

UK and EU National Security and Investment Screening Update: June 2022

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Key Takeaways

- Governments in the UK and elsewhere in Europe are demonstrating a clear willingness to exercise new and enhanced powers to review business transactions on national security grounds, including by calling transactions in for review retrospectively (*Newport Wafer Fab* in the UK and *Heyer Medical* in Germany), and where a stake of less than 25% is acquired (*Altice/BT Group*).
- The concept of “national security” is not defined in the UK’s National Security and Investment Act 2021 (NSIA) and it seems clear that the UK government will interpret the term broadly if it deems appropriate to do so. Recent experience indicates that scrutiny of transactions on national security grounds will even extend to situations where potential acquirers are based in closely allied jurisdictions and/or have a track record of investment in sensitive sectors of the UK economy if the UK government considers it necessary to protect the UK’s national security. Market participants should bear this in mind in their approach to planning for and structuring transactions, particularly where targets operate in sensitive areas.
- Recent announcements by the UK government regarding several high-profile transactions which have been subject to lengthy national security reviews provide an indication of the approaches to mitigating national security concerns the UK government may expect to see in transactions involving areas of particular sensitivity.
- The NSIA has been in effect for nearly six months and the recently published first annual report on the regime provides useful insights into how it operated in practice in the first three months. It should be comforting to investors that the Investment Security Unit (ISU) of the Department of Business, Energy and Industrial Strategy (BEIS), which has primary responsibility for implementation of the NSIA procedures, has generally appeared to act quickly and pragmatically on transactions which do not raise national security concerns.

United Kingdom

Altice’s increased stake in BT Group called in for national security assessment

In December 2021, the French telecoms group Altice announced that it had increased its shareholding in BT Group plc, the largest fixed and mobile network operator in the UK, from 12.1% to 18%. At the end of May 2022, the UK government announced that it was exercising its power under the NSIA to call in the “acquisition by Altice of 6% of [the] shares in BT” for a full national security assessment. The UK government has 30 working days to complete this assessment, although that period can be extended.

While it is not difficult to understand the importance of BT from a national security perspective given its critical importance to the UK’s telecoms infrastructure, this intervention introduces a new element of uncertainty for market participants seeking to build significant stakes in public companies, particularly where those companies operate in areas which may be of sensitivity from a national security perspective.

The NSIA provides a “bright line” threshold of 25% of an entity’s shares or voting rights. Below that mandatory notification is not required for acquisitions in sensitive sectors. In addition, the UK government has the power to call-in transactions more broadly where the 25% threshold of shares and/or voting rights is exceeded.

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While it has not been publicly confirmed, it appears that the UK government based its decision to call in Altice's purchase on the grounds that a shareholding of this size provides Altice with the ability to "materially influence" BT Group's policy, an alternative basis for the government to exercise its call-in power under the NSIA. This concept of "material influence" appears to have been taken from UK competition practice, where it is applied on a case-by-case basis and can be difficult to define with precision. Investors seeking to acquire significant stakes in companies which are engaged in sensitive sectors will need to proceed with caution in light of this development.

UK government calls-in in Nexperia's completed acquisition of Newport Wafer Fab

Under the NSIA, the UK government has the power to call in transactions for review retrospectively even if they have already completed. After much public controversy, in May 2022, the UK government called in for an NSIA review the acquisition by Nexperia, a Dutch subsidiary of a China-based technology firm, of Newport Wafer Fab (NWF), notwithstanding the fact that the transaction had closed in December 2021.

This call-in indicates the UK government's willingness to exercise its powers to impose conditions on, or even potentially to unwind, transactions after they have closed, highlighting another form of deal uncertainty stemming from the NSIA for transactions which may conceivably raise national security concerns. It followed intense media and political scrutiny of the NWF acquisition, including calls for government intervention from Tom Tugendhat, chair of the House of Commons Foreign Affairs Committee.

While there has been some public debate about how advanced NWF's technology is, and therefore whether the transaction in fact raises national security concerns, the government's decision to call in the acquisition appears to have been motivated by its status as part of a semiconductor industry, which is of strategic significance to the UK, in particular from the perspective of maintaining national capability in this sector.

This case underscores the need for parties to take a broad view of what might be of interest to the UK government insofar as national security interests are concerned, particularly where potential acquirers have close links to jurisdictions which may be perceived to threaten the UK's national security. It also highlights the practical impact that political and media pressures can have in such situations, emphasising the need for the consideration of appropriate strategies to navigate and manage such pressures.

UK government is "minded" to clear both Cobham's proposed acquisition of Ultra Electronics and Parker-Hannifin's proposed acquisition of Meggitt on the basis of undertakings in lieu of Phase 2 investigations

In late June 2022 the UK government made important announcements with respect to two high-profile transactions which have been subject to lengthy national security reviews under the Enterprise Act 2002 (Enterprise Act), the precursor to the NSIA.

On June 23, 2022, the Secretary of State for BEIS announced that he was minded to accept undertakings proposed by Cobham Ultra Acquisitions Limited in connection with its proposed acquisition of Ultra Electronics Holdings plc, a UK defence company, in lieu of a Phase 2 investigation and launched a public consultation in respect of the undertakings. The announcement followed a Phase 1 process under the Enterprise Act commenced very shortly after the announcement of the deal in August 2021, during which the Competition and Markets Authority conducted an initial investigation and submitted a report to the Secretary of State. Cobham is controlled by Advent International, a U.S.-based global private equity firm, which acquired Cobham plc, itself a UK defence company, in early 2020.

The proposed undertakings to be provided in the Cobham/ Ultra transaction are detailed and extensive and cover a range of behavioural and structural matters which appear to be intended to address the national security concerns identified by the Secretary of State in the review of the transaction, following advice from the Ministry of Defence. These include the creation of "SecureCos", UK legal entities which encompass the UK Ultra facilities that deliver sensitive capabilities to the UK government, and step-in rights enabling the UK government to require the transfer of ownership of the SecureCos on national security grounds, either to a third party or the UK government.

The consultation period on Cobham's proposed undertakings expires on July 3, 2022, following which the Secretary of State will decide whether or not the undertakings are sufficient to clear the transaction without a Phase 2 investigation.

Similarly, on June 28, 2022, BEIS announced that two separate consultations, addressing both national security and competition considerations, were being launched in relation to the proposed acquisition of Meggitt plc, a UK aerospace company, by Parker-Hannifin Corporation, a US-headquartered company which supplies components to the mobile, industrial and aerospace markets globally and is listed on the New York Stock Exchange. The transaction was originally announced on August 2, 2021 and

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the Secretary of State issued a public interest intervention notice under the Enterprise Act on October 18, 2021. The public consultations on the proposed undertakings will end on July 13, 2022.

As is the case with the Ultra transaction, the Secretary of State has made it clear that he is minded to accept the undertakings offered by Parker-Hannifin to address the national security concerns raised by the deal, following advice from the Ministry of Defence. The proposed undertakings are focused on ensuring that Meggitt's existing contracts with the Ministry of Defence are honoured and that the Ministry of Defence will be notified in advance if there is a material change to Meggitt's ability to supply it, and reinforcing the commitment to existing security arrangements protecting sensitive UK government information in Meggitt's possession.

It is worth noting that the proposed undertakings in both the Ultra and the Meggitt transactions include obligations on the target companies to avoid doing anything which would cause their relevant capabilities which are sensitive from a national security perspective to become subject to the United States' International Traffic in Arms Regulations (ITAR). In order to comply with this obligation, the companies are required to maintain internal ITAR control plans in a form agreed with the UK government and to agree to response plans with the UK government in the event that a sensitive capability becomes subject to ITAR after the transactions close as a result of a change in the scope or application of ITAR.

These requirements appear to reflect concerns which have been raised by commentators in a number of recent transactions about the possibility of acquisitions of UK defence and technology businesses by US acquirers resulting in the target businesses becoming subject to onerous US regulations.

UK publishes first annual report on NSIA regime

On June 16, 2022, the ISU published its [first annual report on the operation of the NSIA](#), covering the first three months of the new regime's operations.

In that span, the ISU received 222 notifications, of which 17 (less than 8%) were called in for further review. This is broadly in-line with the UK government's expectations prior to commencement of the regime. These figures compare favourably with figures for the European Union (EU), whose first annual report on its investment screening mechanism indicated that 14% of cases notified to the EU's central investment screening mechanism were referred to a detailed Phase 2 review.

The most common sectors called in for mandatory notifications in the UK were defence, military and dual use, critical suppliers to government, artificial intelligence, and data infrastructure. The average time to call-in from the date of initial notification was 24

working days for mandatory notifications, and 22 working days for voluntary notifications.

The report is broadly consistent with our understanding of market experience during the period and indicates that the new regime is working well. The ISU has acted quickly and pragmatically on transactions which are relatively straightforward from a national security perspective, which will be of comfort to investors. Concerns which had been fairly widely expressed in the market prior to the commencement of the regime that a large number of defensive filings would be made and lead to an immediate backlog and delays do not appear to have been realised in practice. However, investors in the most sensitive sectors of the economy, in particular the defence, artificial intelligence and data infrastructure sectors, should plan for meaningful government scrutiny.

On the same day the annual report was released, the ISU also published the terms of its Memorandum of Understanding (MOU) with the UK competition regulator, the Competition and Markets Authority (CMA). The MOU makes clear that there are both informal and formal lines of communication between the ISU and the CMA regarding transactions, and it sets out rules of the road for engagement between the two bodies on matters such as timing and remedies.

European Union

GlobalWafers's abandons acquisition of German silicon wafer manufacturer Siltronic

The impact of foreign direct investment controls on corporate transactions has of course also been witnessed recently in regimes beyond the UK. In December 2020, GlobalWafers, a Taiwanese silicon wafer manufacturer, launched a public takeover of Germany's Siltronic, a leading silicon wafer manufacturer. It made a voluntary filing with the German foreign direct investment regulator, the Federal Ministry for Economic Affairs and Climate Action (BMWK), shortly after launch.

Despite the transaction being cleared by the Committee on Foreign Investment in the United States in March 2021, the BMWK exercised its powers to extend its review period and stop the clock to seek further information. It raised concerns ranging from the security of supply for European industry (Siltronic is the last remaining independent European silicon wafer supplier) to geopolitical concerns about potential Chinese interest in Siltronic (possibly through Chinese merger control remedies or the risk of Chinese military action in Taiwan).

GlobalWafers unsuccessfully sought to challenge a further extension of the review period in the German courts, and the transaction was terminated in January 2022 after the tender offer expired in the absence of German approval.

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The complex sensitivities surrounding Chinese investment and the semiconductor sector are echoed in recent Italian vetoes of Chinese acquisitions of Italian semi-conductor players, such as LPE in March 2021 and Applied Materials in November 2021.

Germany unwinds Aeonmed acquisition of Heyer Medical

Similar to the retrospective intervention by the UK government in the NWF transaction, Germany's BMWK recently prohibited Chinese Aeonmed Group's previously completed acquisition of German medical device manufacturer Heyer Medical AG.

Aeonmed Group had acquired Heyer Medical, a manufacturer of ventilators to treat respiratory diseases and for anaesthesia, in March 2020, after it was restructured due to financial difficulties. Despite two years of apparent negotiations between the BMWK and the parties, the BMWK ultimately prohibited the deal. Press reports attributed the veto to the German government's concerns with the security of supply of essential medical products, and the potential role of Chinese political influence.

European Commission overrides Hungarian veto of Vienna Insurance Group's acquisition of Aegon Group's Hungarian business

In March 2022, Vienna Insurance Group (VIG) closed its acquisition of Aegon Group's (Aegon) subsidiaries in Hungary, Poland, Romania and Turkey, despite the transaction being blocked by the Hungarian government under its investment screening laws.

While the transaction obtained EU merger clearance for antitrust purposes in August 2021, it was blocked by the Hungarian government under emergency legislation introduced in the context of the COVID-19 pandemic.

Highlighting a key interplay between EU merger regulation and domestic investment screening, the European Commission (EC) investigated the Hungarian decision and concluded that it had breached Article 21 of the EU Merger Regulation. Article 21 gives the EC exclusive competence to examine concentrations with an EU dimension, but permits EU member states to take measures to protect their legitimate interests.

In the Aegon case, the EC expressed doubts as to whether the veto was genuinely aimed at protecting Hungary's legitimate interests, noting that VIG and Aegon are both well-established EU insurance companies with existing presences in Hungary. The transaction proceeded after Hungarian authorities withdrew their veto in light of the EC's conclusions.

The transaction provides a potential roadmap for parties that receive an EU merger clearance for antitrust purposes, but face a member state rejection under investment screening laws. Given the practical difficulties of judicial review, where a transaction is in a sector that does not present a fundamental national security concern, pursuing an EC decision under Article 21 may be an effective means of challenging a domestic veto.

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