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The UK national security and investment regime – a review of the first year

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In the 12 months since the UK NSIA regime became fully operational, it has demonstrated its ability to disrupt cross-border deals and, in over a dozen cases to date, prohibit or condition approval on far-reaching remedies. The regime remains challenging to navigate and the UK Government's intervention rate is expected to increase in the year ahead. This briefing highlights key enforcement trends and process issues that dealmakers should consider early in deal planning.

An active regulator

Under the UK National Security and Investment Act 2021 (NSIA), the Investment Security Unit (ISU) started to accept filings on 4 January 2022. One year in, the Secretary of State for the Department for Business, Energy and Industrial Strategy (BEIS), who previously had ultimate decision-making responsibility for reviews, has blocked four transactions and has imposed conditions in a further 10 transactions on the basis that they may pose a risk to UK "national security" – a concept not defined in the NSIA.

Today, the Government moved the ISU to sit within the Cabinet Office, with ultimate decision-making power now resting with Oliver Dowden (SoS), Chancellor of the Duchy of Lancaster, a close ally of the Prime Minister. This signals the increasing importance with which the new NSIA regime is regarded by the current Government and foreshadows a potential uptick in deal intervention rates with a greater risk of political considerations determining outcomes.

NSIA review processes and outcomes remain challenging to predict. For matters involving a target with activities in one or more of the 17 sensitive sectors subject to the mandatory filing regime, [1] or where there is a credible prospect of call-in under the voluntary regime, deal teams should consider early in the deal planning phase whether there is meaningful risk of a protracted review or conditions being imposed.

Through reference to our experience of working across a range of complex NSIA reviews, this briefing identifies process considerations and enforcement trends to consider when navigating a filing process.

Filing requirements not limited to traditional M&A

The NSIA casts a wide net, with reviews potentially required not only for traditional M&A but also a range of other transactions, including:

- **Minority share acquisitions** of more than 25% are notifiable and further filings may also be triggered by subsequent acquisitions that cross the 50% or 75% ownership thresholds. The ISU also has the discretion to call in acquisitions of less than 25% if they confer "material influence" over a target's commercial strategy.
- **Internal reorganisations** where there are changes in the corporate ownership of an entity active within one of the

17 sensitive sectors, but ultimate beneficial ownership remains the same. If the internal reorganisation is part of a restructuring which also leads ultimately to a change of control of the target, two (or more) separate filings may be required.

- **Grant of a licence agreement** (e.g., the first prohibition case, involving an intellectual property licence agreement between the University of Manchester and Beijing Vision Technology Company Limited).
- **Lending transactions** that involve the transfer of legal title or control.
- **Appointment of a liquidator or receiver** where the liquidator or receiver gains voting rights over a solvent subsidiary of the liquidated entity.

Timelines can be lengthy

While the NSIA sets out statutory review timelines – the review period can run for a maximum of 105 working days (approx. 5 months) – its practical application is less predictable once a deal is called in for in-depth review. That is a result of stop-the-clock information notices – of which there can be several rounds – that can prolong the process considerably. In complex cases, the ISU may also seek a voluntary extension.

The pace of ISU communications is also often slow, in part because the ISU acts as an intermediary between the parties, on the one hand, and various other government departments reviewing the deal, on the other. The difficulties around obtaining clarity on substance (discussed below) also stem from the fact that the ISU's assessment may rely on government classified information.

In practice, complex reviews may run for 6-8 months and potentially longer. Deals that do not get called in are typically cleared within 1-2 months of notification. In the immediate term, procedural delays may also result from today's moving of the ISU from BEIS to the Cabinet Office.

Range of sectors and acquirer types in focus

The NSIA prohibition and remedies cases to date demonstrate that the ISU is closely scrutinising a range of sectors. In addition to the obvious category of military and dual-use matters, where three cases have been subject to prohibition or remedy, the ISU has also blocked or imposed conditions in a range of other sectors, including energy (three cases), communications (two cases), satellite and space technology (two cases), and quantum technology (three cases).

Although there is a clear focus on acquirers with actual or potential links to China and Russia (which accounted for all publicly known prohibition decisions in 2022), acquirers domiciled elsewhere are not immune from close scrutiny. In 2022, remedies were also imposed in deals involving acquirers from the UAE, the US and the UK.

In fact, the true number of deals that collapsed as a result of NSIA scrutiny is unlikely to yet be clear. In contrast to antitrust processes, the SoS is not obliged to publish a prohibition decision or notice of deal withdrawal where transacting parties decide to terminate a deal prior to a decision deadline.

UK industrial policy and the substantive risk assessment

Under the NSIA, the ISU is required to consider "target risk" (the activities of the target), "acquirer risk" (the extent to which the acquirer poses national security risk) and "control risk" (the type/level of control being acquired).[2]

In the majority of cases, the "target risk" will be the primary driver of the assessment. However, there are certain categories of acquirers that are viewed as problematic, even if the target they are seeking to acquire only has limited UK sensitive activities. Where a potentially problematic acquirer is looking to buy a business that may have sensitive

activities in the future (e.g., *Nexperia/Newport Wafer Fab*) or where the UK concludes that its infrastructure is already over-reliant on an acquirer and any incremental increase in that reliance would be problematic, that may be sufficient to prohibit a deal on "acquirer risk" grounds.

Throughout reviews, the ISU is typically unwilling to provide insights into the status of its analysis. ISU commentary during calls with notifying parties will focus almost exclusively on process. Guidance on whether there are undefined "national security" concerns under consideration will not be shared until the latter stages of a review.

Decision-making can also be driven by other government departments to which notifying parties do not have direct access. For example, in telecom-related transactions, ISU questions and the outcome of a review are likely to be heavily influenced by the views of the National Cyber Security Centre and Department for Culture, Media and Sport. The outcome of defence-related reviews will largely rely on feedback provided to the ISU by the Ministry of Defence. Notifying parties should therefore design engagement strategies to make sure that deal rationale is clearly understood by all government stakeholders in order to allow for as quick and efficient a review as possible.

Relatedly, NSIA outcomes are potentially influenced by broader political and geopolitical dynamics. Members of the US Congress actively petitioned the Biden administration to engage with the UK regarding Nexperia's acquisition of Newport Wafer Fab, a deal which the Government ultimately determined should be unwound. The recent move of the ISU into the Cabinet Office is likely to increase the ability of politicians and administrations in allied countries to influence outcomes. Parties should also be aware of intensifying cooperation between the ISU and its counterparts in allied countries that may prompt in-depth scrutiny of certain deals. It is prudent to have advisers look across filing jurisdictions and design engagement strategies to take account of parallel reviews and the prospect of the ISU cooperating with its counterparts elsewhere.

Use of interim order powers

The mandatory regime suspends closing until the ISU has reached a decision. However, under the voluntary regime, the ISU has demonstrated its willingness to impose restrictive interim orders, pending the outcome of its review. These may impose restrictions that go even further than the standstill obligation under the mandatory regime and prohibit any communications between the parties altogether. Parties should therefore consider carefully deal timing implications, long-stop dates and integration planning mechanisms, even for matters that may be subject to discretionary call-in under the voluntary regime.

A preference for behavioural remedies

In contrast to antitrust regulators, the ISU is willing to impose non-structural, behavioural remedies. These may include keeping certain strategic capabilities within the UK, information restrictions, security measures and government oversight through approval of board members, auditors and security officers.

As conditions to clearance that are imposed by the ISU tend to be loosely drafted behavioural remedies, continuing post-clearance dialogue between the parties and authorities may be required. Whether this trend will continue remains to be seen, as the ongoing monitoring required by such remedies may stretch the ISU's resources as it takes on more remedy cases over time.

Unilateral remedy design

Where "national security" concerns are identified, remedies are not negotiated with the parties. The adoption of a Final Order, imposing remedies or blocking a deal entirely, is a unilateral decision taken by the SoS considering the recommendations of the ISU.

Transacting parties do have an opportunity to make written representations with regard to the ISU's remedy analysis. However, as the ISU will only provide a high-level and non-exhaustive list of remedies it is considering, and the parties have limited insights into the concerns that those remedies are designed to address, the ability to make meaningful representations that influence outcomes is typically limited.

Once a Final Order has been adopted, there is also limited scope to vary it. While the parties can request variation of the Final Order, the ISU will tend to grant it only if there is a material change of circumstances. Of the Final Orders that have been imposed so far, there has only been one variation (*Beijing Infinite Vision Technology Company Ltd./The University of Manchester*). There has also been one revocation (*Electricity North West Limited/Redrock Investment Limited*), granted on the basis the parties decided not to proceed with the acquisition.

Judicial review?

Although parties have limited influence over the contents of a Final Order, they do have the right to apply for judicial review with the High Court on (albeit relatively limited) grounds of illegality, procedural unfairness or irrationality.

To date, *Nexperia/Newport Wafer Fab* is the only NSIA case which has led to a judicial review application. Nexperia has lodged an application on the basis that the Final Order was disproportionate and therefore illegal, as the ordered divestment of Newport Wafer Fab puts hundreds of jobs at risk and other remedies had been offered but rejected by the Government. The outcome of the application is pending, but will set a precedent for future deals and may prompt refinements to ISU review processes.

Confidentiality considerations

As notices of Final Orders (not the Final Order itself) are published on the UK Government website, some buyers may have legitimate concerns around any potential reputational damage and whether they will face any difficulties in negotiating future deals in the UK.

When it becomes clear that the SoS will likely block the deal (typically only a few days before they adopt a decision), withdrawing from the deal altogether may therefore be the preferred course of action to limit disclosure. As long as the buyer notifies the ISU of its intention to terminate the deal before the Final Order is adopted, that will avoid the publication of the Final Order and indeed any other information pertaining to the deal. Relatedly, if it becomes apparent that the SoS will likely impose remedies, the parties may no longer find the deal commercially attractive and want to pull out (confidentiality considerations aside). In high-risk deals, parties should therefore take care to design appropriate termination provisions in deal documents.

Looking ahead

The ISU is expected to continue to be very active in the year ahead, particularly as it now sits within the Cabinet Office with reviews closely scrutinised by high-ranking political decision-makers. The current Government appears broadly approving of outcomes to date and a change in enforcement practices therefore seems unlikely. As the regime continues to develop, transacting parties are encouraged to carefully consider risk allocation at an early stage in deal planning to reduce commercial uncertainty and to seek the views of legal counsel when navigating the complexities of an ISU review.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] Namely: Advanced Materials, Advanced Robotics, Artificial Intelligence, Civil Nuclear, Communications, Computing Hardware, Critical Suppliers to Government, Cryptographic Authentication, Data Infrastructure, Defence, Energy, Military and Dual-Use, Quantum Technologies, Satellite and Space Technologies, Suppliers to the Emergency Services, Synthetic Biology and Transport.

[2] UK Government Notice, National Security and Investment Act 2021: Statement for the purposes of section 3 (published 2 November 2021), available here.