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UK FDI: National Security & Investment Law is Approved by Parliament

May 4, 2021

Foreign Direct Investment

On Wednesday 28 April, the UK Parliament adopted the National Security & Investment Law ("**NS&I Law**"). The law received Royal Assent the following day and will come into legal effect in late 2021.

The NS&I Law will introduce mandatory notification and pre-clearance requirements for transactions in 17 "core" sectors. This long-awaited piece of legislation has passed through Parliament substantially un-amended, except that the investment threshold for mandatory notification has been raised from the acquisition of a 15 per cent. to 25 per cent. interest in shares or voting rights in an acquisition target. The UK Government retains extensive discretion to "call-in" investments for review, both within and outside the 17 "core" sectors, including (i) acquisitions of control of assets and (ii) equity investments below the 25% threshold where "material influence" is acquired, if it reasonably suspects that a transaction gives rise to national security risks.

In the period since the National Security and Investment Bill was published in November 2020, the UK has left the European Union and the UK government has moved to refresh its approach to inward investment more generally (with a particular focus on technology). Through the launch of the Advanced Research and Innovation Agency ("**ARIA**"); a renewed focus for the UK's Infrastructure Bank; the establishment of a planned new "Office for Investment" (led by Lord Grimstone); and the establishment of the Investment Security Unit ("**ISU**", which will receive and manage notifications under the NSI Law), the landscape for investment in the UK is much-changed. Investment-related concerns feature across a range of UK Government policies and priorities, not least the UK's Integrated Review of foreign and defence policy (published in March 2021) having highlighting a number of tense relationships with countries from which investment may attract greater scrutiny.

During this period, the UK government has continued to use its existing powers to investigate transactions on national security grounds under the public interest invention regime [1] established under the Enterprise Act 2002. Of particular interest in this regard was the decision, on 19 April

[1] Once the NSI Law is in force, the public interest intervention regime (Enterprise Act 2002) will be partially repealed so that the review of national security considerations occurs under the NSI Law. The public interest regime will continue to apply for the review of transactions on grounds of media plurality, financial stability and public health emergency considerations.

2021, by the Secretary of State for the Department for Culture Media & Sport to issue a public interest intervention notice in respect of the proposed acquisition of the UK semi-conductor company ARM Limited by Nvidia Corporation.

Scrutiny of Foreign Investment

The adoption of the NS&I Law brings the UK in line with many other countries that have enhanced their powers to scrutinise foreign investment during the past two years and particularly over the last year, influenced by COVID-19 and other global trade and supply concerns. The UK's Five-Eyes partners all have well-established regimes for the review of foreign investment—several of which have been recently updated. The European Union began cooperating in the review of foreign direct investment ("**FDI**") in October 2020 under the EU FDI Regulation and via individual Member State laws, newly adopted or recently expanded.

What is significant about the UK's NS&I Law is that is introduces mandatory notification obligations for investments into the UK where none have existed before—contrasting with the UK's merger control regime under which filing is voluntary and associated public interest intervention laws (each under the Enterprise Act 2002) under which the UK Government discretion to intervene in transactions where certain defined public interest considerations are raised.

Under the NS&I Law, transactions subject to mandatory filing obligations and completed without clearance will be deemed void, ushering in a suspensory review regime in the UK for qualifying transactions for the first time. This change in approach has led to concern from the UK's business and investment and innovation communities, as well as politicians, that the NS&I law will act to deter investment in the UK. There is concern, in particular, that uncertainty for investors is presented by the absence of a definition of "national security", potentially allowing the UK Government considerable discretion in the application of the new NS&I regime.

The UK's Department of Business, Energy & Industrial Strategy ("**BEIS**"), which has acted as the promoter of the NS&I legislation and will have a primary role in its operation and implementation, has consistently countered such concerns by repeating three key commitments:

i. to provide clearance for the vast majority of transactions promptly and within the initial (phase I) review period of 30 working days;

ii. to limit its interest to issues of national security, and not broader economic concerns (including further describing the intended use of the call-in power in statutory guidance that will operate alongside the NS&I Law); and

iii. to provide adequate and suitably trained staff from a range of backgrounds to deliver the work of the ISU that will sit at the centre of cross-departmental national security review.

Additionally, the Office for Investment will have the role of driving investment in the UK, notwithstanding the raising of regulatory hurdles to investment in the core sectors.

Principal Features of the NS&I Law

Indeed, the NS&I legislation has passed through Parliament with almost all its main features intact—

- The NS&I Law will introduce mandatory filing and pre-clearance requirements for transactions in 17 core sectors:
  1. advanced materials
  2. advanced robotics
  3. artificial intelligence;
  4. civil nuclear;
  5. communications;
  6. computing hardware;
  7. critical suppliers to the Government;
  8. critical suppliers to the emergency services;
  9. cryptographic authentication;
  10. data infrastructure;
  11. defence;
  12. energy;
  13. military and dual-use;
  14. quantum technology;
  15. satellite and space technology;
  16. synthetic biology (renamed from "engineering biology"); and
  17. transport.
- The definitions of these 17 sectors have yet to be confirmed, but the Government has already consulted on the proposed scope of the sectors and has proposed some important revisions in an interim publication in March 2021, including to narrow the focus of the "artificial intelligence" and "synthetic biology" core sectors.
- Across the 17 sectors, an acquisition of an interest in a qualifying entity (including a company, partnership, unincorporated entity or trust) will be subject to mandatory notification in circumstances where an investor acquires control in an entity (meaning the acquisition of more than 25%, 50% or 75% of shares or voting rights in an entity), or can stop or pass any form of resolution in an entity. The Government amended the NS&I bill during its passage through the House of Lords to remove the requirement to notify acquisitions of a 15% interest in shares or voting rights (although the call-in power may still be exercised in respect of such transactions if considered to give rise to "material influence"—see below).
- No other de-minimis thresholds apply. In particular, no transactions are proposed to be exempt by transaction value or otherwise, for example based on target turnover.
- There are also no exemptions based on investor characteristics (although the NS&I Law allows for such exemptions to be introduced at a later date), and the requirements of the UK NS&I Law apply equally to UK-based investors.
- The Secretary of State for BEIS (who has decision-making power under the NS&I Law) will not be limited to oversight of transactions occurring in the 17 core sectors and will be empowered to "call-in" investments in <u>any</u> sector that could give rise to national security concerns. This reserve "call-in" power will be available for a maximum five-year period following the date of an investment, subject to the Secretary of State acting within six months of becoming aware of the transaction.
- Transactions (whether concerning the 17 core sectors or not) may be called-in if "material influence" is acquired—a concept that may have expansive meaning if recent

UK competition law precedents are applied, and potentially bringing within review investments in which much less than a 25% interest is acquired if the acquirer gains material influence over the a target company based on the surrounding facts and circumstances.

- A system of voluntary filing will be established, allowing potential acquirers to seek prior-clearance for their transaction and certainty (where available) that a national security review will not be opened in respect of a planned transaction. All asset transactions are subject to the voluntary filing regime.
- The UK Government will also be able to review certain extra-territorial deals if a change in control occurs in respect of an entity making supplies into the UK, and transactions that transfer rights and interests in assets may also be scrutinised. In these respects, the UK NS&I regime appears broader than many comparable regimes, but BEIS is expected (and required under the NS&I Law) to provide guidance to clarify how its call-in powers will be exercised, including in this regard.
- The review of transactions under the NS&I law will occur in several stages, with an initial review period commencing on acceptance of a notification and lasting for not more than 30 working days (phase I). Where the transaction is then "called-in" by the Secretary of State for substantive review, the ISU will have a further 30 working day period (phase II) to carry out a more detailed national security assessment. This 30-day period may be extended by the Secretary of State up to a further 45 working days (phase II+) and potentially further extended by agreement between the Secretary of State and the acquirer (phase II ++).
- In the absence of formal notification of a transaction, the power of the Secretary of State to call-in an investment for review will usually endure for five years from the date of investment, but may be shortened to a six month period once the Secretary of State is made aware of the transaction (e.g. from press coverage). However, there is no time limit on the exercise of call-in powers where a transaction subject to mandatory notification requirements is completed without clearance.
- A comprehensive penalty framework is envisaged to address any failure to comply with the new regime—in particular, transactions requiring mandatory notification will be automatically void if completed without clearance (although retrospective validation may be requested). Added to this, both criminal and civil sanctions will apply to non-compliance with the mandatory and other aspects of regime, including:
    i. financial penalties in the greater amount of (a) up to 5% of the global turnover of the business in question and (b) £10 million;
    ii. corporate criminal penalties; and
    iii. imprisonment of up to five years and director disqualification for up to 15 years for specified directors and officers.
- The NS&I regime will have a degree of retroactive effect, such that any transaction that took place after 12 November 2020 may be called-in for national security review.

In the coming months prior to the NS&I Law coming into effect, a total of eight pieces of secondary, implementing legislation are required to be passed. These measures will provide important details concerning the operation of the NS&I regime, including (among other things) in respect of the anticipated use of the call-in power, to settle the definitions of the 17 core sectors and determining the precise manner of notification (mandatory and voluntary) and information required to be submitted. On this later point, BEIS is known to be consulting with practitioners and companies in respect of the ISU's proposed notification and case management systems.

The ISU is, nonetheless, already operational and available to respond to queries on a preliminary (although non-binding) basis until it is fully empowered. This may be helpful to those currently planning or undertaking transactions, and we have found the ISU to be responsive to the queries we have raised on behalf of clients to date.

Technology Investment—ARIA and the UK Infrastructure Bank

Considering the UK's investment landscape broadly, the focus of the UK Government on the availability of investment is increasingly apparent and it appears positioned to respond to concerns from innovators that domestic funding has become too difficult to access at key development milestones. While the NS&I Law includes provisions allowing for targeted funding to be made available to companies (and others) directly impacted by an order made under the legislation, both ARIA and the UK Infrastructure Bank represent a significant development in the willingness of the UK Government to invest—at arm's length and through independent agencies of Government—in emerging technology, including at the earliest stages.

ARIA, in particular, is modelled on the successful US DARPA programme, and represents a fund of £800 million available for investment in "high-risk research that offers the chance of high rewards" potentially "supporting ground-breaking discoveries." ARIA, working as complement to the existing body for UK Research and Innovation, is aimed to position and maintain the UK as a world class base for scientific research and innovation.

The UK Infrastructure Bank will have a broad remit to facilitate both public and private sector activities across primary areas of UK infrastructure, including water, waste, clean energy, transport and digital networks. With a planned total £22 billion ultimately to be made available to provide funding (as equity or debt capital, or by way of guarantees), the UK Infrastructure Bank is aimed especially towards infrastructure projects that support the key ambitions of the UK Government in tackling climate change and promoting the levelling-up of infrastructure across all the regions of the UK.

Covington has significant experience in advising on foreign investment regimes like the NS&I Law, as well as other regulatory risks, in jurisdictions around the world and we look forward to working with clients to help them navigate the UK's new investment legal infrastructure.

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