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National Security & Investment Act regime

How may the **National Security and Investment Act 2021** affect transactions?

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The National Security and Investment Act 2021

What is the legislation?

The National Security and Investment Act 2021 (the "**Act**") gives the United Kingdom government / regulatory bodies powers to investigate investments into UK companies, or acquisitions where (i) the entity or asset is located in the UK or (ii) the entity carries on, or the target asset is used in connection with, activities in the UK or the supply of goods or services to UK persons, which they consider may have "national security" implications.

Regardless of sector, the Act's scope is broad enough to catch a large number of investments and acquisitions with connections to the UK in the interests of national security.

The Act grants a governmental body, the Investment Security Unit (the "**ISU**"), which sits in the Cabinet Office, the power to call in certain transactions to assess whether the transaction might give rise to a national security risk. The investor or acquirer in these relevant transactions are required to notify the ISU, giving details on the transaction for their review. In FY23/24, 906 notifications were received by the ISU, and 37 of those transactions were called in for further assessment. Ultimately, the power to call in, clear or block a relevant transaction will sit with the relevant UK Secretary of State (SoS).

"National security" is not defined by the Act or the UK government and allows the government to consider a wide range of potential risks. This flexibility isn't, however, ideal for assessing the risk of transactions.

How do I know if I'll have a problem?

Generally speaking, the rules will apply if a person or entity acquires a requisite level of control over your company, or an asset. The main criteria for assessing this control are:

1. a party's shareholding stake or voting rights meet certain thresholds (see thresholds below);
2. irrespective of voting rights, a party acquires rights that allow them to pass or block resolutions governing the affairs of your company;
3. a party becomes able to materially influence the policy of your company (e.g. gaining a right to appoint a director, if that appointment enables the appointor to influence the strategic direction of the company); or
4. a party becomes able to use an asset, or direct or control how an asset is used.

'"National security" is not defined by the Act or the UK government and allows the government to consider a wide range of potential risks.'

Crucially, the government has designated certain key sectors as particularly sensitive areas of the economy. There are 17 of these sectors in all, ranging from Transport to Cryptographic Authentications, and covering a broad range of technologies – such as Synthetic Biology, AI and Communications, amongst others. A full list is available here, with detailed definitions of each sector. We'll refer to these below as the 'key sectors'.

While it might seem obvious with some key sectors (Nuclear, Military etc) whether a business might fall within scope (Defence, for example, received more than twice the proportion of notifications than the next largest area of the economy in FY 23/24), the definition of other key sectors (such as Communications, Synthetic Biology etc) is often less obvious but could conceivably also catch many businesses.

For example, it may seem that a transaction involving a cleaning business does not give rise to a risk to national security, but if that cleaning business has access to defence facilities and/or contracts with the Ministry of Defence, it may be relevant for the key sector of Defence and parties may need to consider the Act carefully before moving forward with a transaction.

If your business operates in a key sector and control of your business changes as per points '1' and '2' on the page above, then an investment in your business will be subject to the Act.

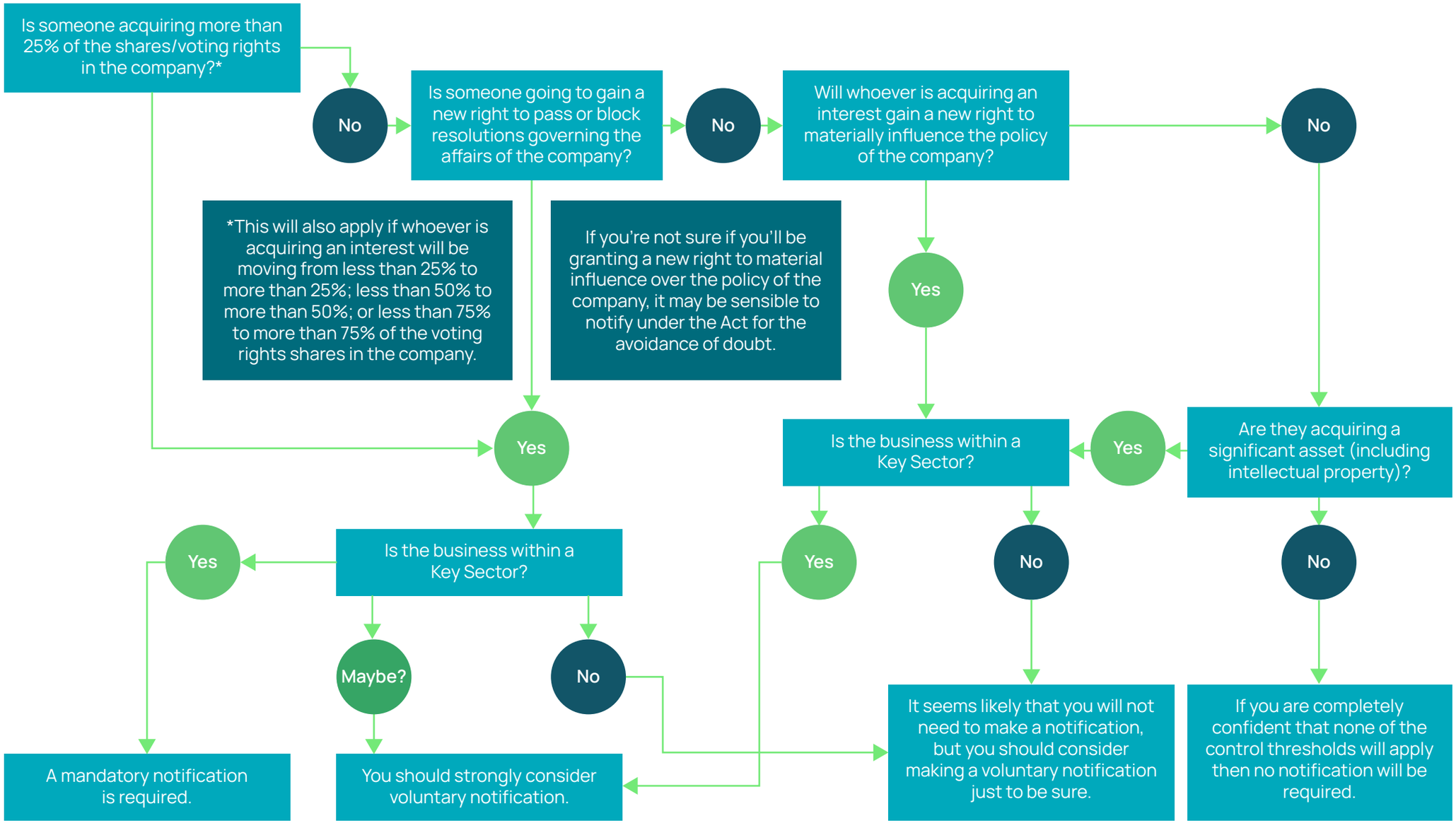
Regardless of being in a key sector or not, the Government can call in any transaction where it feels that control of your company may have changed based on certain risk factors, the SoS considers that there are national security implications. In FY23/24, four call-in notices were issued for non-notified acquisitions.

The flowchart on page four summarises what you need to consider in the case of an acquisition of a stake in a UK company (or a company carrying on business in the UK). Slightly different considerations will apply to an asset acquisition, noting this could include intellectual property or real estate (as per point '4' on the page above).

In relation to point '3' on the page above, it is worth noting that some of this will depend just as much on the practical governance arrangements of the entity as on the legal documentation. In a minority investment scenario, where the investor appoints an investor director, not every investor director will be in a position to "influence the strategic direction of the company" in the way envisaged by the Act. But, the way other investor directors operate in practice (or even how much they are listened to) could arguably give them more sway over the company's actions.

"...the Government can call in any transaction where it feels that control of your company may have changed and there may be any form of national security risk."

Will a notification need to be made under the Act?



What do I need to do to comply with the Act?

There are two options:

For complete certainty, any transaction involving a change of control (i.e. all acquisitions of more than 25% of the share capital of a target) as mentioned above would need to be notified to the ISU.

If you or (if you are target company) your investor or buyer are comfortable that there is no possible national security risk and the relevant business does not operate in a key sector, you could simply complete the transaction in the expectation that the transaction will not be called in.

Note that the SoS can call in a transaction for review up to five years after it has taken place, but no longer than six months after the Government first became aware of it – so if the completed transaction has been widely publicised and more than six months have passed, then the transaction should cease to be at risk of being called (though we are not aware whether the government's "awareness" of transactions having been tested in this way).

However, investors in, or acquirers of, businesses which fall within any of the key sectors will need to make a mandatory notification to the ISU in the cases of change of control points '1' (shareholding and/or voting rights above threshold) and/or '2' (able to pass or block resolutions) on page two.

Businesses in a key sector that don't fall into the above (e.g. where an investment may result in some other influence being granted to the investor, or a transaction involves the sale of an important asset) should strongly consider making a voluntary notification.

The SoS has claimed that they will review all notifications within 30 working days (six weeks) of receipt of a complete notification. In FY23/24, all accepted notifications were within this time period.

However, in some transactions, the 30 working day period and potential further 45 working day additional review period may be critical to the viability of a financing or acquisition, so it is important to make an application, if required, as soon as possible and possibly even before the signing of the transaction documents. In FY23/24, 12 notified acquisitions of the 37 which were called in were subject to the additional review period of 45 working days.

Note that the main obligations under the Act actually apply to the investor or acquirer, not to the company itself. So it is primarily the investor or acquirer which will need to ensure compliance (though there are plenty of reasons a target company should also play a part – see below).

What are the repercussions of failing to comply?

Non-mandatory

If it was not mandatory to notify the ISU, but the SoS later calls in the transaction and decides that it could give rise to a national security risk, then they are likely to impose conditions.

The exact conditions will vary based on the circumstances, but market experience from conditions imposed by the Competition and Markets Authority demonstrates that these can be difficult and costly to implement – particularly if the investment has already completed. In a worst case scenario, the SoS could seek to block a transaction (or in the case of the SoS taking retroactive action, order the transaction to be '"unwound"').

"In a worst case scenario, the Secretary of State could seek to block a transaction."

Mandatory

If a transaction falls within the scope of the mandatory notification scheme and does not receive SoS approval, but is nevertheless completed, the relevant investor commits an offence and may be imprisoned and/ or suffer a significant fine. In FY22/23, 671 of the 866 notifications received were mandatory.

Critically, the relevant transaction would automatically be considered void. This means that, despite the parties having signed paperwork and the seller or investee company having received funds, the investment would be deemed never to have legally happened and would need to be unwound.

In fact, the requirements of the Act mean that it will no longer be legally possible to complete an investment round or purchase requiring mandatory notification, without having received formal clearance from the SoS.

If all obligations are on investors or acquirers, why should other parties be concerned about this?

The Act will likely have implications for (i) the certainty of transactions (e.g. will investors or acquirers be dissuaded by the potential for SoS scrutiny?), and (ii) the timeline for the total transaction. Timing in particular can be of critical importance for funding rounds, as businesses often need to secure investment in order to pay their suppliers, fund staff salaries, continue in operation, etc.

A need to notify the ISU may lead to transactions taking longer than expected, and there will be additional costs involved to make sure any notification is made properly and in good order.

To help you, we've created a flowchart on page seven that sets out a possible timeline for a voluntary notification on what would be a standard transaction. In FY23/24, the Government took on average 27 working days to decide whether to call in a transaction. based on a voluntary notification, and 28 working days for mandatory notifications.

In addition to timing risks, note that some investors or acquirers may seek to pass on the risk of any breach of the Act to the company / its Founders through warranties and other assurances.

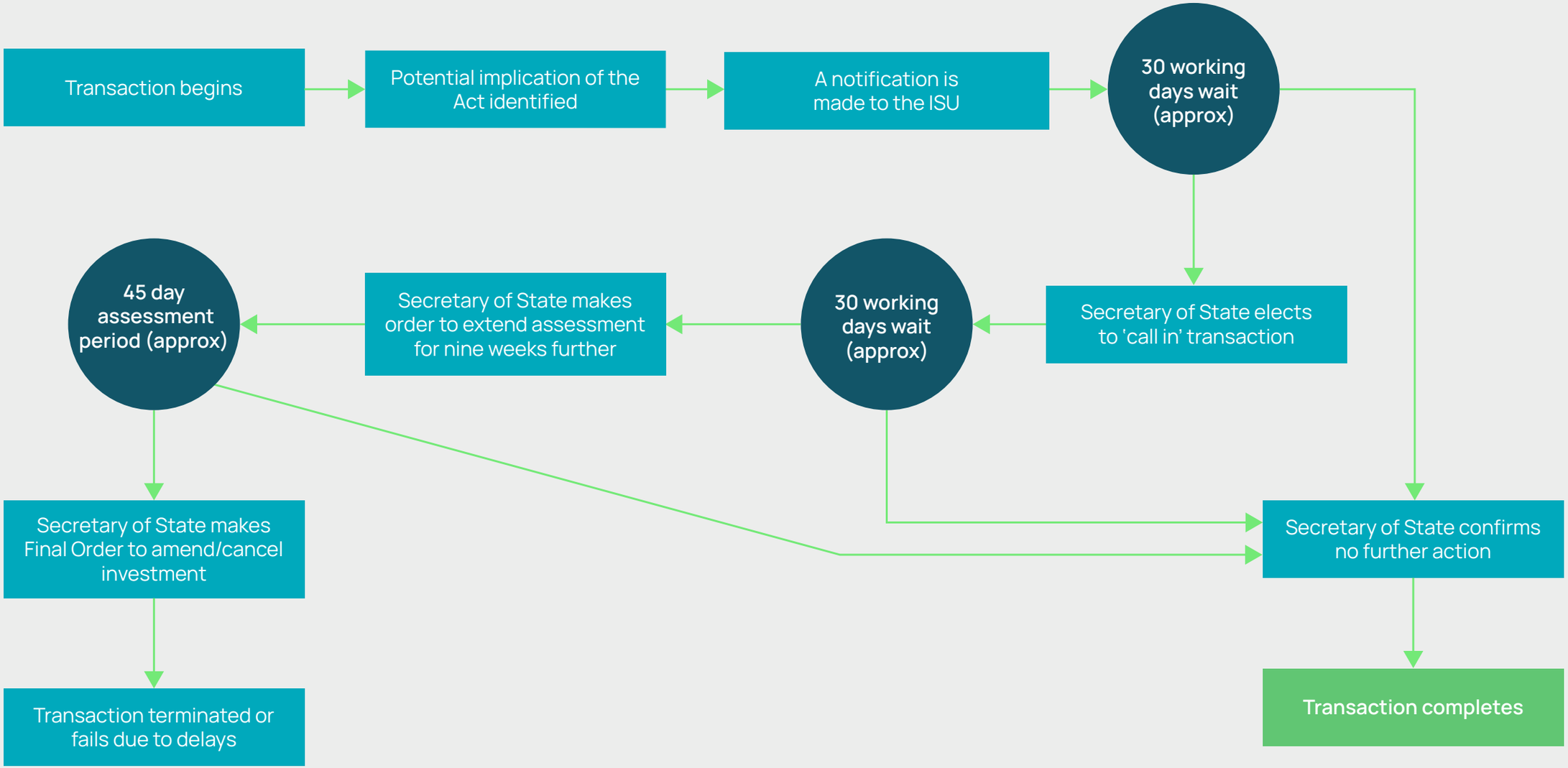
In any case, investors or acquirers are going to need the help of founders or management to fully understand their business and make an appropriate notification to the ISU if required.

The due diligence process should include questions and disclosures that are relevant to an assessment of whether the Act applies (e.g. a target company will be asked to confirm if it considers itself to fall within a key sector). Whilst the burden to notify falls on the investor or acquirer, they are ultimately reliant on the information provided by the target company, so to as to understand its activities.

New warranties may be requested, such as requesting that the sellers or founders warrant that their responses to diligence enquiries on the Act (and on which an investor or acquirer decided to notify or not notify under the Act) were made on a reasonable basis, to ensure that the responder's take the diligence process seriously.

"...the requirements of the Act mean that it will no longer be legally possible to complete a transaction requiring mandatory notification, without having received formal clearance from the Secretary of State."

A sample timeline for a notification



FAQs

Will the Act only affect transactions involving foreign investors or acquirers?

The terms of the Act will apply whether the investor or acquirer is based in or outside the UK, subject to the relevant trigger events occurring. This means that even internal corporate restructurings could fall within the scope of the Act.

What if I am carrying out a group reorganisation?

The Act will cover internal corporate re-organisations where such reorganisations include a change of control, even where that change of control involves the same ultimate beneficial owners as previously controlled the group. Particularly if businesses operate in a key sector, the Act should be considered in detail when conducting reorganisations.

How do I go about making a notification to the ISU?

An online portal has been established for the purposes of making notifications to the ISU, and it is through this portal that communications will take place.

Ashfords has advised a large number of clients on compliance with the Act, and made a number of notifications to the ISU.

Further information

A number of detailed guidance notes have been published by the Government including:

- a general guidance note;
- guidance on the use of 'call in' powers;
- guidance on mandatory notification sectors; and
- 'Market Guidance' on updates to guidance following the Cabinet Office's experience whilst the Act has been in force.

"...investors or acquirers are going to need the help of founders or management to fully understand their business and make an appropriate notification to the ISU if required.."

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