specify whether there will be any right to use the earnout payments as an offset against any required payments under indemnification claims or otherwise. A seller may seek to delay other payments being made until the earnout is finally determined. The parties should consider whether there will be any adjustment with respect to payments made (or missed) in previous installments based on subsequent performance.

Distinguish earnout disputes from other disputes. If a post-closing earnout dispute arises, the sale agreement should be carefully analyzed to distinguish and separate from the earnout dispute any issues that actually give rise to claims of breach of non-earnout-related representations and warranties, fraud, indemnification, or other issues. The agreement also should provide whether the buyer can offset indemnity claims against earnout payments.

The risk associated with the final earnout payment. In a number of cases (including *Edinburgh*), all earnout payments have been made other than the *final* payment due. This not uncommon pattern suggests that *throughout the period* the parties should monitor the performance of the business with respect to the calculation of the earnout and be aware of and try to resolve disputes as they arise.

Selecting dates for the Earnout Period. Determining the optimal length of an Earnout Period will involve, for either party, a balancing of factors. Perhaps most importantly, a longer period will provide a more reliable look into how the business performs, but will also entail a longer period during which there are restrictions on the business, a longer wait for the earnout payment, possibly longer involvement by the seller in managing the business, and an increased potential for the business' performance to be affected by *general* industry or market conditions (or other factors not related to the specific business acquired). At the same time, of course, a longer period may be preferred by a seller to provide sufficient time for the business' value to grow. Thus, the preferred route will depend on the specific factual context. As highlighted in *Glidepath*, dates for the Earnout Period included in a draft agreement should be reconsidered and (if appropriate) revised if the signing and closing date of the agreement extends beyond the date that the parties initially anticipated.[3]

ENDNOTES:

[1]C.A. No. 2017-0500-JRS (Del. Ch. June 6, 2018).

[2]C.A. No. 1220-VCL (Del. Ch. June 4, 2018).

[3]Further practice points relating to specifically tailored earnout terms, and discussion of the major Delaware earnout decisions, are included in our article, *The Enduring Allure and Perennial Pitfalls of Earnouts* (January 2018), https://corpgov.law.harvard.edu/2018/02/10/the-enduring-allure-and-perennial-pitfalls-of-earnouts/.

UK CITES SECURITY REASONS FOR PROPOSED DEAL NOTIFICATION REGIME

By Matt Evans, Leon N. Ferera, William E.H. McDonald, Laura Fraedrich and Chase D. Kaniecki

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The UK government has published a consultation paper on national security and investment which proposes far-reaching rules to enable it to scrutinize and ultimately block deals it believes may give rise to national security concerns where "hostile actors" might use ownership of, or influence over, businesses and assets to harm the United Kingdom. The proposals, which are described in further detail below, will,

in many ways, bring the UK foreign direct investment review regime more in line with the Committee on Foreign Investment in the United States ("CFIUS") review process in the United States.

The proposals envisage a voluntary national security notification regime which, in theory, could cover any sector of the economy, although guidance is given as to likely areas of focus. Where deals complete without being notified for national security clearance, the government proposes having a six-month window following completion in which to assert jurisdiction to review the deal.

The proposed regime will cover not just acquisitions of majority shareholdings, voting rights or asset ownership but any deal giving the acquirer "significant influence" over an entity or asset. An acquisition of more than 25% of shares or votes in an entity would be covered, and even a lower shareholding, in particular if accompanied by a veto right over the business plan, could meet the test. No deal will be too small to be exempted from the new regime. The proposed timetable for a national security review seems likely materially to slow the pace at which qualifying deals can be completed, with a proposed review period of up to 21 weeks (105 working days), with further extensions possible.

The proposed changes, if introduced in line with the government's consultation paper, can be expected to introduce additional costs and uncertainty of foreign investment in the United Kingdom. Given the extent of the changes, the period of the consultation and the need for new primary legislation, it is unlikely that the new regime will come into force until well into 2019 at the earliest. Potential acquirers of companies doing business in the United Kingdom which may find themselves in the future subject to this new regime may wish to consider bringing forward their investments so as to avoid its application.

In addition, given the similarities between the proposals and the current CFIUS review process in the United States, parties might, at least initially, consider looking to CFIUS precedent for clues as to how the changes could be implemented from a practical perspective.

Context

The paper emphasizes that the proposals are not intended to deter, or change the United Kingdom's approach to, foreign investment. The paper explains that the proposed new regime is "only related to national security" and is intended to allow the government to take measures where "hostile actors" might use ownership of, or influence over, businesses and assets to harm the United Kingdom. It goes on to state that "foreign investment and an active and competitive economy are key to the UK's growth and development; the UK warmly welcomes the contribution that foreign investment makes and seeks to increase international partnerships in areas such as research and innovation. Only a small number of investment activities, mergers and transactions in the UK economy pose a risk to our national security."

The new approach is not intended to change the UK's openness to foreign investment or its open and dynamic economy. The government will, apparently, continue to strive to increase overseas investment from, and collaboration with, partners across the world. The paper also observes that the United Kingdom is not alone in wanting to implement a regime of this kind and that other countries and international organizations have updated their rules and powers (or are in the process of doing so) to ensure that they can protect their own national security interests. For example, although the United States already has an interagency committee, known as CFIUS, that has the authority to review transactions that could result in control over a U.S. business by a foreign person, new legislation that would significantly change foreign direct investment review in the U.S. by, among other things, expanding the jurisdiction of CFIUS, is expected to become law in the very near future. In addi-

tion, the UK proposals and other foreign direct investment related developments in Europe could reignite the discussion on the draft EU Regulation Establishing a Framework for the Screening of Foreign Direct Investments into the European Union. The European Union has identified the investment screening proposal as a legislative priority and aims to adopt the Regulation by the end of the year.

The proposals in the paper are far-reaching in scope, and it remains to be seen how, if and when implemented, they would be put into practice.

Key Questions

Why Is the United Kingdom Doing This?

The United Kingdom believes it needs to update its ability to scrutinise and, if necessary, block deals that may pose a risk to UK national security. It wishes to reform current laws to enable it to protect the country from hostile actors using ownership of or influence over businesses and assets to harm the United Kingdom. It believes its proposed reforms will bring the United Kingdom closer in line with other countries' existing foreign investment regimes, such as the United States.

What Types of Transaction Could Be Caught?

The UK calls relevant transactions "trigger events." Similar to the current CFIUS review regime in the U.S., trigger events will be transactions that grant a party significant influence or control over entities or assets.

This would include:

- acquiring more than 25% of shares or votes in an entity;
- acquiring more than 50% of an asset;
- acquiring further significant influence or control beyond the above thresholds; and
- acquiring the ability to direct the operation of an asset or direct the operations or the strategic direction of an entity.

A trigger event could include a person who acquires a minority shareholding (less than 25%) but who nevertheless is the largest shareholder and/or whose recommendations are likely to be, or are likely almost always to be, followed by other shareholders.

The government envisages that a trigger event could also include a situation in which a foreign state has the right to appoint its representative to a business' board of directors and thereby have the means or opportunity directly or indirectly to shape that entity's operations or strategy. This could be of particular relevance to companies whose significant shareholders include state-owned enterprises.

Which Areas of the Economy Are Affected?

In theory, all areas of the economy could be subject to the proposed new regime. The government has identified certain "core areas" that are most likely to give rise to national security risks. These are:

certain national infrastructure sectors:

- civil nuclear,
- defense,
- communications,
- energy,
- transport;

certain advanced technologies:

- advanced materials and manufacturing science,
- artificial intelligence and machine learning,
- autonomous robotic systems,
- computing hardware,

- cryptographic technology,
- nanotechnologies,
- networking and data communication,
- quantum technology,
- synthetic biology;

critical direct suppliers to the government and emergency services sectors;

and military or dual-use technologies.

The government has made clear that sectors outside these core areas may also fall within the proposed new regime. This will depend on a case by case assessment. In addition to specific sectors of the economy that qualify as national infrastructure sectors, such as finance, chemicals, food, health, space and water, the government has flagged that the acquisition of land in close proximity to a sensitive site may raise national security concerns, as may the acquisition of significant influence over a supplier that indirectly provides goods or services to a core area.

How Does One Notify a Deal?

The government envisages a notification template and the possibility of submitting an online notification. This will be voluntary—it is not proposed that potentially qualifying deals must be notified before they complete. A nominated senior government minister will consider the notification to decide whether to call it in for a national security assessment. The consultation paper is silent as to whether this initial notification and screening process will be made public. We would expect it to be confidential. If the senior minister calls the deal in for a national security assessment, that decision will be publicly announced. The government will then undertake its assessment before deciding either that it will take no further action or that remedies must be imposed. Its final decision will be made public. This is different from the CFIUS review process, pursuant to which, absent a block by the President of the United States, the fact that a transaction was reviewed by CFIUS and its outcome is kept confidential by the U.S. government.

How Long Will the Process Take?

The government recommends submitting voluntary notifications at as early a stage as possible. It proposes an initial screening to decide whether to call the deal in for a national security assessment lasting up to 15 working days, extendable by another 15 working days. If the deal is not called in by the government at the end of that initial screening, then the government has effectively concluded that no national security concerns arise and the parties may close the deal in the knowledge that the government will not intervene. If the deal is called in for a national security assessment, that assessment will last up to 30 working days but can be extended by a further 45 working days. The proposed regime envisages possibilities to stop the clock in response to information requests and for the parties to agree on further extensions. Parties can therefore expect to have to wait between three and six weeks before learning whether the deal will be called in for review and that any review will last a further six to 15 weeks. This is compared to the current CFIUS review process, which recently has been taking between 16 to 24 weeks from start to finish.

What If an Acquirer Decides Not to Notify a Deal?

The government is proposing a voluntary notification regime, meaning that parties will be free to close deals without first seeking national security clearance. If the government becomes aware of a deal that may raise national security considerations and that deal has not closed, the government may call it in for review and may even impose restrictions to prevent closing pending the outcome of the government's review.

If a deal closes without being notified to the government, the government will have up to six months after

closing in which to call it in, following which it loses the right to intervene.

What Remedies Can the Government Impose for Deals Raising National Security Concerns?

The government wishes to avoid providing an exhaustive list of remedies it would impose to address concerns it has identified.

Indicative remedies include:

- limiting access to a particular site operated by the acquired entity to certain named individuals;
- permitting only personnel with appropriate security clearances to have access to certain information;
- forcing a new acquirer to retain an acquired entity's existing supply chain for a set period;
- restricting the transfer or sale of intellectual property rights;
- giving government approval rights over the appointment of directors or other key personnel;
- retaining UK staff in key roles at particular sites;
- requiring that the government be given access to information on the company's activities; and
- blocking or unwinding the deal in its entirety.

These are consistent with the measures imposed by CFIUS to mitigate national security concerns associated with a particular transaction within the jurisdiction of CFIUS.

What Sanctions Will the Government Have to Enforce the New Regime?

The proposals envisage civil and criminal penalties for failure to comply with conditions, orders or information-gathering demands during a review process. For each offence, either a civil or a criminal penalty could be imposed, but not both. Under the criminal powers, individuals could be fined or imprisoned for infringements of the new regime. Under civil offences, companies could be fined up to 10% of global turnover and individuals the higher of up to 10% of total income or £500,000.

How Will the New Regime Sit with the Current UK Public Interest Test?

Currently, the government can ask the Competition and Markets Authority ("CMA") to assess on public interest grounds deals raising national security concerns and those deals affecting either the stability of the financial system or media plurality. Under the proposed new regime, the CMA will lose the right to review on public interest grounds deals affecting national security but will retain its powers to review on public interest grounds deals affecting media plurality or the stability of the financial system.

The new regime will replace the recently introduced lower qualifying thresholds for review of deals involving military and dual-use technologies, quantum technologies and computer processing unit-related deals. Those deals that fall within the new national security regime may nevertheless still be reviewed by the CMA on competition grounds.

What Happens Next?

Interested parties had until October 16, 2018 to submit responses to the government's consultation. The government will now consider those responses before concluding on its preferred new regime. It will then draft new legislation which will be debated in, and need approval from, the UK parliament. It seems unlikely that a new national security regime, if approved, would come into force before the second quarter of 2019. It is possible that the new legislation will adopt many of the same concepts included in the pending legislation in the United States, which, as noted above, would significantly change the foreign direct investment regime in the United States.