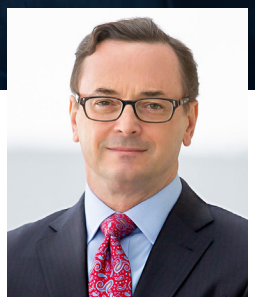
Client Alert:

The United Kingdom Strengthens its Foreign Direct Investment Procedures

JUNE 2021

by Scott Boylan and Annabel Kerley



Scott Boylan
Partner, StoneTurn
sboylan@stoneturn.com
+1 202 349 1130

Annabel Kerley
Partner, StoneTurn
akerley@stoneturn.com
+44 (0)20 7427 0401

The United Kingdom (U.K.) government passed the National Security and Investment Act of 2021 (the Act) on April 29 through Royal Assent. The Act crafts a robust regulatory framework aimed at foreign investment in the name of national security and provides that the government will consider the target risk, the triggering event's risk, and the acquirer's risk. It is important to note that although the Act will not take effect until later this year, transactions dating back to November 12, 2020 up to the present day can be subject to review. With this system on the horizon, both U.K. and foreign investors should tread carefully.

How has the landscape changed?

Later this year, the Act will allow the government to perform regulatory actions much like the United States' Committee on Foreign Investment in the U.S. Yet it differs and surpasses its American equivalent in several ways. First, the Act outlines both civil and criminal penalties for failure to notify. This can be in the form of a financial penalty or imprisonment, in addition to the proposed transaction becoming void. Second, the Act applies to both U.K. and foreign acquirers. Finally, under CFIUS and other country regimes, safe harbor exists in turnover or market share situations—the Act provides neither. Indeed, the U.K. government had few hesitations in bolstering review powers.

How is the Act put into play?

The Act uses precise terminology to activate notification requirements and review capabilities while also redefining existing language. "Trigger events" can

StoneTurn

activate notification requirements, where a person or entity gains control of a "qualifying entity" or "qualifying asset." These two key terms are not only crucial but broadly defined: a qualifying entity is one which conducts activities in the U.K., is recognized or formalized outside the U.K., and supplies goods or services within the U.K. A qualifying asset can be tangible property, information, techniques, or an idea which holds industrial, commercial or, economic value. Thus far, one can see how the Act could be applied to countless transactions.

A core concern for potential investors is when "control" is gained per the Act. As touched upon earlier, the Act creates a threshold framework. If a party gains or increases an interest in a qualifying entity of 25, 50, or 75% of equity or voting rights—control is triggered under the Act. Should a party acquire voting rights in an entity which allows it to have governing influence over the entity, control is triggered. If a party gains "material influence" over the entity, it has also gained control per the Act.

What must a regulated party do under the Act?

Once the Act takes effect, notification to the Department of Business, Energy, and Industrial Strategy (B.E.I.S.) can be mandatory or voluntary. If the transaction occurs in one of the 17 areas outlined by the Act, notification will be mandatory. These 17 areas are believed to implicate national security and critical areas under the Government Response to the Consultation on Mandatory Notification in Specific Sectors Under the National Security and Investment Bill published in March of 2021. If an acquirer makes a transaction in one of these areas without notifying the government, significant monetary penalties or even imprisonment can occur—all while the transaction is deemed void. If parties to a transaction believe national security may be implicated, they are encouraged to voluntary notify B.E.I.S.

In either notification, B.E.I.S. will review the triggering event for 30 days to determine whether the transaction should be "called-in" for assessment. During the interim, the government can freeze the transaction, impose monitoring, and order information to be disclosed. If assessment occurs, B.E.I.S. will "call-in" the triggering event and a full national security assessment will occur. This process can take up to an initial 30 days but may be extended an additional 45 days if the government determines it necessary. At the end of the reviewing process(es), B.E.I.S. can clear the triggering event, issue an order imposing conditions or remedies or, reject the transaction.

Looking forward

The Act broadens existing acquisition thresholds, specifies definitions of regulated industries, and alters existing legislative text. B.E.I.S. is also expected to publish additional legislation providing clarification and details regarding procedure. Moreover, the government is expected to publish secondary legislation and guidance further defining the 17 key areas, creating a new entity on investment, and creating a new unit within B.E.I.S. The Act will supplant the Enterprise Act, however, the Competition and Markets Authority—which focuses on other public interests, will remain good law.

In total, the National Security and Investment Act of 2021 demonstrates a shift from past economic principles of openness to increased scrutiny comparable to CFIUS in the U.S. This is done in the name of protecting U.K. security and critical industries; and investors must be well-advised and cautious when acquiring interests in U.K. entities.

In fact, to ensure deal success, investors focused on U.K.-based acquisition targets should prepare for enhanced oversight now:

1. **Anticipate Mitigation or National Security Concerns:** Foreign investors should expect some form of limitations on how they will operate a U.K. asset and take a hard look at the transaction from a national security perspective.
2. **Check Compliance:** Has the target company been a good corporate citizen? Past compliance failures may slow deal approval.
3. **Anticipate Additional Costs:** Additional controls imposed by the government can add unexpected costs to business operations and should be factored into deal ROI.
4. **View Mitigation from Customer Perspective:** Before sidelining a deal that may trigger review or mitigation protocols as prescribed by B.E.I.S., consider whether these additional measures can be leveraged as a competitive advantage. Although potentially burdensome, mitigation terms that require a higher level of security, for example, may be a net positive if customers will view it as a unique differentiator in a crowded market.

About the Authors

Scott Boylan, a Partner with StoneTurn, has more than 30 years of experience in advising public- and private-sector organizations on a broad range of international legal and business issues, including trade compliance, investment security and government contracting. He has been involved in all aspects of the Committee on Foreign Investment in the United States (CFIUS), from negotiating mitigation agreements for the government, sellers and buyers to establishing and leading compliance protocols for mitigated companies.

Annabel Kerley, a Partner with StoneTurn, qualified as a Chartered Accountant in 2004. For over 13 years, she has specialized in forensic accounting, building up a considerable track record in leading criminal, regulatory and corporate investigations in the financial services, technology, media, retail, public sector and healthcare industries.

Christopher Waters, a researcher at global advisory firm StoneTurn, contributed to this article.