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Four-Part Series: National Security and Investment Act 2021

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National Security and Investment Act 2021, Part 1 – Background and Key Features

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In a series of articles in the coming months we will consider the National Security and Investment Act 2021 (the "NSI Act") and its impact on the real estate finance market.

In this month's article, we will provide some background on the NSI Act and introduce some of its key features. In the following months, we will discuss the notification and intervention provisions, sanctions for non-compliance, and impact on the real estate finance market in respect of the NSA Act.

Background

The NSI Act came into force on 4 January 2022. The NSI Act is a significant piece of new legislation which establishes a stand-alone statutory regime for government scrutiny of, and intervention in, acquisitions and investments for the purpose of protecting national security in the United Kingdom (the "UK").

The provisions of the NSI Act replace the existing public interest merger regime provisions of the Enterprise Act 2002 to the extent that a transaction involves national security considerations. The NSI Act gives the UK Government the power to screen transactions where there is a change of control of entities or assets, even when these assets are based overseas.

Key considerations

Lenders and investors should give due consideration to the NSI Act in order to protect their transactions and officers from potential criminal liability. They should also ensure that they are cognisant of the new rules given the broad scope of the mandatory notification system under the NSI Act.

Lenders should also carefully consider the implications of the NSI Act in respect of their secured lending transactions, especially when it comes to share security and enforcement.

Some key issues for investors to consider are:

- whether their transaction requires mandatory notification? and if not, may a voluntary notification be advisable?

- ensuring that NSI Act considerations are factored into deal timelines and documentation to manage the risks of delay or Government intervention.

As noted above, we will explore these issues during the course of this series in the coming months.

Key features of the NSI Act

The key features of the NSI Act include:

- mandatory notification of some transactions in 17 specified sectors (see below);
- voluntary notification for certain transactions that may give rise to national security concerns; and
- call-in powers under which the government's powers to "call-in" transactions across all sectors of the economy on national security grounds are significantly extended.

We will explore the notification requirements in next month's issue.

What are the 17 designated sectors?

The NSI Act establishes a mandatory notification requirement where a change of control occurs in relation to an entity with "specified activities" within any of the 17 designated sectors, namely: (a) Advanced Materials; (b) Advanced Robotics; (c) Artificial Intelligence; (d) Civil Nuclear; (e) Communications; (f) Computing Hardware; (g) Critical Suppliers to Government; (h) Critical Suppliers to the Emergency Services; (i) Cryptographic Authentication; (j) Data Infrastructure; (k) Defence; (l) Energy; (m) Military and Dual-Use; (n) Quantum Technologies; (o) Satellite and Space Technologies; (p) Synthetic Biology; and (q) Transport (the "sensitive sectors").

The sensitive sectors and final definitions for these sectors are set out in a Statutory Instrument – the National Security and Investment Act 2021 (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021. The sector definitions are relatively detailed and technical and, recognising their complexity, the Department for Business, Energy and Industrial Strategy has published guidance to help explain what the definitions are intended to capture and how to apply them.

Closing thoughts

Despite this guidance, parties may also need to consider several of the sector definitions given a number are closely linked, and take care that even if a target's core activities are not within one of the sensitive sectors it does not have other activities that are caught (*e.g.*, a technology product involving artificial intelligence or advanced robotics).

In next month's edition of *REF News and Views* we will further expand on the NSA Act's notification and intervention provisions.

National Security and Investment Act 2021, Part 2 – Notification and Intervention Provisions


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In this month's edition of *REF News and Views* we are going to continue our series on the National Security and Investment Act 2021 (the "NSI Act") and discuss its notification and intervention provisions.

To recap, in last month's edition of *REF News and Views* we provided some background on the NSI Act and introduced some of its key features. In particular, the NSI Act establishes a mandatory notification requirement where a change of control occurs in relation to an entity with "specified activities" within any of the 17 designated sectors (which include Artificial Intelligence, Defence and Energy) (the "sensitive sectors").

Background

The NSI Act established a hybrid regime falling into two parts:

- a "mandatory regime": requires a person that acquires a specified level of control over a certain type of entity (a "qualifying entity") that undertakes particular activities in the UK in one of the sensitive sectors to notify, and obtain approval from, before completing their acquisition; and
- a "voluntary regime": allows parties to submit transactions for approval – and also allows deals to be called-in retrospectively even if not voluntarily notified.

Notifications are made to the Investment Security Unit (the "ISU"), which sits within the Department for Business, Energy and Industrial Strategy (the "BEIS"). The ISU operates the NSI Act regime (although this is performed in the name of the Secretary of State for Business, Energy and Industrial Strategy (the "Secretary of State")).

Real estate transactions or transactions involving real estate could fall within either the mandatory regime or the voluntary regime, depending on the specific circumstances of the transaction. If there is a trigger event in relation to a property SPV qualifying entity and that SPV carries on a particular activity in one of sensitive sectors in the UK, this will fall within the mandatory regime and require notification. We will explore this in further detail later in the series.

Notification and intervention framework

Mandatory notification

The test for a mandatory notification is broadly in two parts: (a) there needs to be a trigger event; and (b) the transaction needs to involve a qualifying entity.

The trigger events for mandatory notification are where a person gains control in a qualifying entity whereby:

- the percentage of the persons shareholding or voting rights held increases:
    - from 25% or less to more than 25%;
    - from 50% or less to 50% or more; or
    - from less than 75% to 75% or more; or
- the person acquires voting rights in a qualifying entity and, as a result, is able to secure or prevent the passage of any class of resolution governing the affairs of the qualifying entity.

Voluntary notification

Whether or not a transaction involves a target entity in a sensitive sector, there are trigger events which apply under the voluntary regime (which do not require mandatory notification).

Such events are as follows:

- the acquisition of material influence over a qualifying entity's policy; or
- the acquisition of a right or interest in, or in relation to, an asset of a certain type (a "qualifying asset") providing the ability to use or control the asset (either entirely or to a greater extent). A qualifying asset can include any tangible property, land, or intellectual property. Foreign entities and assets can be caught by the NSI Act regime if they have a connection with activities carried out in the UK, or the supply of goods or services to persons in the UK.

In these cases, parties need to consider whether a voluntary notification is advisable.

Connection with the UK

To fall within the NSI Act regime, a target entity or asset must be from, in or have a sufficient connection with the UK:

- a qualifying entity must carry on activities in the UK or supply goods or services to people in the UK; and
- a qualifying asset must be used in connection with activities carried on in the UK or the supply of goods or services to people in the UK.

The BEIS has published specific guidance on when target entities and assets outside the UK are within the scope of the NSI Act regime. It should be noted that the BEIS takes a relatively broad approach when determining this scope (assessments will also be fact-specific and may not be straightforward).

Call-in power

The Secretary of State has the power to produce what is known as a “call-in” notice if:

- it reasonably suspects that a trigger event has taken place in relation to a qualifying entity or qualifying asset; or
- if there are arrangements in contemplation, which, if affirmed, will result in a trigger event taking place in relation to a qualifying entity or qualifying asset.

If a call-in notice is served by the Secretary of State then an initial 30 working days’ assessment period is triggered during which the Secretary of State will investigate the transaction.

A transaction can be called in up to six months after the Secretary of State becomes aware of it (and up to five years after completion).

Prior to an acquisition or investment, an investor can therefore elect to make a voluntary notification to the ISU.

Closing thoughts

It is worth noting that, for real estate deals, the most important issue is whether the property is “in proximity to a sensitive site” (such as critical national infrastructure sites or government buildings or because of the intended use of the land). Assets may be subject to the regime where they are closely linked to the activities of the sensitive sectors or in other areas that are closely linked to those sectors. If so, a transaction can fall within the voluntary regime, but there is little guidance as to what comprises a sensitive site. Despite this, government guidance suggests that it rarely expects to intervene in asset transactions.

To the extent that any transaction involves a qualified entity or qualifying asset, parties and their counsel should factor in the impact of the notification requirements under the NSI Act on the deal timeline and transaction execution.

In next month’s edition of *REF News and Views* we will explore the sanctions under the NSI Act for non-compliance.

National Security and Investment Act 2021, Part 3 – Sanctions for Non-Compliance

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In this month's edition of *REF News and Views*, we are going to continue our series on the National Security and Investment Act 2021 (the "NSI Act") and explore the sanctions under the NSI Act for non-compliance.

To recap, in last month's edition we discussed the notification and intervention provisions contained within the NSA Act. In particular, the NSI Act establishes a hybrid regime falling into two parts:

- a "mandatory regime," which requires a person that acquires a specified level of control over a certain type of entity (a "qualifying entity") that undertakes particular activities in the UK in one of the sensitive sectors to notify, and obtain approval before completing their acquisition; and
- a "voluntary regime," which allows parties to submit transactions for approval, and also allows deals to be called-in retrospectively, even if not voluntarily notified.

Real estate transactions or transactions involving real estate could fall within either the mandatory regime or the voluntary regime, depending on the specific circumstances of the transaction. As such, real estate investors should take note of the far-reaching sanctions and enforcement provisions contained in the NSA Act designed to ensure compliance.

What Are the Sanctions for Non-Compliance?

Call-In Power

As discussed last month, the UK's Secretary of State for Business, Energy and Industrial Strategy (the "Secretary of State") has the power to produce what is known as a "call-in" notice if:

- it reasonably suspects that a trigger event has taken place in relation to a qualifying entity or qualifying asset; or
- if there are arrangements in contemplation which, if affirmed, will result in a trigger event taking place in relation to a qualifying entity or qualifying asset.

If a call-in notice is served by the Secretary of State, then an initial 30 working days' assessment period is triggered during which the Secretary of State will investigate the transaction.

A transaction can be called-in up to six months after the Secretary of State becomes aware of it (and up to five years after completion of the transaction).

As a result of this risk, prior to an acquisition an investor may wish to make a voluntary notification to the Investment Security Unit of the Department for Business, Energy and Industrial Strategy. As noted above, this could include the acquisition of real estate assets.

Enforcement

Further, the Secretary of State has the power under the NSI Act to impose remedies to address any national security concerns or risks.

The NSI Act provides for:

- a transaction requiring mandatory notification to be void if completed without approval;
- the imposition of civil fines of up to the higher of £10 million or 5% of worldwide turnover for non-compliance, including competing a notifiable transaction without approval. This can include a "daily rate" fine (of up to £200,000 or 0.1% of turnover per day) to incentivise rapid compliance;
- civil enforcement, including injunctions to enforce compliance; and
- criminal sanctions for non-compliance (including completion of a notifiable transaction without approval, non-compliance with an order, or non-compliance with a requirement to provide information), with penalties including fines, imprisonment and disqualification as a director.

The statutory basis for offences under NSI Act can be found in Part 3, Section 32-36 of the NSI Act. Individual officers of a company may be guilty of an offence, as well as the corporate body itself.

Criminal Proceedings

The Secretary of State has the discretion to refer suspected offences under the NSI Act to the police for possible criminal investigation. This will usually be considered only in the most serious matters. Once a matter is referred to the police, all decisions in respect of investigation, charging and prosecution rest with the police and the Crown Prosecution Service.

Overview of Orders Published To Date

The UK Government has published Guidance on how to comply with the NSI Act and what can be expected if an individual or firm is subject to orders and notices.

Since the NSI Act came into force in January 2022, the UK Government has reviewed more than 800 transactions for possible national security concerns. The Secretary of State has prohibited five transactions, four of which involve Chinese investors and one involves Russian investment. At least two of the prohibitions (the acquisition of Newport Wafer Fab by Nexperia BV and the acquisition of Upp Corporation Ltd by L1T FM Holdings UK Ltd.) are reportedly under appeal.

Closing Thoughts

Whilst the vast majority of transactions reviewed under the new NSI Act regime are expected to be cleared without needing remedies, the new regime is far-reaching with serious consequences for non-compliance. Parties to transactions should keep this in mind and take note that a much wider national security review would be required than under the Enterprise Act regime.

In our next month's edition of *REF News and Views* we will discuss the NSI Act's impact on the real estate finance market.

National Security and Investment Act 2021, Part 4 – Impact on the Real Estate Finance Market

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In this month's edition of *REF News and Views* we are going to wrap up our series on the National Security and Investment Act 2021 (the "NSI Act") and explore the NSI Act's impact on the real estate finance ("REF") market.

In last month's edition of *REF News and Views* we explored the sanctions available under the NSI Act for non-compliance. We explained that the Secretary of State for Business, Energy and Industrial Strategy (the "Secretary of State") has wide-ranging powers to "call-in" transactions if:

- it reasonably suspects that a trigger event has taken place in relation to a certain type of entity (a "qualifying entity") or asset ("qualifying asset") in the UK in one of the designated 17 sensitive sectors (the "sensitive sectors"); or
- there are arrangements in contemplation which, if affirmed, will result in a trigger event taking place in relation to a qualifying entity or qualifying asset.

Further, we highlighted that the NSI Act regime is far-reaching with serious consequences for non-compliance. The Secretary of State has the power to impose remedies to address any national security concerns or risks, including:

- a transaction requiring mandatory notification to be void if completed without approval;
- the imposition of civil fines of up to the higher of £10 million or 5% of worldwide turnover for non-compliance, including competing a notifiable transaction without approval. This can include a "daily rate" fine (of up to £200,000 or 0.1% of turnover per day) to incentivise rapid compliance;
- civil enforcement including injunctions to enforce compliance; and
- criminal sanctions for non-compliance (including completion of a notifiable transaction without approval, non-compliance with an order, or non-compliance with a requirement to provide information), with penalties including fines, imprisonment and disqualification as a director.

Impact on the REF Market

How does the NSI Act impact on the REF market? At a holistic level, lenders should carefully consider the implications of the NSI Act in respect of their secured lending transactions, especially when it comes to the taking of share security and prior to taking any enforcement action.

When managing a transaction, counsel should factor in possible delays while waiting for ISU approval on the deal timeline and transaction execution. As inconvenient as any potential delays may be, the severity of the consequences of failure to obtain prior approval far outweighs this.

Consideration in Respect of the Type of Assets

While lending and taking security are not in of itself within the mandatory notification regime, the nature of the underlying transaction which is being financed needs to be carefully considered when assessing whether a mandatory or voluntary notification should be made.

Assets may be subject to the regime where they are closely linked to the activities of the sensitive sectors or in other areas that are closely linked to those sectors. Land may also be an asset of national security interest where it is, or is proximate to, a sensitive site (such as critical national infrastructure sites or government buildings) or because of the intended use of the land. This is perhaps the most important issue to consider in REF deals.

As we have previously noted, if there is a trigger event in relation to a property holding SPV that is a qualifying entity and that SPV carries on a particular activity in one of sensitive sectors in the UK, then this will fall within the mandatory regime and require notification.

Equitable Charges over Shares

One of the most relevant questions to the REF market regarding the NSI Act is whether the creation of equitable charges under secured lending transactions could constitute a trigger event under section 8(2) of the NSI Act such that a charge could be within scope of the mandatory notification requirements, because to do so would have far-reaching consequences.

Following discussions between Department for Business, Energy and Industrial Strategy ("BEIS") and the City of London Law Society ("CLLS"), BEIS offered the following guidance:

> "Whilst the grant of a security over shares could create an equitable interest in such shares, such an interest would not appear to grant any control over such shares, as referred to in section 8(1) [of the NSI Act], until the happening of an event that would provide control. Therefore we do not think this falls within the scope of mandatory notification until such an event that would grant control.
>
> Notwithstanding the above, the Government is considering whether any further clarification is appropriate and, if so, what format that should take."

Accordingly, on the basis that any equitable share charge would not appear to grant any control over such shares unless an event providing control occurs, a secured lender would not need to notify or obtain pre-clearance from the Secretary of State at the point of creation/grant of such share charge, even if the shares relate to a qualifying entity. We would expect that the majority of share changes in REF deals are structured on this basis.

However, it should be noted that any enforcement action could be also be a triggering event requiring BEIS approval. This is worth considering as it may affect the timing of the enforcement of the security as a lender may need to seek approval from the BEIS in order to transfer or sell the shares in question.

In this regard, we would strongly suggest that lenders seek specialist advice at the point of taking security and prior to any enforcement action.

Closing Thoughts

We would like to conclude our NSI Act series by pointing out that the NSI Act presents a narrow but deep risk. Lenders and investors should give due consideration to the NSI Act in order to protect their transactions and officers from potential criminal liability and other significant punitive measures. They should also ensure that they are cognisant of the new rules given the broad scope of the mandatory notification system under the NSI Act.