

# NATIONAL SECURITY & INVESTMENT ACT

Don't let your investment round get caught by the broad scope of **the new National Security & Investment Act**

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# THE NEW NATIONAL SECURITY & INVESTMENT ACT

## What is the new legislation?

The National Security and Investment Act 2021 will give governmental regulatory bodies powers to investigate investments into UK companies, which they believe may have “national security” implications.

National security might seem like a high bar and not something that will apply to your business. But, tread carefully because the legislation’s scope is broad enough to catch **a large number of UK equity financing transactions**.

The Act grants a new governmental body the power to *call in* certain transactions to assess whether the transaction might create a national security risk.

“National security” is not defined by the Act or the Government and is kept purposefully vague so that the Government can flex its approach. This flexibility isn’t, however, ideal for working out whether or not your investment round will be called in!

Furthermore, although the Act only comes into force from 4 January 2022, it allows the Government to go back to 12 November 2020 and *call in* transactions that have already completed. So it’s important to be aware of the requirements of the Act right away.

## How do I know if I’ll have a problem?

Firstly, the new rules will only apply if any person or entity acquires a new level of control over your company. The main criteria for assessing this control are:

1. a party’s shareholding stake or voting rights meet or cross certain thresholds (see thresholds below);
2. irrespective of voting rights, a party acquires rights that allow them to pass or block resolutions governing the affairs of your company; or
3. a party becomes able to materially influence the policy of your company (e.g. gaining a right to appoint a director, if that appointment enables the appointor to influence the strategic direction of the company).

Point one above will apply when someone moves across the following thresholds:

- from 25% or less of the company’s total issued shares (and/or voting rights) to more than 25%;
- from 50% or less to more than 50%; or
- from less than 75% to 75% or more.

Points two and three are less clear, but it is easy to imagine how either of these could be triggered on a fairly standard investment round. We have seen countless investments over the years where investors are given these kinds of control rights.

It is worth noting that some of this will depend just as much on the practicalities as on the legals. Not every investor director will be in a position to "influence the strategic direction of the company" in the way envisaged by the Government. But, the way other investor directors operate in practice (or even how much they are listened to!) could arguably give them more sway over the company's actions.

It is also worth noting that the Government has marked certain sectors as important to the UK economy and therefore particularly susceptible to national security risks. There are 17 of these sectors in all, ranging from Transport to Cryptographic Authentications, and including a number of sectors with a broad tech focus and a fairly wide remit – such as Synthetic Biology, AI, and Communications, amongst others. A full list is available [here](#), with detailed definitions of each sector. We'll refer to these below as the '**key sectors**'.

Whilst it is obvious with some key sectors (Nuclear, Military etc) where a business might fall within scope, other sectors (such as Communications, Synthetic Biology etc) could conceivably encompass many businesses. Whilst it may seem obvious that the development of a games console might not be of national security interest, given that Computing Hardware is a key sector, a gaming business with an upcoming financing round may need to comply with the Act.

"...the Government can *call in* any transaction where it feels that control of your company may have changed and there may be any form of national security risk."

If your business operates in a key sector and control of your business changes or updates as per points one and two above, then your business is very likely to be subject to the Act.

Regardless of being in a key sector or not, the Government can *call in* any transaction where it feels that control of your company may have changed and there may be any form of national security risk.

**The flowchart on page three summarises what you need to consider.**



## What do I need to do to comply with the Act?

There are two options:

- a. for complete certainty, any transaction involving a change of control as mentioned above would need to be voluntarily notified to the Department for Business, Energy and Industrial Strategy ("BEIS"), and BEIS would need to give clearance; or
- b. if you and your investors are completely comfortable that there is no possible national security risk, you could simply complete the investment and hope for the best. Note that BEIS can *call in* a transaction for review up to five years after it has taken place, but no longer than six months after the Government first became aware of it – so if the completed investment has been widely publicised and more than six months have passed then you should be clear (though the Government's "awareness" of transactions hasn't yet been tested in this way).

However, businesses who fall within any of the key sectors will need to make a mandatory notification to BEIS in the cases of change of control points 1 (shareholding and/or voting rights above threshold) and /or 2 (able to pass or block resolutions) above.

Businesses in a key sector that don't fall into the above (e.g. where an investment may result in some other influence being granted to the investor, or involves the sale of an important asset) should strongly consider making a voluntary notification.

"In a worst case scenario, BEIS could seek to block a transaction."

BEIS has claimed that they will review all notifications within 30 working days (six weeks) of receipt. However, in some transactions, such a potential delay may be critical to the viability of a financing, and many critics are sceptical of the Government's ability to process all notifications in this time.

Note that the main obligations under the Act actually apply to the investors, not to the company itself. So it is primarily the investors who will need to ensure compliance (though there are plenty of reasons you should also play a part – see below).

## What are the repercussions of failing to comply?

### Non-mandatory

If it was not mandatory to notify BEIS, but BEIS later *call in* the transaction and decide that it has resulted in a national security risk, then they are likely to impose conditions. The exact conditions will vary based on the circumstances, but market experience from conditions imposed by the Competition and Markets Authority demonstrates that these can be difficult and costly to implement – particularly if the investment has already completed. In a worst case scenario, BEIS could seek to block a transaction (or in the case of BEIS taking retroactive action, for the transaction to be "unwound").

## What are the repercussions of failing to comply? (continued)

### Mandatory

If a transaction falls within the scope of the mandatory notification scheme and does not receive BEIS approval, the relevant investor commits an offence and may be imprisoned and/or suffer a significant fine.

Importantly, the relevant transaction would automatically be considered void. This means that, despite having signed paperwork and received funds, the investment would be deemed never to have legally happened and would need to be unwound.

In fact, the requirements of the Act mean that it will no longer be legally possible to complete an investment round requiring mandatory notification, without having received formal clearance from BEIS.

### **If all obligations are on investors, why should I be concerned about this?**

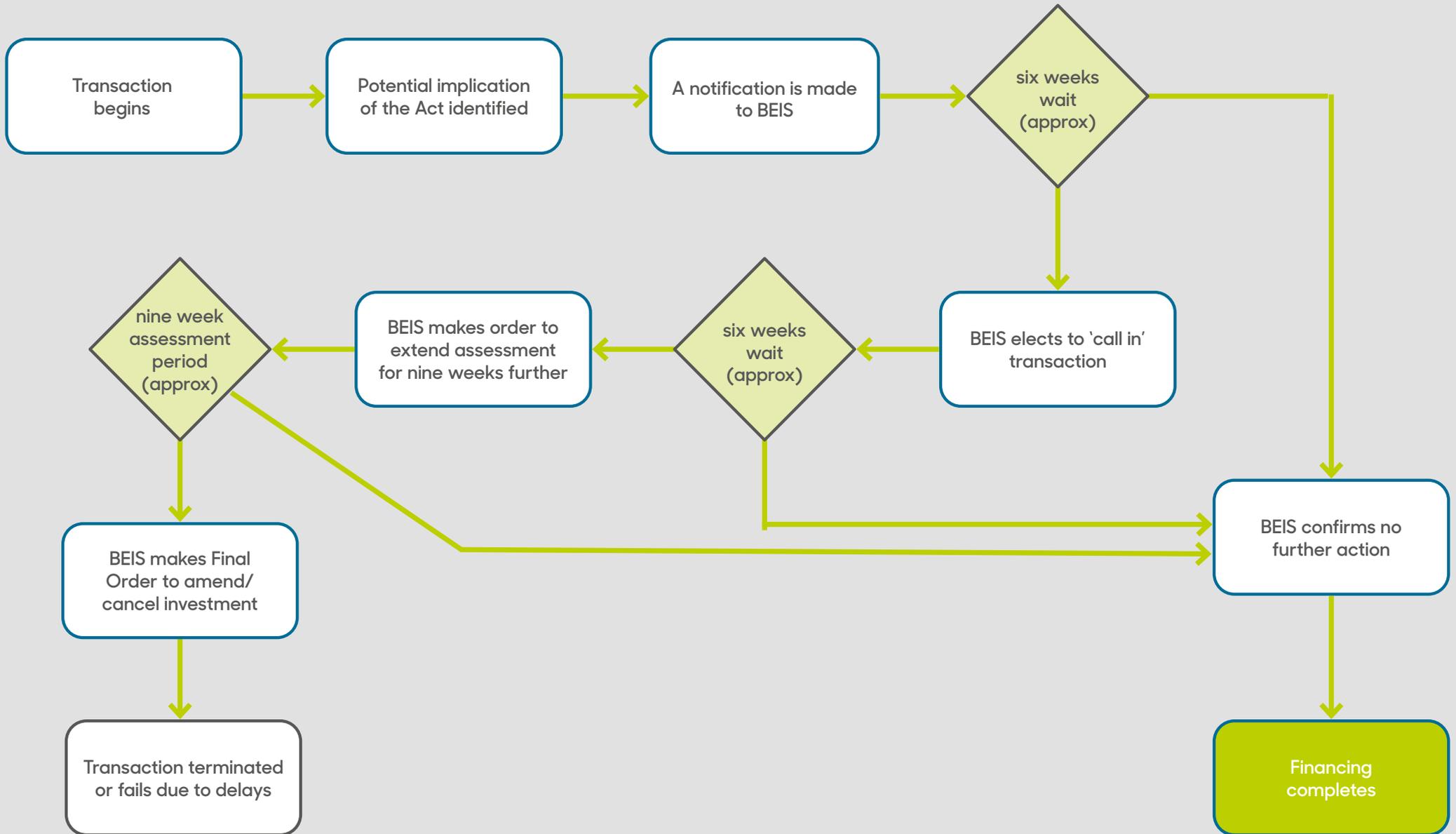
The Act will likely have implications for (i) the certainty of transactions (e.g. will investors be dissuaded by the potential for BEIS scrutiny?), and (ii) the timeline for an investment round. Timing in particular can be of critical importance for funding rounds, as businesses often need to secure investment in order to pay their suppliers, fund staff salaries, continue in operation, etc.

A need to notify a Government Department will ultimately lead to transactions taking longer than expected, and there will be additional costs involved to make sure any notification is made properly and in good order.

**To help you, we've created a flowchart on page six that sets out a possible timeline for a voluntary notification on what would be a standard transaction.**

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# A sample timeline for a notification



In addition to timing risks, note that some investors may seek to pass on the risk of any breach of the Act to the company / its founders. New warranties may be requested, which look to make the founders liable.

Practically speaking, investors are going to need the help of founders to fully understand their business and make an appropriate notification to BEIS if required. The due diligence process that you may be familiar with is likely to be updated to include provisions that are relevant for the purposes of the Act (e.g. you will be asked to confirm if you consider yourself to fall within a key sector). We've updated our standard due diligence enquiries to include the questions likely to be raised.

A problem for your investors is ultimately also a problem for you.

## FAQs

### Will the Act only affect investment from foreign investors?

The terms of the Act as drafted apply to both foreign and domestic investments, so it will affect all transactions that result in a change of a degree of control as set out in the Act.

### To avoid issues, should I seek to complete an investment round prior to 4 January 2022 (when the Act comes into force)?

The Act will grant BEIS powers to scrutinise investments from 12 November 2020 onwards. Therefore, if you have secured any equity financing in the period from 12 November 2020, or will do before 4 January 2022, such investment remains at risk of being 'called-in' by BEIS and could be subject to scrutiny.

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### How do I go about making a notification to BEIS?

It is expected that an online portal will be established for the purposes of making notifications to BEIS, and it is through this portal that communications will take place. If you have familiarity with the Future Fund Loan process, then we understand that the operation of the portal will be similar.

### Further information

A number of detailed guidance notes have been published by the Government including:

- [A general guidance note](#)
- [Guidance on the use of 'call in' powers](#)
- [Mandatory notification sectors](#)

## Key Contacts

If you have any further questions on how the new rules will impact your business, please contact:



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