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NEWS & ANALYSIS

What PE investors need to know about the UK National Security Review proposal

The proposed bill will likely become law in early 2021 and will likely affect private equity investment activity into the UK, write lawyers from Akin Gump

The covid-19 pandemic has seen a substantial increase in opportunistic state-backed investment in distressed assets globally. This has fuelled long-standing frustration with the UK government's deficient powers of intervention in foreign investments involving sensitive infrastructure and technology critical to national security.

The UK government is attempting to strengthen its intervention powers through the National Security and Investment Bill 2019-20, announced in December 2019 which is likely to become law in early 2021. Details of the bill are yet to be published, but we anticipate that it will be based largely on the government's 2018 White Paper.

The proposals are likely to affect a wide range of investment activity and could impact private equity firms that count foreign nationals and foreign governmental entities among their investors. It will therefore be critical for these players to treat the prospect of the bill as a gating issue when planning investment activity within sensitive aspects of the UK economy towards the end of 2020 and beyond.

The proposals at a glance

The current proposals would capture, among other things, all equity investments of 25 percent or more, and also below 25 percent in cases where one or more special rights will also be acquired (including the ability to appoint/remove a director or veto certain investments) in UK businesses and assets (including intellectual property). The sectors targeted include civil nuclear, defence, energy, telecommunications, transport, military and dual-use, and advanced technologies (e.g. artificial intelligence, quantum computing etc).

The government proposes to apply a three-pronged approach for the assessment of national security risks represented by: the relevant transaction, the target of the transaction and the acquirer/investor. It is the latter assessment that will focus on aspects such as the identity, history, affiliations, ownership and controllers of foreign acquirers and investors.

Parties will need to decide whether to submit a voluntary notification to the government. If a voluntary notification is submitted, then the government would have up to six weeks to decide whether to 'call-in' the transaction for a full national security assessment. This assessment could take up to 15 weeks and will involve a detailed assessment of the transaction and the nature of national security risks it presents. Such assessments are 'black box' akin to other national security focused processes such as export licensing for dual-use and military items.

The government could clear, block, approve the transaction with conditions, or even unwind a transaction if it has occurred within the last six months. It can also do so for transactions not submitted voluntarily. Interim restrictions could also be imposed during the review, the most common of which is likely to be a stay on completion pending the review's outcome.

How PE investors should start planning

Although the usual absence of control rights for limited partners could insulate many fund acquirers from triggering the regime, for funds investing in sensitive sectors that have significant participants and/or co-investors that are foreign nationals or foreign governmental actors, the proposals could have material implications. These funds should be preparing themselves for regulatory scrutiny and assessing strategies for mitigating the potential impact of the regime on their investment activity.

Funds should consider introducing steps early in the investment or divestment process to identify whether the relevant target assets include UK assets in sensitive sectors and, if so, the likelihood of regulatory intervention, so that their approach to the relevant transaction can be tailored suitably.

For acquisition processes, funds should anticipate sell-side concerns regarding timing, deal certainty and maintaining competitive tension, and have a clear strategy for allaying them. Funds should prepare themselves for disclosure (in differing degrees, to regulators and sellers) of proposed investment structures and the level (or absence) of control that their foreign participants will have over the fund or proposed investment, as well as their wider investment goals.

Particularly with the possibility of a transaction unwinding where national security risks are identified, managing seller concerns and mitigating potential competitive disadvantage (such as conditions to completion) will be important. Buyers should ensure that process documentation is not overly restrictive and allows buyers to drive the process with a view to minimising the impact of that disadvantage. This should include flexibility for the parties involved to seek informal guidance from the government on whether a notification would be advisable.

Conversely, on the sell-side, to enable the seller to assess relative bidder risk in the early stages, funds should ensure process documentation provides the seller with early and sufficient information on bidders, as well as visibility and control over the regulatory process (including approaches to the regulator in any auction phase).

Finally, on the structuring side, funds should consider to what extent existing or customary investment structures and documentation should be re-visited where to do so could reduce regulatory risk (and therefore potentially reduce deal execution risk), improve bargaining position and/or mitigate potential seller concerns. Structural solutions could include adding or extending rights to exclude certain investors from sensitive investment/co-investment opportunities, information barriers, modification of investor rights and/or warehousing of investments pending, or as a condition of, regulatory approval. ■

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