluding that there were insufficient reasons to block the deal on specific security grounds and following ongoing pressure from members of US congress in relation to the transaction. NWF is reported to have been (prior to the Nexperia transaction) transitioning to manufacture of compound semiconductors which use materials beside conventional silicon and are components for electric vehicle batteries (identified by US Secretary of State Antony Blinken, as a key sector of the 21st century economy that we cannot allow to become completely dependent on China"). CFIUS has previously blocked other deals in the compound semiconductor area, as far back as the President Obama era block of a Chinese purchasers' acquisition of Aixtron (which led to reconsideration of the transaction by the German foreign investment agency and ultimately collapse of the deal).

B. BT/Altice

In December 2021, Patrick Drahi's telecoms group Altice increased its ownership of the UK-headquartered BT to 18 percent from 12 percent. This subsequently fueled speculation about a takeover attempt – although Patrick Drahi has stated that he does not intend to make an imminent takeover bid- and triggered a six-month standstill obligation under the Takeover Code, the second of which expires in June 2022.

5 NWF is an open-access foundry, providing volume manufacturing services for the compound semiconductor on silicon, silicon chip manufacturing, and photonics markets. Its semiconductor technologies are used in EV engines.

6 https://committees.parliament.uk/publications/9581/documents/162217/default/.

7 https://hansard.parliament.uk/lords/2022-04-07/debates/A045984E-8BCD-4EF2-927E-A3172F54B8CE/NewportWaferFab.

The Government's announcement in May 2022 that it would review the increased stake in BT demonstrates that the Government is prepared to carefully scrutinize acquisitions of comparatively small minority stakes (i.e. below the 25 percent level that give rise to a mandatory notification under the NSIA) for companies perceived as UK "national champions" – even where the acquirer is from a so-called friendly country, such as France.

While BT is clearly sensitive in terms of UK national security, the decision to review may also be in part driven by concerns that Altice may increase its stake (following the upcoming lapse of the Takeover Code restrictions in June), rather than solely by concerns that the incremental 6 percent stake in BT is of itself a threat to national security.

VII. WHAT'S NEXT?

The Department of Business, Energy and Industrial Strategy has undertaken to do a review of the first six months of the NSIA and thereafter to do an annual report (as CFIUS does) setting out how many notifications and call ins there have been. It will be interesting to see whether the Government's projections for 1,000 to 1,830 filings per year in its original impact assessment was accurate in light of the prevalence of precautionary filings. In the meantime, investors appear to have taken the NSIA requirements in their stride and with the exception of Chinese outbound M&A (which statistics show has declined considerably in the UK but also elsewhere), the NSIA does not appear to have had a significant chilling effect on inbound UK M&A.

As explained in this article, there is, however, legal uncertainty regarding the interpretation of several important points under the NSIA. We therefore look forward to the anticipated market guidance notes from the ISU toprovide greater clarity for transacting parties and reduce the burden on investors and the ISU caused by the precautionary notification of transactions raising no conceivable national security concerns.

It will also be interesting to see how the reviews of the Ultra and Meggitt transactions play out, but also the NWF and BT deal call ins. These cases have the potential to showcase what types of remedies could be expected (particularly in a completed transaction such as NWF), how long a call in (as opposed to a proactively notified) process is likely to be, and what issues the UK Government is likely to focus on. The NWF case, in particular, is expected to be a "critical test case" of the UK Government's appetite to exercise its new powers in the face of considerable US congressional and Foreign Affairs Committee pressure.

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