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UK Cabinet Office Publishes Second Annual Report on UK National Security and Investment Act

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On 11 July, the UK Cabinet Office published the second Annual Report on the UK National Security and Investment Act (the Act).¹ Last year's Annual Report only covered the first three months of the regime after its introduction in January 2022, so this year's Annual Report is the first to provide a much more complete picture of how the Act has been working in practice. Highlights from the Annual Report are presented below, together with a summary of other important developments over the last year.

Highlights from the Annual Report

- **Defence Dominates.** According to the Annual Report, nearly 47% of all mandatory notifications concerned activities in the defence sector. Given the defence sector is a clear focus of attention, we carefully diligence trigger points for transactions involving such businesses. We can often rule out notification requirements under some of the other 17 high-risk sectors more quickly based on confirmatory questions addressed to the target business, especially where the target maintains no sensitive government contracts. We would be more hesitant to rule out filings in the defence sector however, given the obvious policy focus under the Act.
- **Number of filings lower than expected and a relatively small number 'called in' for a detailed review.** A total of 866 filings were received by the Investment Screening Unit (ISU) – the body tasked with overseeing the filing and review process – in the year to 31 March 2023, well below the government's top-end prediction of 1,830 (and in fact below even 1,000, which was the bottom of its estimated range of expected filings). This figure includes a wide range of transaction structures caught by the Act, including internal restructurings and fund-to-fund transfers. Only 65

transactions were 'called in' for a more detailed review during the year (approximately 7.5% of all filings received). The proportion of voluntary filings has increased in the year covered in the Annual Report, suggesting the business and legal community are taking quite a cautious approach and notifying where they think the ISU may be interested in the case.

- **Defence, Military and Dual Use and Advanced Materials sectors most frequently subject to in-depth review, together with acquisitions by Chinese acquirers.** Of the transactions 'called in' for in-depth review, 37% were associated with the Military and Dual Use sector, 29% with Defence, and 29% with Advanced Materials. In addition, 42% of called in transactions involved Chinese acquirers. However, it is also noteworthy that 32% of called in transactions concerned UK acquirers and 20% concerned U.S. acquirers.² Whilst the nationality of the acquirer is an important consideration, these figures suggest the activities undertaken by the target is the most important factor – meaning a deal can be called in even where the acquirer is from a 'friendly' allied country of the UK. This is something we have observed in our practice, and it underlines the need to understand the potential sensitivity of target business activities from a national security perspective during due diligence – not always an easy task as such information may be closely guarded or not a focus of an acquirer's commercial due diligence.
- **Remedies imposed across a range of sectors.** Whilst the Defence and Military and Dual Use sectors represent the majority of remedy cases, the government has imposed remedies across a range of other sectors including Communications, Energy, Computing Hardware, Advanced Materials and Satellite and Space Technology. This highlights that technologies and infrastructure in a range of sectors can be considered as important for national security purposes, for reasons which may not always be clear to those outside of government intelligence circles.
- **Reviews are mostly quick but can be very lengthy where remedies are required.** The vast majority of deals are cleared within the first 30 Business Day period (28 Business Days on average). However, where a transaction is subject to remedies, on average an additional 77 Business Days are required. The predictability of timing for reviews under the Act in straightforward cases has been applauded, however, it is harder to predict the timeline for reviews in more complex cases which can be subject to more than one extension of timing.

Other developments in the last year

At the start of 2023, responsibility for the regime was moved from the Department for Business, Energy and Industrial Strategy (BEIS) to the Cabinet Office, overseen

currently by the Deputy Prime Minister, Oliver Dowden. There was speculation that this move 'closer to government' would see the process become more political in nature and less business friendly, although the government has subsequently issued new guidance in an attempt to make the review process more transparent. From a user's perspective, we haven't yet observed any material change in the process as a result of this shift.

To date, **five deals have been blocked or unwound – all involving Russian or Chinese buyers.** The government has prohibited deals across a variety of sectors, including telecommunications; semiconductors; dual-use electronics; and the licensing of dual-use vision sensing technology; but all with the common theme of the country of origin of the controlling investors. The government has intervened in transactions where the immediate acquirers is seemingly based in a neutral third country (e.g., Luxembourg, the Netherlands) but who were found to be ultimately controlled by Russian or Chinese (or Hong Kong) investors. The government has also not been afraid to unwind completed deals, including, for example, the completed acquisition of chip manufacturer Newport Wafer Fab by Nexperia, a Chinese-owned Dutch semiconductor manufacturer, which completed in July 2021 and was prohibited in November 2022. Nexperia is challenging this prohibition decision.

A further **10 transactions have been approved subject to conditions.** Common conditions are broadly similar to those imposed under the 'Public Interest Intervention Notice' system that existed prior to the Act. These have included requirements to (i) maintain strategic capabilities/security of supply in the UK or ensure continued UK ownership of the relevant companies, (ii) protect, provide access to or restrict the sharing of sensitive information and/or technology, (iii) create a UK board of directors with approval authority over key strategic decisions, (iv) obtain the government's approval to appoint specific operators, (v) maintain UK headquarters or presence and protect/expand employees and local R&D capabilities, and (vi) notify the transfer of assets out of the target. Moreover, while all blocked deals have related to acquisitions by Chinese or Russian acquirers, **conditions have been imposed on both UK and non-UK acquirers.** A recent case notably involved the imposition of conditions on an asset acquisition by a Canadian acquirer.

In response to concerns regarding transparency, **government updated its guidance** in April 2023. Key takeaways include the following:

- **Filing pre-signing:** the government has clarified its position regarding filing pre-signing, now explaining that there should be a good faith intention to proceed before a filing is made (albeit it is the acquirer's own risk if such an agreement is not

in place and the transaction structure subsequently changes to the deal notified, meaning that a further approval may be required).

- **Transaction notifiability:** the ISU has now stated it is open to providing guidance as to whether or not a deal is notifiable (in order to obtain guidance, detailed information about the proposed transaction needs to be provided – including the names of the parties – and there is no guarantee of a quick response).
- **Supporting information:** the ISU now welcomes the submission of supporting information with the filing, including such details as transaction rationale, an explanation as to why the deal does not raise national security concerns, and any relevant financial documents. This suggests the ISU acknowledges the online filing form is unhelpfully restrictive in what it allows parties to submit.
- **Material financial distress:** the ISU has also set out the evidence that it requires in transactions where the target is in material financial distress and a speedy decision is necessary in order to save the business. In particular, the ISU would expect to see analysis from restructuring and insolvency advisors, cash flow statements, balance sheets, and correspondence with suppliers and creditors. In our experience, the ISU has been able to move quickly in situations of financial distress.

Final observations

The Act has prompted a much smaller number of filings than were predicted, although the last year has seen a reduction in M&A activity which doubtless partly accounts for this. This lower level of activity has probably been beneficial for the ISU as it has been getting to grips with the regime and helped to ensure that the vast majority of cases are dealt with efficiently.

Our experience to date with the Act, the ISU, the Cabinet Office and BEIS has been positive, and engagement has been focussed on the more complex cases (as it should be). There are some areas where the scope of the regime could be tightened to focus on relevant cases. In particular, the guidance on the 17 sectors which fall within the scope of the Act could be refined and more detail provided, in light of the experience the ISU is gaining.

There will no doubt be further important developments in the coming year – not least the first judicial examination of the Act as Nexperia seeks to challenge the government's prohibition of its (completed) acquisition of Newport Wafer Fab. Further, the move to the Cabinet Office signals government's engagement, at the highest level, in this regime. We can expect to continue to see close scrutiny of sensitive

transactions and would not expect government to hold back from intervention in future cases, wherever it deems this necessary.

1. The National Security and Investment Act 2021 – Annual Report 2022-2023:

<https://www.gov.uk/government/publications/national-security-and-investment-act-2021-annual-report-2023> - July 2023 ↩

2. These figures aren't necessarily a true proportion of all filings given that one acquisition can be associated with more than one country. ↩

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Related Services

Practices

- Antitrust & Competition

Suggested Reading

- 14 July 2023 Press Release Kirkland Advises Eli Lilly on Acquisition of Versanis
- 13 July 2023 Press Release Kirkland Advises Gen II Fund Services on Acquisition of Crestbridge
- 12 July 2023 In the News Litigators of the (Past) Week: A Defense Win for Gilead and Teva in a Rare Trial on Pay-For-Delay Claims

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