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NATIONAL SECURITY AND INVESTMENT ACT 2021 - WELCOME TO THE CORRIDOR OF UNCERTAINTY

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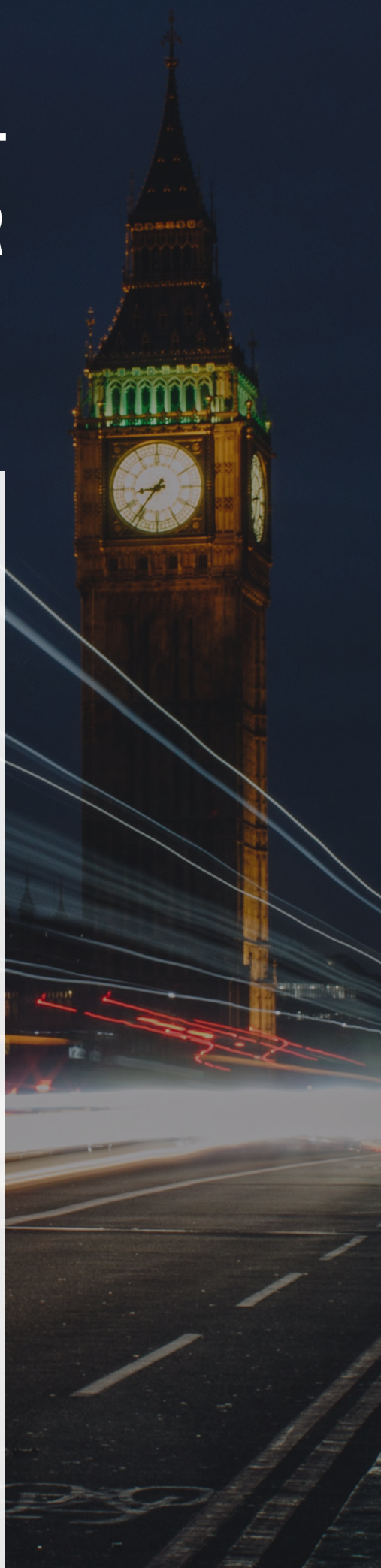

Sir Geoffrey Boycott, record-breaking opening batsman for Yorkshire and England, has famously never been short of a view on pretty much any topic.

One subject that has though escaped the benefit of his wisdom has been the new national security screening legislation for M&A transactions that became law this week. The five long years since the UK Government first mooted these proposals will feel to those following the legislation very much like one of the many marathon innings of Sir Geoffrey.

Unwittingly, Sir Geoffrey has summarised better than most the risks now live and real for merging parties not only in the UK, but given the extraterritorial reach of the legislation, in other jurisdictions also. Sir Geoffrey originated (or at least popularised) the cricketing phrase 'corridor of uncertainty' to describe the terrifying situation where a ball is bowled into a narrow zone that leaves the batsman clueless as to whether the ball will come in to strike their wicket or veer sharply outwards and nick the bat on the way through, opening up the risk of a catch. For the batsman, the ball landing in the corridor of uncertainty is as unwelcome as it is impossible to predict and respond to adequately, with negative consequences the only realistic outcome.

The National Security and Investment Act 2021 has to all intents and purposes replicated that situation – the expectant batsman is the Secretary of State for Business, Energy and Industrial Strategy, who will be sole decision-maker on the hundreds of transactions annually that will need to be notified under the Act, with transactions of all shapes and sizes being bowled at them, some at great velocity and with real menace. Most will land safely outside the corridor of uncertainty and the Secretary of State can easily see these off. Deals too small, too obviously without genuine security risk or wider political sensitivity, and those that are patently unacceptable, will make clearance or prohibition straightforward.

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GUESSING GAME

For a material number of transactions though, it will be not be certain until the deal is announced exactly what will be the level of public, political or media interest emanating from the backbenches, Opposition, columnists and leader writers, trade unions, rival firms, security establishment, friendly nations and economic partners. These might be deals with only a questionable national security risk but a much greater political risk and depending on the level of opposition being whipped up, risk getting dragged into the corridor of uncertainty. The Secretary of State will have very great difficulty in determining whether this is a transaction that they can leave untouched.

The new legislation itself has created a situation where despite welcome late changes to raise the bar in terms of the minimum level of shareholding at which scrutiny will usually take place (up from 15% to 25%) it remains the case that certainly hundreds, potentially even thousands, of transactions will be notified annually. The Secretary of State has no option but to review those transactions being thrown in their direction, having to make a call one way or the other. What makes it even more challenging is that the legislation intentionally avoids defining what constitutes national security risk, leaving the Secretary of State jurisdiction to determine this largely on their own terms, restrained only by thin guidance, personal objectivity and the distant threat of potential judicial review. Further, it is the Secretary of State alone making this decision, sitting in a quasi-judicial position, which differs from regimes such as the Außenwirtschaftsverordnung in Germany or CFIUS in the US, where there is a much greater degree of direct cross-government involvement in decision-making, in doing so dispersing, disseminating and sharing political risk.

Where the UK has landed with the new regime is more closer to revolution in assessing M&A transactions, than evolution of the current outdated regime. Aside from mandatory notification in 17 sectors deemed higher security risk, the new power to unwind completed deals without necessary clearance up to five years post-closure, means deals with even the faintest whiff of sensitivity will be notified by cautious parties under the 'voluntary' regime. While some have found comfort in informal precedent being established in decision-making to help manage notification risk, the nature of a singular decision-maker means the outlook of whoever is the Secretary of State is important, but this will last only until the next office holder, who may have an entirely different worldview. As a guide, the role of Secretary of State for Business, Energy and Industrial Strategy has had four holders in the last three years.

Nor can much comfort be obtained from the jurisdiction of acquirers. The legislation eschews a 'white list' of lower risk regimes, again in contrast to CFIUS in the US, which affords at least some degree of preference to investment from Australia, Canada, and the UK. While concern over Chinese investment has increased exponentially since the `Golden

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Era' that former Chancellor George Osborne attempted somewhat optimistically to initiate between the UK and China, it is seldom commented that the major UK national security interventions in recent years under existing legislation have involved acquiring parties from very close UK allies.

Think here in the last two years alone the acquisition of Cobham by Advent, Inmarsat by a consortium of Apax Partners, CPPIB, Ontario Teachers' Pension Plan Board and Warburg Pincus, and most recently ARM by NVIDIA. Yes, the targets have a degree of potential risk, but as Alan Priestley of technology research and advisory firm Gartner commented in relation to the ARM intervention: "It's an interesting one because most of the chips used by the UK military for UK security purposes are manufactured by other companies in other countries anyway". That there have been increasingly voluble calls from quarters including the Opposition to intervene and 'protect' ARM as an economic asset, is perhaps not irrelevant and will embolden those who equate 'national security risk' to 'political risk'.

THE CHALLENGE FOR DEAL MAKERS

For deal makers then, the challenge when the new regime goes live later this year will be to ensure as much as possible that as well as quantifying and mitigating security risk, any associated political risk is fully addressed across the litany of contentious areas that might help drag the transaction into the corridor of uncertainty, such as jobs, investment, pension liabilities, HQ and tax jurisdiction, and to ensure that these are communicated consistently and effectively when the deal is announced and throughout the completion process (and beyond closure).

Spare a thought though for the Secretary of State, trapped at the crease with no option other than to face down the constant barrage of deals being thrown in their direction, desperately hoping that as many as possible will land safely outside the corridor of uncertainty. While the current holder of that office is a skilled and deft political operator, for his successors perhaps less astute, reading just one of those deals incorrectly might just leave open a rather unfortunate dismissal from the crease.

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