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UK National Security and Investment Screening Regime

Client Briefing

February 2021

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The UK Government announced in November 2020 far-reaching changes to its powers to screen investments in the UK on the basis of national security grounds that will include a new UK review body similar to the Committee on Foreign Investments in the United States (CFIUS). This Curtis client briefing discusses in Part I the proposed National Security and Investment Bill currently pending in Parliament, and provides in Part II an overview of the currently-existing regulatory regime that will be superseded by the new legislation, which is expected to become law in the second half of 2021.

The proposed legislation empowers the UK government to retroactively review transactions that were completed before the new legislation came into force. If you would like to discuss the proposed legislation and how it may affect your investments or investment plans, please contact the persons listed in this client briefing or inquire with your regular Curtis contact.

PART I

I. Executive Summary of the National Security and Investment Bill 2019-2021

1. UK Government Embarks on Overhaul of its National Security and Investment Regime

(a) **Rationale for the Bill:** The UK government felt a need for a new and comprehensive national security and investment screening regime and, in particular, a need to introduce a separate national security investment regime, divorced from competition regulation:

> "Our current powers largely in this area date from 2002 – technological, economic and geopolitical changes mean that reforms to the government's powers to scrutinise transactions on national security grounds are overdue. Several of our allies, including the United States, Australia, Canada, have also made changes to their investment screening processes in recent years. The National Security and Investment Bill will provide the government with new powers to screen investments so that screening stays effective now and into the future. It will also give businesses and investors a clear and predictable process, so that they can continue to do business in the UK with confidence."

(b) **Interplay with the Existing Enterprise Act 2002 ("EA 2002"), as amended:** Once the Bill is passed and becomes law, the Secretary of State's (SoS) ability to review mergers which give rise to a national security

consideration under the EA 2002 will be replaced by the new national security and investment regime under the new Act (subject to limited transition period provisions).

2. Key Features of the National Security and Investment Bill 2019-2021

(a) **Significant Change:** The UK will be changing from a "light touch" security regime sitting, effectively, on top of the UK merger regime with no mandatory notification / filing requirement which reviewed 1-2 deals per year (and historically blocked none) to a stand-alone, more comprehensive national security and investment screening regime with its own separate reviewing body (the new Investment Security Unit (ISU)).

(b) **ISU:** The new reviewing body will be headed by the SoS for the Department of Business, Energy & Industrial Strategy (BEIS) with initial staff of 100 which, according to UK government projections, will be reviewing 1,000 – 1,830 cases per year.

(c) **Broadening the Scope of Review:** The range of investments in scope has been expanded in the Bill, for example, by removing the existing turnover and share of supply thresholds and also including acquisition of assets.

(d) **New Notification:** The Bill introduces a hybrid mandatory / voluntary notification of relevant transactions to the ISU, in contrast to the existing regime that does not provide for any mandatory notification requirement.

(e) **Wide Triggers:** The Bill provides that mandatory notification triggers will apply to relevant transactions in specified sectors. It is expected that 17 sectors will be subject to the mandatory notification regime. The definitions of these sectors are broadly drawn and are currently subject to further review and approval by the relevant bodies.

(f) **Interim Period Review:** Transactions signed in the interim period, being after the Bill was first introduced in Parliament on 11 November 2020, which close before the commencement date of the new Act, might have a mandatory notification requirement and the SoS can still call in a trigger event.

(g) **Retrospective Review:** ISU will have the power to retrospectively review transactions for up to five years after a trigger event takes place.

(h) **Civil and Criminal Penalties:** Significant civil and criminal consequences for non-compliance will be introduced with the Bill, including

(i) penalties up to GBP 10 million (in the case of an individual) or up to the higher of GBP 10 million and 5% of worldwide turnover of the business (in the case of a business) - such turnover includes the worldwide turnover of any business owned or controlled by that business;

(ii) imprisonment of up to five years for the relevant individual(s); and,

(iii) if a transaction subject to a mandatory notification is completed without clearance, it will be legally void (although the SoS will have the power to retrospectively validate the transaction).

The Bill provides for extra-territorial application in respect of criminal offences specified, i.e., it operates:

(i) regardless of whether the offences are committed in or outside the UK;

(ii) whether or not the individual who has committed the offence(s) is a UK national; and

(iii) whether or not the relevant entity which has committed the offence(s) is incorporated or otherwise formed or recognised under the law of a country or territory in or outside the UK.

3. Legislative Status

(a) **Introduction of the Bill**: The National Security and Investment Bill was announced in the Queen's Speech on 19 December 2019. The Bill was first introduced into the UK Parliament on 11 November 2020 where it had its first and second readings.

(b) **Current Legislative Status:** The Bill has been considered by the Public Bill Committee which has reported the Bill, without amendments, to the House of Commons, following which there will be a third reading, before the Bill in the form approved by the House of Commons goes to the House of Lords where a similar process will take place. There will then be a consideration of amendments before the approval of the final version of the Bill by each House and the royal assent. Assuming there will be no parliamentary delays, it is anticipated that the Bill (with any amendments) is likely to be passed not earlier than about spring 2021. Once the Bill has received the royal assent, it will be known as the National Security and Investment Act. The provisions of the Act may come into effect immediately,

after a set period or only after a commencement order by a government minister.

(c) **Territorial Scope and Trigger Events Timeframe:** The Bill envisages that the new regime will apply to all of the UK in relation to the relevant events occurring on or after 12 November 2020, with certain transitional provisions specified in the Bill in respect of trigger events occurring during the period beginning on 12 November 2020 and ending on the day immediately preceding the date of commencement of the Act.

II. Overview of the National Security and Investment Bill 2019-2021

1. Key Definitions

(a) **"Qualifying Entity":** any entity carrying on activities in the UK or supplying goods or services to persons in the UK.

(b) **"Qualifying Asset":** (1) land, (2) tangible moveable property, or (3) ideas, information or techniques which have industrial, commercial or other economic value. This includes (i) trade secrets, (ii) databases, (iii) source code, (iv) algorithms, (v) formulae, (vi) designs, (vii) plans, drawings and specifications, and (viii) software. An asset must be used in connection with activities carried on in the UK, or the supply of goods or services to persons in the UK.

2. National Security and Investment Bill 2019-2021

(a) **Review Triggers:** There are three key ways in which a review by the SoS will be triggered:

(i) Mandatory notification by the acquirer of a notifiable Qualifying Entity in key sectors of the economy;

(ii) Voluntary notification by the acquirer of a Qualifying Asset or Qualifying Entity in other sectors of the economy; or

(iii) The SoS at his/her own initiative through the exercise of a "call-in" power.

(b) **SoS's Powers:** The SoS has a wide range of powers under the Bill, including a power to carry out a full assessment of the potential risks and, where necessary and proportionate, impose remedies to address such risks.

(c) **Call-in Power:** The SoS has the power to issue a call-in notice for national security purposes if he/she reasonably suspects that:

(i) A trigger event has taken place in relation to a Qualifying Entity or Qualifying Asset and the event has given rise to or may give rise to a risk to national security; or

(ii) Arrangements are in progress or contemplation which, if carried into effect, will result in a trigger event taking place in relation to a Qualifying Entity or Qualifying Asset, and the event may give rise to a risk to national security.

3. Notifiable Acquisition – Mandatory Notification for key sections of the economy

(a) **A Notifiable Acquisition is Where:**

(i) A person gains control of a Qualifying Entity; or

(ii) A person acquires a right or interest in or in relation to a Qualifying Entity and as a result the percentage of the shares or voting rights that the person holds in the entity increases from less than 15% to 15% or more.

(b) **Relevant Sectors**: It is expected that 17 sectors will be subject to the mandatory notification regime and the government is currently in the consulting process to determine what types of entity within each sector may come under the mandatory regime. The scope of the mandatory notification regime will be set out in secondary regulation before commencement of the bill. The 17 proposed sectors within which mandatory notification will be required are:

(i) Advanced Materials;

(ii) Advanced Robotics;

(iii) Artificial Intelligence;

(iv) Civil Nuclear;

(v) Communications;

(vi) Computing Hardware;

(vii) Critical Suppliers to Government;

(viii) Critical Suppliers to the Emergency Services;

(ix) Cryptographic Authentication ;

(x) Data Infrastructure;

(xi) Defence;

(xii) Energy;

(xiii) Engineering Biology;

(xiv) Military and Dual Use;

(xv) Quantum Technologies;

(xvi) Satellite and Space Technologies; and

(xvii) Transport.

(c) **Process:** A person must give notice to the SoS before the person gains control of the Qualifying Entity or acquires the right or interest in or in relation to the Qualifying Entity that increases their percentage of the shares or voting rights from less than 15% to 15% or more.

(d) **Failure to Notify:** A notifiable acquisition that is completed without the approval of the SoS is void.

(e) **Secretary of State Power:** Where the acquisition was subject to mandatory notification and the party did not notify the SoS, there is no time limit for when the SoS has the power to call in a trigger event.

4. Voluntary Notification for other sectors in the economy

(a) **Voluntarily Notify the Secretary of State:** Where the arrangement or trigger event does not result in a notifiable acquisition, a seller, acquirer or the Qualifying Entity may give notice to the SoS that a trigger event has taken, or will take, place in relation to a Qualifying Entity or Qualifying Asset.

(b) **Secretary of State Power:** The SoS has the power to call in a trigger event which has taken place up to six months after it becomes aware of such event so long as it is within five years of the trigger event occurring.

5. Call-in Notice Powers

(a) **Trigger Event:** A trigger event occurs where:

(i) **A person gains control of a Qualifying Entity:**

(1) Shares / voting rights increase (i) from less than 25% to more, (ii) from less than 50% to more, or (iii) from less than 75% to more;

(2) Acquisition of voting rights enables them to secure or prevent the passage of a resolution governing the affairs of the entity; or

(3) Acquisition enables the person to materially influence the policy of the entity.

(ii) **A person gains control of a Qualifying Asset:** the person acquires a right or interest in or in relation to the asset and as a result the person is able:

(1) to use the asset, or use it to a greater extent than prior to the acquisition; or

(2) to direct or control how the asset is used, or direct or control how it is used to a greater extent than prior to the acquisition.

6. Considerations of the SoS when Exercising the Call-in Power

The SoS has issued a draft statement setting out how the SoS expects to use the call-in power and the risk factors the SoS expects to consider when deciding whether to use it. The SoS has set out that the three key considerations they will take into account will include:

(a) **The Target Risk:** the nature of the target and whether it is in an area of the economy in which the government considers risks more likely to arise. Generally speaking, there are three levels of risk:

(i) **Core areas:** areas where national security risks are more likely to arise and mandatory notifications may apply, including:

(1) National infrastructure sectors;

(2) Advanced technology;

(3) Military and dual-use technologies; and

(4) Direct suppliers to the Government and Emergency Services.

(ii) **Core activities:** the SoS will identify specific activities in which risks are most likely to arise and in which the call-in power is most likely to be used. These core activities will primarily be within the core areas.

(iii) **The wider economy:** in the wider economy, it is generally considered that any trigger events are unlikely to pose risks to national security.

(b) **The Trigger Event Risk:** the potential of the underlying acquisition of control to undermine national security in practice. The trigger event risks include the potential for:

(i) Gaining control of a crucial supply chain / obtaining access to sensitive sites with the potential to exploit;

(ii) Disruptive or destructive actions – the ability to corrupt processes or systems;

(iii) Espionage – the ability to have unauthorised access to sensitive information; and

(iv) Inappropriate leverage – the ability to exploit an investment to influence the UK.

(c) **The Acquirer Risk:** the extent to which the acquirer raises national security concerns. This is an acknowledgement that while an acquisition of control may have the potential to undermine the UK's national security, the vast majority of acquirers would not use an acquisition to do so. A key example provided is pension funds, as pension funds may be long-term investors in entities that operate in the UK's national infrastructure, but will not often seek to interfere in their processes. Factors the SoS will take into

account when considering the Acquirer Risk will be determined on a case-by-case basis, and may include:

(i) those in ultimate control of the acquiring entity;

(ii) the track record;

(iii) whether the acquirer is in control of other entities within a sector or owns significant holdings within a core area; and

(iv) any relevant criminal offences or affiliations.

The SoS has set out that the National Security and Investment regime doesn't regard state-owned entities, sovereign wealth funds or other entities affiliated with foreign states as being inherently more likely to pose a national security risk, recognising they may have full operational independence raising no national security risks. The SoS has stated that he/she will consider the entity's affiliations to hostile parties rather than the existence of a relationship with foreign states in principle, or their nationality.

7. Call-in Acquisitions of Control of Assets

(a) The SoS expects any intervention in asset transactions to be rare, unless assets are integral to the core activities of an entity operating in a core area, or an asset is in a core location. The SoS has provided a set of examples for when he/she may intervene.

(b) **Examples for Asset Intervention:**

(i) **Land:** where it is or is proximate to a sensitive site, such as national infrastructure sites or government buildings.

(1) Asset D is a piece of land adjacent to a sensitive Ministry of Defence facility. Party E wishes to buy Asset D. The acquisition may give rise to national security risks as the proximity of Asset D could allow a hostile actor to gather sensitive information about the operations of the Ministry of Defence facility.

(ii) **Tangible moveable property:** such as physical designs and models, technical office equipment and machinery.

(1) Asset F is a moulding machine used by Business G to manufacture components for UK military aircraft. Business G upgrades their facilities and Party H seeks to acquire Asset F from Business G. This may give rise to national security risks as the asset may allow a hostile actor to replicate the engineering of, or identify potential vulnerabilities in, components used in active UK military aircraft.

(iii) **Ideas, information or techniques which have industrial, commercial or other economic value:** such as trade secrets, non-physical designs and models and source code.

(1) Asset I is the underlying source code used by Business J in its computer programs used by UK air traffic control operators. Business J is approached by Party K who wishes to acquire the right to access and use Asset I. This may give rise to national security risks as the asset may allow a hostile actor to identify vulnerabilities in the programs used to monitor and communicate with aircraft in UK airspace.

PART II

III. Regime in Effect Pre-COVID-19 - Enterprise Act 2002

1. Competition and Markets Authority

(a) **Background:** There is currently no specific law governing or restricting foreign investment in the UK. Instead it is addressed within the UK's competition regulations and primarily reviewed by the Competition and Markets Authority (CMA). The focus of foreign investment reviews has traditionally been to guard against anti-competitive market practices and uphold proper conduct in takeover situations.

(b) **Enterprise Act 2002:** The government's authority to intervene in mergers is based on the EA 2002. The CMA is the primary government agency responsible for reviewing qualifying mergers under the EA 2002 using competition law principles.

(c) **Intervention in a Merger:** The SoS has authority to intervene in a merger by making:

(i) a Public Interest Intervention Notice; or

(ii) a Special Public Interest Intervention Notice.

2. Public Interest Intervention Notice (Section 23 EA 2002)

(a) **First Scope:** Applies to all relevant CMA merger situations if the following intervention thresholds are met:

(1) UK turnover of the target exceeds GBP 70 million; or

(2) target's existing share of supply of goods or services in the UK is at least 25%.

Where the above thresholds are met, then the following public interest grounds (Section 58 EA 2002) apply:

(1) National security;

(2) Plurality of the media; and

(3) Stability of the financial system.

(b) **Second Scope:** Applies to merger situations where CMA thresholds are not met, if the following intervention thresholds are met:

(1) UK turnover exceeds GBP 1 million; and

(2) existing share of supply of goods or services in the UK is at least 25%.

Where the above thresholds are met, then the following public interest grounds apply:

(1) Development or production of items for military or dual-use;

(2) Design and maintenance of aspects of computing hardware; and

(3) The development and production of quantum technology (quantum computing).

(c) **Notification:** Parties are not required to notify the SoS or the CMA of an intention to enter into a merger. It is simply advisable to notify if the relevant jurisdictional thresholds are met as the CMA may investigate transactions and impose orders. The CMA has the power to unwind a merger.

3. Special Public Interest Intervention Notice (Section 59 EA 2002)

Scope: Applies to merger situations where no CMA thresholds for intervention pursuant to a Public Interest Intervention Notice apply, but the following special public interest grounds are met:

(a) Relevant government contractor with designated confidential information; and

(b) Supply of at least 25% of all newspapers or 25% of all broadcasting.

4. Intervention on National Security Grounds – Examples

(a) **Intervention:** Under the EA 2002, the government has only intervened on grounds of public interest on 20 occasions – once on financial stability

grounds, seven times on media plurality grounds and twelve times on national security grounds. No transaction has been blocked on specified public interest grounds.

(b) **Example 1: Gardner Aerospace's acquisition of Northern Aerospace**

In June 2018 Better Capital announced it had agreed to sell Northern Aerospace Ltd, one of the aerospace industry's largest suppliers of aircraft components, to Gardner Aerospace Holdings Ltd, a wholly owned subsidiary of the Chinese company Shaanxi Ligeance Mineral Resources.

The SoS issued a public interest intervention notice on 17 June 2018. The transaction was subsequently allowed to go ahead.

(c) **Example 2: Gardner Aerospace's proposed acquisition of Impcross**

In 2019 Gardner Aerospace was in exploratory conversations for the acquisition of Impcross, a southwest England-based engineering firm involved in the manufacture and assembly of control and actuation components for civil and military aircraft.

The SoS issued a public interest intervention notice on 5 December 2019 against the acquisition and in March 2020, following deeper scrutiny of the deal, Gardner Aerospace announced it had abandoned the acquisition.

Gardner Aerospace subsequently gave a series of undertakings not to renew its approach, which were accepted by the SoS in September 2020 as sufficient to mitigate the national security risk.

(d) **Example 3: Attempted takeover of AstraZeneca by Pfizer**

AstraZeneca is a British pharmaceutical company, so the attempted takeover by Pfizer, an American pharmaceutical corporation, resulted in intense opposition from politicians, scientists and the board of AstraZeneca.

Key concerns regarding the attempted takeover included the loss of AstraZeneca jobs, research and intellectual property, despite Pfizer stating it planned to keep AstraZeneca jobs, giving a five-year commitment to complete a new research centre in Cambridge, and providing commitments to retain a factory in Britain and keep a fifth of research staff in Britain. Such

discomfort around takeovers was particularly acute at the time, following various takeovers such as Kraft's takeover of Cadbury's, as Kraft promised to keep Cadbury's Somerdale factory open, then backtracked and said it would close it after the deal closed.

Opinions were divided about whether the government should intervene on public interest grounds or remain neutral. It was considered that the SoS could use his/her public interest powers to intervene in the takeover. It led to a debate around the public interest test and the need for it to be broader as the Pfizer deal wasn't really considered to fall within either national security, financial stability or media plurality.

Ultimately AstraZeneca's board refused to approve or recommend the bid and Pfizer walked away.

IV. Changes to Enterprise Act 2002 in Response to the COVID-19 Pandemic

1. The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order June 2020

(a) **Purpose:** To enable the UK government to maintain in the UK the capability to combat and mitigate the effects of public health emergencies. The reforms cover businesses directly involved in the pandemic response.

(b) **Effect:** This Order amended the public interest considerations set out in Section 58 EA 2002, in relation to which the SoS may intervene on grounds of national security, to include as a specified public interest consideration businesses critical to the UK's ability to combat and mitigate the effects of public health emergencies.

(c) **Expansive:** The government indicated that these powers could be applied broadly, beyond direct acquisitions in the healthcare section, and could include:

(1) Pharmaceutical companies;

(2) Vaccine research;

(3) Manufacture of medical supplies and personal protective equipment;

(4) Food supply chain;

(5) Logistics companies that play an essential role in keeping supply chains moving; and

(6) Private healthcare companies.

2. The Enterprise Act 2002 (Share of Supply) (Amendment) Order July 2020

(a) **Purpose:** To extend the previous 2018 amendment to the UK merger control regime and prevent the opportunistic acquisition of certain businesses.

(b) **Effect:** This order increased the government's powers to scrutinise and intervene in mergers in three additional sectors of the economy considered to be important to national security. As such, the order applied the lowered turnover test and share of supply test to transactions in three further sectors:

(i) Artificial intelligence;

(ii) Cryptographic authentication; and

(iii) Advanced materials sector.

If you have any questions regarding the existing and/or new legislation and how it may affect your UK investment plans, please contact any of the persons listed below or speak to your usual Curtis contact.

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