ARTICLE

New mandatory notification regime for transactions in the UK

The UK has introduced new legislation that, from 4 January 2022, will require transactions in certain specified sectors to be approved by the UK government before they can be completed.

SHOOSMITHS

+44 (0)3700 863 000 | www.shoosmiths.co.uk

A new regime

The UK is introducing a new regime which, from 4 January 2022, will require prior approval for transactions in certain specified sectors. Many of the sectors are technology-focused and attractive to venture capital investors. The new regime, contained in the National Security & Investment Act 2021, will also give the UK government the ability to "call in" for review on national security grounds transactions in all sectors of the economy (with the government having the ability retrospectively to review transactions that have taken place since 12 November 2020). It is likely to have significant implications for VCs and their portfolio companies, most likely upon exit but potentially also in respect of investments into those companies.

The new regime is very broad and will affect many transactions. In outline:

- **There will be 17 sectors for which prior approval is required.** These are listed in the table below. They include communications, computer hardware, data infrastructure, defence, energy and transport. The proposed definitions of these sectors are very broad.
- **There are no materiality thresholds.** If the target has any activities (no matter how big or small) in the UK in one or more of the specified sectors, prior approval will be required.
- **Transactions will be caught by the regime where control over the target is acquired, but the test for "control" will be very low. The test will be met, for example, by any shareholding over 25% (as well as by certain increases in shareholding thereafter), so could apply to investments as well as exits.**
- **Whilst the regime is intended to enable the UK government to review deals on national security grounds, transactions in the specified sectors will require approval regardless of whether they give rise to any national security issues.** The government estimates that around 1,800 deals will be notified for approval each year, of which only a very small proportion will give rise to any concerns.
- **Failure to obtain approval will render the transaction void and will constitute a criminal offence by the investor/purchaser (and potentially also by its officers).** In practice, any failure to obtain approval may also lead to commercial challenges on future investments or acquisitions involving the same target (for example, in the event of an exit by the investor).
- **Where a transaction gives rise to national security concerns, the UK government will have extensive powers to take steps to address those concerns.**

Shoosmiths' views

At Shoosmiths, we are consistently in the top 5 firms ranked by Experian for the number of UK deals we advise on each year. We are therefore well placed to assess the likely impact of this new regime. Our key observations include:

- **The impact of this new regime will be significant – many deals will require prior approval.** As indicated above, the government estimates that around 1,800 transactions will be notified for approval each year – but we think that may be an underestimate given the breadth of the definitions of the 17 sectors below and the absence of any materiality thresholds.
- **Describing the regime as a "national security" one is to some extent misleading - most transactions that require approval will not give rise to any national security considerations at all.** Whilst the purpose of the regime is to enable the UK government to screen transactions for national security concerns, most transactions that require prior approval will very clearly not give rise to any national security concerns but will require approval simply because the target is active in one of the 17 sectors (which, again, are very broadly defined).
- **It will be crucial that parties and their advisers take appropriate care to establish whether approval is required – the consequences of getting it wrong will be significant.** Aside from the risk of criminal sanctions, any failure to obtain approval is likely to cause complications in any future sale process involving the target (and is likely to be picked up by prospective purchasers in due diligence) given that it will render the transaction void.
- **When conducting due diligence on transactions, it will be important to establish whether any previous (post 4 January 2022) transactions or investments involving the target should have been approved under the regime.** If the target was the subject of a previous investment or transaction that should have been approved, but was not, that would render the transaction and or investment in question void (which could have obvious repercussions for subsequent purchasers of the business).
- Although the regime does not start until 4 January 2022, parties and their advisers should already be considering its potential implications. In particular:
  - For any deals being contemplated now but which might not complete before 4 January 2022, consideration must be given to whether mandatory approval will be required before the transaction can complete (bearing in mind that approval may take up to 30 working days in straightforward cases).
  - For deals that will complete before 4 January 2022, consideration should be given to whether there is any risk of the UK government "calling in" the transaction for review once the regime has come into force. Note that, in the period before the regime comes into force, there is scope to seek informal advice from the Investment Security Unit (ISU), which is the new government body that has been set up to administer the regime.
- Importantly, however, the new regime is not intended to deter investment in UK businesses. Whilst the regime will enhance the UK government's ability to monitor and review transactions from a national security perspective, the expectation is that it expresses concerns about only a very small number of deals each year.

We would, of course, be very happy to support you on any investment transactions in which the target has activities in the UK and where the new regime might apply.

The 17 sectors for which there will be mandatory prior approval are:

- 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
- Transport (ports, harbours and airports)

The precise scope of each sector is set out in Regulations that accompany the new regime. The regime will apply where the target has activities in the UK in one or more of the above sectors.

Contact

Simon Barnes
Partner
+44 (0) 3700 868 912
simon.barnes@shoosmiths.co.uk

Al Peet
Partner
+44 (0) 3700 864 163
alastair.peet@shoosmiths.co.uk

Steve Barnett
Partner
+44 (0) 2072 057 057
steve.barnett@shoosmiths.co.uk

DISCLAIMER

SHOOSMITHS

+44 (0)3700 863 000 | www.shoosmiths.co.uk