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The UK's New Mandatory Filing Regime for Foreign Investments–First Impressions

On 4 January 2022, the UK's new National Security and Investment Act (the "NSI Act") came into force.

The NSI Act signals a fundamental paradigm shift in the UK regulatory landscape. The UK, famous for being one of the most open economies for foreign investments globally, now operates a foreign direct investment ("FDI") screening regime that imposes a mandatory standstill requirement on 17 "sensitive" sectors (the "Specified Sectors"). Further key features of the new NSI Act include (1) a review of acquisitions resulting in the acquisition of more than 25% of the interests in a target entity, (2) an additional broad call-in power granting the UK Government discretion to review transactions for up to five years, and (3) the power to impose penalties, including significant fines (5% of worldwide turnover or GBP 10 million (around USD 14 million), whichever is greater) or criminal sanctions (up to five years' imprisonment). The NSI Act is an entirely new regime for the UK, and a marked contrast to the to-date discretionary antitrust and public interest regime overseen by the UK's Competition and Markets Authority (the "CMA").

Any such new broad regime is likely to attract concern by investors in terms of the scope of the Specified Sectors (and hence, the filing obligations), process, and timing. It is reasonable to expect that notifying parties will have some apprehension in relation to teething issues and a potential backlog of cases, particularly in the early months of the new regime. Nevertheless, a review of the NSI Act and initial feedback on the work of the Investment Security Unit ("ISU") allow for cautious optimism that (1) the ISU is determined to provide legal clarity early on, (2) despite an expected "bottlenecking" at the launch of the NSI Act created by its retroactive application, the ISU has been swift in starting the formal clock on review periods by confirming applications are complete,[1] (3) the ISU has shown it is also quite responsive to informal outreaches to provide guidance early on, and (4) unlike other FDI regimes, the ISU has issued helpful and detailed guidance on which transactions are "in scope". To this end, the UK is to date proving to be a potential role model for other (nascent) FDI regimes in rolling out an FDI regime with (so far) reasonable legal certainty.[2]

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1 In this regard, it should be noted that the template notification form has a set-word limit per response, suggesting that the ISU has a desire to keep arguments brief and dispatch filings quickly.

2 The Government has already announced that it intends to publish a six-month review of the NSI Act in summer 2022, which may include guidance to limit the scope of the transactions requiring notification further. See https://www.gov.uk/government/speeches/new-national-security-regime-from-4-january-2022.

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Yet, some areas of concern remain: (1) the concept of UK nexus seems overly broad, with no exclusions for de minimis revenues or even the requirement for a UK entity across some of the industry sectors, (2) there appears to be no carve-out for UK acquirers – even a UK to UK acquisition could require notification, (3) the inclusion of pre-notification periods and the use of "stop the clock" mechanisms have the potential for review periods to elongate, and (4) the scope and number of Specified Sectors is broad.

The extent to which the NSI Act strikes a balance between protecting national security versus a "chilling effect" on UK business facing further regulatory hurdles, therefore, remains to be seen.

Recap of the NSI Act's Key Features[3]

On 20 December 2021, Lord Callanan, the British Minister for Business, Energy and Corporate Responsibility, issued an open letter to businesses and investors in which he described the regime as "*the biggest shake up of the UK's national security investment screening powers for 20 years*".[4] He is not wrong. Key features of the new NSI Act include:

(i) ***Mandatory filing requirement:*** The requirement for mandatory filings of transactions resulting in the acquisition of more than 25%[5], 50%, or hitting 75% shareholding/voting rights,[6] or the power to block a class of resolutions, in entities active in key sectors that the UK Government considers most sensitive (the "Specified Sectors", which are listed below). There is no nationality requirement – even acquirers from the UK will potentially need to make a filing if their acquisition is above the thresholds and the target is active in the Specified Sectors.[7] Similarly not all the Specified Sectors depend on a UK entity to be triggered, and sales into the UK or relevant contracts may be sufficient.

(ii) ***Corporate and personal penalties:*** Transactions caught under the mandatory regime cannot close until approval is received, and the penalties for breach are potentially severe, including substantial fines of up to 5% of worldwide turnover or GBP 10 million (around USD 14 million) (whichever is higher), and directors[8] are personally liable, facing potential imprisonment of up to five years.

(iii) ***Power to review non-reportable deals:*** The UK Government is also granted broad call-in powers, which allow it to review mergers up to five years after their completion (or up to six months in cases where the UK Government was made aware of the transaction).[9] This call-in

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3 See our prior alerts here and here for a comprehensive overview of the key features of the NSI Act.

4 See UK Government website, 'New national security regime from 4 January 2022' available here.

5 The original NSI bill had a lower 15% mandatory notification threshold, but this has been removed from the enacted law. Indirect interests are also caught, provided the person holds a majority of shares or voting rights, the ability to appoint or remove a majority of the board, or has the right to exercise "dominant influence".

6 The definition of "shareholding" is broad, and includes share capital and rights to profits.

7 By contrast the EU Foreign Direct Investment Screening Regulation (Regulation (EU) 2019/452) (the "EU FDI Screening Regulation") only applies to investments from a non-EU person into the EU. In this sense, calling the NSI Act an "FDI" regime is a misnomer – it applies regardless of the nationality of the acquirer.

8 For the purposes of the NSI Act, whether a person is a "director" is a question of substance over form: a director includes a person who has 'the position of a director', including those whose directions or instructions the directors of the body corporate are accustomed to acting on.

9 The UK Government's statement (available here) provides an indication in relation to how the Secretary of State expects to exercise the power to give a call-in notice.

power applies across all industries, and can be triggered by the mere acquisition of "material influence", a nebulous concept taken from UK competition rules (that as a rule of thumb covers acquisitions of 15% or more).[10] Acquisitions of assets (as opposed to entities) will not require mandatory notification under the NSI Act, but are still in the remit of the UK Government's call-in powers.

What are the Specified Sectors?

A transaction will be subject to the mandatory notification requirement if the target is active in one of the Specified Sectors.[11] These are:

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

While 17 mandatory sectors at first glance might seem overwhelming, the UK Government has made an admirable effort to clearly define the boundaries of the sectors, with extensive definitions included in the *NSI Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021) (the "Sectors Regulation").* The scope of the definitions has also been narrowed relative to earlier drafts of the NSI Act.[12] Further still, the UK Government has published additional guidance[13] (albeit, non-exhaustive) on

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10 "Material influence" is not defined in the NSI Act, but the UK Government noted that it intends to interpret this concept in line with the UK's merger control regime, as administered by the CMA. CMA guidance from December 2020 suggests that the concept could cover any shareholding level, even below 15%, where other factors (such as board representation, veto rights, voting practices, or other contractual arrangements) are present.

11 Outside of these sectors, the UK Government still has the discretion to review transactions affecting media and newspaper plurality, the stability of the financial system, and the capability to combat public health emergencies under the public interest grounds in the Enterprise Act 2002, which continue to be administered by the CMA.

12 For example, the scope of the original definition of "**artificial intelligence**" was intended to catch any entity active in artificial intelligence that can be used to perform a complex task (a vague and broad term). In the Sector Regulations, it has been significantly limited to now only capture entities active in artificial intelligence that is used for specific purposes, being the identification or tracking of objects, people or events, advanced robotics, or cybersecurity. Similarly, the definition of "**data infrastructure**" has also been limited from the initial proposal, which could capture an entity that owned or operated a UK data site; now, the regime only captures owners or operators of relevant data infrastructure if those services are provided to certain users, namely public sector authorities. In general, the scope of the Specified Sectors has been narrowed, but there are exceptions. For

how it interprets the definitions in the Sectors Regulation – and is intent on providing further clarity early on, expected around summer 2022.[14]

The UK Government has provided comprehensive "bright-line" definitions (unlike some other European FDI regimes). Regrettably, the type of sectors considered "sensitive" varies by jurisdiction too. Whereas the EU FDI Screening Regulation includes provisions for catching transactions in the "electoral and financial infrastructure", "food security", "health", "personal information", and "land and real estate" sectors, the UK's NSI Act does not.[15] In contrast to the UK, the sectors included in the EU FDI Screening Regulation are not mandatory filing sectors, but rather set the framework by which Member States can consider the potential effects of a transaction. How FDI screening is implemented into national regimes therefore remains with each Member State accordingly.

The Review Process and Experience to Date

The new screening process will be administered by a new unit, the ISU, which forms part of the UK Government's Department of Business, Energy and Industrial Strategy ("BEIS").[16] The new unit is headed by Jacqui Ward, previously the principal private secretary (which is a senior UK civil servant position) to several Ministers.

Template for review: The UK Government has published the template notification form and the accompanying guidance on how to complete and register a notification form.[17] The notification requires details on the activities of the target, including details on any supplies made to the UK Government, and any UK Government classified information held. On the acquirer side, the notification form asks for details of governmental shareholding ownership or voting rights (there is no lower threshold), and a structure chart showing all shareholders with 5% stakes and above, including their nationalities – a task that may be especially onerous for private equity funds.

Timeline: The statutory clock for the UK Government to formally review the transaction only starts after it has given notice to the parties that it has accepted the notification as complete. After a mandatory notification is accepted, the UK Government will have 30 working days to decide whether or not to initiate a full review of the transaction. If a full review is initiated, then the UK Government will have another 30 working days (the "assessment period") to review the case and decide on remedies, if any. The assessment period can be extended by another 45 working days and, following that, a further amount of time as agreed to between the UK Government and the acquirer in the transaction.

The timeline in practice: One important feature of the regime is that the timeline only starts once the UK Government accepts the notification as complete. In effect, this introduces a pre-notification process,

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example, the definition of "**suppliers to the emergency services**" now includes the supply of "components", as well as the supply of goods and services.

13 See National Security and Investment Act: guidance on notifiable acquisitions, available here.

14 See the letter of Lord Callanan, Minister for Business, Energy and Corporate Responsibility (4 January 2022), published here: https://www.gov.uk/government/speeches/new-national-security-regime-from-4-january-2022

15 As noted above at footnote 11, the UK Government will retain discretion to review certain transactions on public interest grounds under the Enterprise Act 2002.

16 Until 4 January 2022, the review of mergers with a national security element were overseen by the CMA under the Enterprise Act 2002.

17 The form can be accessed on the UK Government's website, available here, and the accompanying guidance is available here.

similar to that in place for antitrust filings to the CMA or the European Commission. As to how long the pre-notification process will take is not yet clear, but based on feedback to date, the ISU has endeavored to be swift in its initial review.[18] This is commendable, particularly given that the ISU only started accepting notifications under the NSI Act on 4 January 2022, so some "bottleneck" issues in the early months are expected, as companies seek to file their deals early on. For context, the UK Government expects to review some 1830 cases a year, which is almost 30 times the number of CMA cases previously reviewed per year.[19]

Second, given that this is an entirely new regime, we can expect some teething issues at the beginning, and dealmakers should factor potential delays into their timelines. However, the ISU has shown to be quite responsive also to informal outreaches to provide guidance early on, and the UK Government has already announced that it intends to issue new guidance around summer 2022.[20]

Whilst still in its infancy, initial feedback on the regime suggests that there is reason to be cautiously optimistic. However, it is early days, and we wait to see whether the UK Government will continue to swiftly review filings, or whether we can expect a creep in the length of pre-notification procedures and the use of "stop-the-clock" information request mechanisms that the NSI Act allows for.

Conclusion

The NSI Act signals a fundamental paradigm shift in the UK regulatory landscape. The UK, famous for being one of the most open economies for foreign investments globally, now operates a FDI screening regime that imposes a mandatory standstill requirement on 17 Specified Sectors. Further, key features of the new NSI Act include (1) a review of acquisitions resulting in the acquisition of more than 25% of the interests in a target entity, (2) an additional broad call-in power granting the UK Government the discretion to review transactions for up to five years, and (3) the power to impose penalties, including significant fines (5% of worldwide turnover or GBP 10 million, whichever is greater) or criminal sanctions (up to five years' imprisonment). The NSI Act is an entirely new regime for the UK, and a marked contrast to the to-date discretionary antitrust and public interest regime overseen by the UK's CMA.

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[18] For the time being, it has been significantly faster than cases under the jurisdiction of the CMA, which took on average 37 working days in 2019/2020.

[19] By comparison: the CMA reviewed 62 Phase 1 cases in year 2019/2020. In the US, there were 313 filings in 2020 under the CFIUS regime, and in Germany, 159 cases were filed under the FDI regime.

[20] https://www.gov.uk/government/speeches/new-national-security-regime-from-4-january-2022.

Yet, some areas of concern remain: (1) the concept of UK nexus is overly broad, with exclusions for de minimis revenues or even the requirement for a UK entity across some of the industry sectors (which is a marked differentiator to many European regimes, e.g. Austria, France and Germany, which all require a local entity), (2) there appears to be no carve-out for UK acquirers – even a UK to UK acquisition could require notification, (3) the inclusion of pre-notification periods and the use of "stop the clock" mechanisms have the potential for review periods to elongate, and (4) the scope and number of Specified Sectors is broad.

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