

The UK's National Security and Investment Act Receives Royal Assent

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Key Takeaways for Private Equity Sponsors and Investors

- On April 29, 2021, the [National Security and Investment Act](#) (the “NSI Act”) received Royal Assent. The NSI Act is expected to come into force later this year, although the precise commencement date has not yet been set.
- The NSI Act imposes new requirements on parties to notify and obtain approval from the Department of Business, Energy & Industrial Strategy (“BEIS”) for “trigger events,” which are defined to include many types of private equity investments and transactions.
- Under the new regime, BEIS will have the power to impose mitigation measures – or even block – trigger events to protect UK national security.
- The NSI Act creates a series of unique challenges for private equity sponsors, as well as their investors and portfolio companies.

Introduction

On April 29, 2021, the National Security and Investment Act received Royal Assent after rapidly progressing through Parliament. This much-publicized and long-awaited legislation establishes a new framework for the UK government to review so-called “trigger events” – which include a wide variety of private equity investments and transactions – on national security grounds. See [here](#) for our previous alert on the new regime.

Parties to a subset of “trigger events” will be required to notify and obtain approval from BEIS before completing such trigger events. In addition, BEIS will have new

powers to review – and in some instances impose mitigation measures or even block – trigger events if necessary to address national security risk.

The NSI Act regime incorporates concepts from the Committee on Foreign Investment in the U.S. and foreign direct investment (“FDI”) review systems adopted by individual EU member states. The NSI Act is a sharp break from the UK government’s past practices and will create a myriad of new challenges for private equity sponsors, as well as their investors and portfolio companies.

Overview of the New Regime

The new regime will utilize a hybrid notification system for trigger events. The trigger events generally involve situations where one party acquires “control” (as defined in the NSI Act) of a qualifying entity or a qualifying asset. More specifically, trigger events will include transactions where a party:

1. acquires or increases its interest in a qualifying entity such that it crosses the 25%, 50%, or 75% thresholds with respect to equity or voting rights;
2. acquires voting rights in a qualifying entity that enables it to secure or prevent the passage of any class of resolution governing the affairs of the qualifying entity;
3. obtains “material influence” over a qualifying entity; or
4. acquires specified control rights over qualifying assets.

For certain trigger events (excluding obtaining material influence over qualifying entities or acquiring control over qualifying assets) involving high-risk sectors, acquirers will be required to submit notifications and obtain approval from BEIS before completing the trigger event. Parties participating in other trigger events will have the option of notifying BEIS if they believe that the trigger event could implicate national security concerns.

Following notification, BEIS will have 30 working days to assess whether the trigger event should be “called in” for a national security review assessment. If BEIS determines that a full assessment is not necessary, then it will notify the parties that it has cleared the transaction.

By contrast, if BEIS elects to call in a trigger event, a full national security assessment will occur. The first phase of the assessment is an initial period of 30 working days. At the conclusion of the initial period, BEIS can clear the trigger event, issue a final order

imposing remedies or extend the assessment period for an additional 45 working days. At the conclusion of the additional period, BEIS can clear the trigger event, issue a final order imposing remedies or the parties can mutually agree to an extension of the assessment period. When analyzing risks associated with trigger events, BEIS will consider target risk, trigger event risk and acquirer risk to assess whether the trigger event poses a risk to UK national security.

A new unit within BEIS, the Investment Security Unit, will screen all trigger events that are notified by mandatory or voluntary filings or that BEIS unilaterally elects to call in. The Secretary of State for BEIS, currently Kwasi Kwarteng, will have ultimate responsibility for all decisions. The proposed regime will replace the Enterprise Act's mechanism for reviewing transactions on national security grounds, but not for other public interest criteria that will remain within the remit of the Competition and Markets Authority.

Although the NSI Act is now formally law, it will not come into force until later this year. In the interim period, BEIS will publish secondary legislation that provides further details regarding how the new regime will operate in practice.

Implications for Private Equity

The NSI Act contains a number of features that will impact private equity sponsors, as well as their investors and portfolio companies.

a. Many Types of Private Equity Transactions Will Constitute Trigger Events Potentially Subject to Mandatory Notification and Approval

"Trigger events" are defined broadly in the NSI Act. In the private equity context, trigger events may include:

- a limited partner acquiring a 25% or greater equity interest in or "material influence" over an investment fund;
- a private equity fund or a co-investor acquiring a 25% or greater equity interest in a portfolio company;
- a private equity fund or a co-investor increasing its ownership stake or voting rights in a portfolio company from greater than 25% but less than 50% to greater than 50% (or from greater than 50% but less than 75% to greater than 75%);
- a private equity sponsor or a co-investor acquiring "material influence" over a portfolio company;

- a private equity fund participating in a debt-to-equity swap in which it acquires a 25% or greater equity interest in a qualifying entity;
- a private equity fund acquiring real estate assets or intellectual property; and
- a joint venture controlled by two private equity sponsors acquiring certain equity, voting or control rights in a qualifying entity or a qualifying asset.

For certain trigger events involving qualifying entities that operate in the 17 high-risk sectors, the relevant acquiring party will be obligated to notify BEIS and obtain its approval prior to closing. If BEIS's approval is not secured before completion, the trigger event will be void under UK law. Furthermore, the UK government has the authority to impose criminal penalties on parties for failing to make mandatory notifications in certain circumstances.

b. The NSI Act Contains Very Few Jurisdictional Limitations

Unlike many other FDI review mechanisms, the NSI Act does not differentiate between foreign and UK parties participating in trigger events. The mandatory notification provisions in the NSI Act apply regardless of the nationality of the acquiring party, provided that the trigger event meets the relevant criteria. This means that a UK private equity fund managed by a UK-based advisor that purchases a UK-headquartered company that operates solely within the United Kingdom could be subject to mandatory notification and approval requirements under the new regime.

The NSI Act also authorizes BEIS to review trigger events with minimal connections to the United Kingdom. BEIS will have the power to call in trigger events that involve qualifying entities or qualifying assets outside of the UK, provided that: (1) the entities carry on activities or supply goods/services in the UK; or (2) the assets are used in connection with activities taking place in the UK.

Under these standards, trigger events with tenuous connections to the UK may be subject to review. For example, a Delaware-domiciled investment fund managed by a New York-based advisor that acquires a French-headquartered manufacturing company without UK operations or personnel could meet the jurisdictional nexus test if the French company supplies products to UK businesses. BEIS has advised that it will "legislate for a tighter nexus test for mandatory transactions" involving non-UK entities. But even if it does so, the NSI Act provides BEIS with the ability to scrutinize a wide range of trigger events with minimal links to the UK.

c. The New Regime Contains Limited Carve Outs

Unlike the UK's merger control regime, the NSI Act does not contain minimum turnover or share of supply thresholds. This means that trigger events will not necessarily be excluded from review because they involve a small, newly formed qualifying entity or a qualifying asset of limited value.

However, the NSI Act has created safe harbours for certain types of transactions. Transactions in which a party acquires less than a 25% interest in a qualifying entity will not be a trigger event, provided that the party does not acquire "material influence" over the policy of the entity or obtain voting rights that allow it to secure or prevent the passage of any class of resolution governing the entity. The inclusion of a safe harbour provision will provide some comfort to private equity sponsors and co-investors taking minority equity positions in certain transactions.

d. The Interim Period to Commencement of the NSI Act Will Create Challenges

The NSI Act is now law, but it will not come into force for several months. The NSI Act itself does not specify the legislation's commencement date, and BEIS has simply noted that it expects the new regime will take effect "towards the end of this year." Prior to commencement, BEIS will draft and publish a series of statutory instruments related to the NSI Act to finalise the 17 high-risk sector definitions and describe other formalities and processes of the new regime.

The undefined interim period may pose issues for private equity transactions. Parties could sign a definitive agreement prior to the NSI Act's commencement date, but not close on the transaction until after the NSI Act has come into effect. For the purposes of the NSI Act, a trigger event occurs at closing, so such a transaction could be subject to mandatory notification and approval. This scenario is most likely to occur when other regulatory approvals are required as conditions precedent to complete a transaction (e.g., FDI approvals in other countries, anti-trust clearances, etc.).

The BEIS review process – which is expected to take several weeks at a minimum – could then delay closing and create challenges to the parties' financing arrangements and contractual obligations (e.g., mutually agreed long-stop dates).

e. Once Enacted, the NSI Act May Lead To Timing Challenges for Dealmakers

The NSI Act contains a proscribed schedule for reviewing trigger events and carrying out national security risk assessments. However, in practice, the timeline for BEIS reviews may be less certain. The "clocks" for each of the relevant time periods (i.e., preliminary review, initial review, etc.) will stop running when the Secretary of State issues an information or attendance notice to a party and will only re-start after the

Secretary of State subsequently issues compliance notices. In addition, BEIS and the parties can mutually agree to indefinite extensions.

These features ultimately could result in lengthy and uncertain review periods, which, in turn, could lead to unpredictable timelines that impact deal certainty. Given the structure of NSI Act, closing over a BEIS call-in will not be a viable option for certain trigger events involving qualifying entities operating within the high-risk sectors.

Conclusion

The NSI Act will present new challenges for private equity sponsors, as well as their investors and portfolio companies. Sponsors should assess how the NSI Act implicates a contemplated transaction early in the transaction process and decide whether notifying BEIS is required or advisable. Private equity sponsors should also take steps to ensure that they have the requisite contractual protections in place to deal with any relevant NSI Act issues. Through careful consideration and a proactive approach, many concerns associated with the new regime can be mitigated, and in some circumstances addressed completely.

Authors

Michael S. Casey

Partner / London

Marcus Thompson

Partner / London

David Higgins

Partner / London

Ivan A. Schlager, P.C.

Partner / Washington, D.C.

Mario Mancuso, P.C.

Partner / Washington, D.C. / New York

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- 29 April 2021 In the News Editorial Advisory Boards 2021
- 28 April 2021 Press Release Kirkland Advises Oaktree Capital Portfolio Company J&J Ventures on Acquisition of Illinois Gaming Systems
- 28 April 2021 Article A Quick Look at New Regulations to Address National Security Threats in Shell Company and Digital Currency Transactions

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