HOUSE OF COMMONS

Business, Energy and Industrial Strategy Committee

Oral evidence: The work of the Investment Security Unit, HC 437

Tuesday 21 June 2022

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Watch the meeting

Members present: Darren Jones (Chair); Alan Brown; Richard Fuller; Mark Jenkinson; Charlotte Nichols; Mark Pawsey.

Defence Committee Member present: Mr Tobias Ellwood.

Questions 1 - 39

Witnesses

I: Dr Ashley Lenihan, Professor of the Practice of International Affairs, Georgetown University; Nicole Kar, Global Head of Antitrust & Foreign Investment, Linklaters; Will Jackson-Moore, Global Private Equity, Real Assets and Sovereign Investment Funds Leader, PricewaterhouseCoopers.

Examination of Witnesses

Witnesses: Dr Ashley Lenihan, Nicole Kar and Will Jackson-Moore.

Q1 **Chair:** Welcome to this morning's session of the Business, Energy and Industrial Strategy Select Committee for our first hearing in our new inquiry on the functioning of the National Security and Investment Act. The session this morning will give us an overview of the policy background for the Act being put into place, the structure of the Investment Security Unit in BEIS, and how it is working in practice, now that it has been up and running since January of this year. We are also delighted to welcome Tobias Ellwood, the Chair of the Defence Select Committee, who is joining us today.

We have three witnesses on the screen: Dr Ashley Lenihan, who is professor of the practice of international affairs at the London School of Economics; Nicole Kar, who is the global head of antitrust and foreign investment at the law firm Linklaters; and Will Jackson-Moore, who is the global private equity head at PwC. Good morning to all of you.

As an easy starter for 10 to kick us off, the Government said that the powers under the Act better reflect the threats that we face today, and that was the rationale for introducing the legislation. Dr Lenihan, could you just explain to us what types of threats the Government felt were a problem and why they therefore needed to introduce this legislation?

Dr Lenihan: Absolutely, and thank you, Chair, for your leadership of this new Committee and for your leadership on this issue, and to the whole Committee. Thank you for having me here today to speak with you.

The issue is that we know that some states use outward foreign investment as a tool of economic statecraft to increase their power and position relative to other states. That behaviour can be strategic. It can be about more than economic or soft power. It can be aimed at reducing the hard power capabilities and capacities, and even at increasing a target state's vulnerabilities in the context of an independent relationship.

The flip side of that coin that you are seeing today is that many advanced and industrialised economies, like the UK, are now updating their domestic legal capacity and institutions to be able to review and, if necessary, to veto, block or mitigate investments that might threaten their national security in such a way. The NSI Act, in line with this, is intended to combat a number of already identified and as yet unidentified threats in the context of the majority of investments that are benign, market-driven and beneficial to the economy.

The UK Government have, wisely, not provided an exhaustive list of their concerns, but having studied this for about 20 years, I am going to give you some historical examples and trending concerns among most western and OECD countries. Historically, states have primarily used these types of investment screening regimes to protect their most

strategic and sensitive businesses and assets from foreign control and manipulation.

During the world wars, concerns were raised over acquisitions that might enable a foreign Government to engage in espionage or sabotage—for example, simply by purchasing land in close proximity to a military facility, or to buy another company that was critical to its national defence. During the Cold War, that solidified, and many western and non-western countries became concerned that another state might acquire a company critical to its defence industrial base—for example, to hijack or destroy critical infrastructure, to nationalise or offshore production facilities, or to offshore or export sensitive technology or otherwise use them to their advantage.

Those concerns have endured and have not gone away, but there are new concerns that have emerged as well that this particular legislation is really trying to encompass. We know that, recently, some states, through either state-owned or affiliated companies, are buying foreign companies to obtain access to or control over, as I said, critical infrastructure—from ports that can impact supply chains, to telecommunications to control the flow of information.

The Covid-19 pandemic has intensified concern that first emerged in 2008 that depressed assets might be snapped up by strategic, state-led or influenced investors like sovereign wealth funds and SOEs. During the pandemic, concerns also again arose over the security and resiliency of supply chains, particularly in the healthcare sector.

As global needs change and resources deplete, concern has also emerged over the fate of companies that control access to finite or difficult-to-extract critical resources—from oil, to potash, to rare earth minerals and metals. The digital revolution that we have seen has led to new concerns over foreign investment in frontier and high-technology companies, especially around telecommunications, surveillance and those holding private data, all of which could enable espionage and sabotage in new ways. We know that private data alone, for example, has increased dramatically in volume and scope and could easily be used for the purchase of a company for the purposes of ransom, blackmail and extortion, or exploitation in some other way.

We have also seen clear concerns emerge in the West, and especially in the UK, over the control of emerging and foundational military and dual-use technologies, and sectors of concern that have deep implications if they were to be controlled by unfriendly or competitor powers, or authoritarian regimes specifically. Those sectors range from advanced technologies and materials to biosynthetics, nanotechnologies and solar and battery technology that is so critical for the future. There are many more and I can provide more examples offline—I am sure that you want me to wrap this up.

The important point here that I should stress is that this new legislation is responding to new and emerging changes in how we understand national security, but these national security concerns, which I looked at historically, have a cumulative rather than a cyclical impact on how we understand national security. This legislation is particularly important to help protect UK essential and national security.

Q2 **Chair:** Just briefly, you said at the start that the UK and other countries were upgrading their legislation in this area. Are there examples, either in the UK or in other countries, where not having this type of legislation has caused a direct problem that therefore justifies the quite expansive drafting in this legislation?

Dr Lenihan: Yes, there are several. The thing to preface is that, over the last 30 years, the number has almost doubled. There are 62 countries that are part of the OECD dialogue on these issues, and we now have at least 50 countries, plus the EU, that have adopted legislation in this area. The bulk of them have been in just the last few years.

That is because there have been a series of particular cases—for example, Aixtron in Germany, KUKA, and a number of others—where western countries have found that, while they have the international legal right to veto and mitigate for an investment in order to protect their national security, they do not always have domestic legislation that fully enables them to have the institutional capacity behind that right to do it in a way that is quick, well-founded and not subject to onerous backlash afterwards because there was not the enabling legislation domestically.

This kind of legislation gives these countries the institutional and legal capacity domestically, and the jurisdiction, to review, monitor and intervene in a way that is consistent, transparent and proportionate, which is very difficult to do if you are just reacting to situations on the fly.

Q3 **Charlotte Nichols:** Like most legislation, the Act has been accompanied by regulations and statutory instruments that define how the Government will implement it. Is there anything in the Government's implementation of the Act so far that surprises you or that you would like to draw the Committee's attention to?

Dr Lenihan: In terms of implementation, the key is that you have an excellent piece of legislation that is broad and flexible in its scope and powers. The key in implementation, which we have seen only about a couple of months of since January, is really going to be its ability to effectively monitor and review these transactions, to implement mitigation agreements and vetoes when needed, in a way that is narrow and highly specific to national security concerns, to not have them bleed into other areas of concern like economic security, and to ensure that they are not decisions that have become politicised.

In order to do that, what I would like to see and what I have argued for elsewhere is to have very clear, regularised and institutionalised feed-in from across different areas of Government—the Ministry of Defence, the FCDO, the Department for International Trade, GCHQ and all these different areas of expertise—in a way that is clear and regular and ensures that that expertise is brought to bear to ensure that mitigation agreements are narrow, that the use is specified and that the process does not become politicised. It also helps, as we have seen in other countries, to protect against problems in the area of judicial review when decisions are made.

To do that, you also need a regime that is a little bit more transparent about process and make-up. At the moment, I know from my research, for example, that certain Departments are feeding in, but from the outside, to an investor, it is very difficult to see that, other than some blanket assurance from Governments that that process happens. In other countries, it is made public which Departments regularly feed in and how they feed into the process—for example, in the US, Germany and Australia—and that has proven very important for investors in terms of their confidence that decisions are being made in a way that is not political and that brings expertise to bear.

The third thing in order to have that institutionalised feed-in and that transparent process is that you really need full institutional capacity behind the ISU. Again, I know that we have seen the annual report, but this only has three months of data; it is difficult to draw conclusions from that three months of data. If we could have a much more transparent process, that would help investors.

Q4 **Charlotte Nichols:** Coming back to your second point there, the most significant secondary regulation has been the definitions of the 17 sectors subject to mandatory notification. During the passage of the Bill, there was some concern raised that sectors with a wide range of applications, like energy and artificial intelligence, might be too widely defined. Are you satisfied with how the Government have now defined these?

Dr Lenihan: For any endeavour like this, it is good that, in the Act, it allows for regulations to be updated over time. It will be very important to monitor, over the next three years, how these sector definitions are received and how useful they are in capturing the strategic transactions that the Government are wishing to cover, and that it does not capture a lot of transactions that the Government do not really need to review.

One of the things that is very unique about this Act among western countries is that the word "foreign" is not included anywhere in the Act. This covers domestic investment as well as foreign investment. It may be found over time that it is not necessary to review all domestic investments in all of these sectors. One of the things that is instructional, and on which I can provide more detailed information and written evidence, is that, in the US, for example, during the update of legislation around the Committee on Foreign Investment in the United States in

2018 under FIRRMA, the introduction of a mandatory notification system for ITC sectors was originally based on its definitions according to standard industrial classification codes—SIC codes.

It was found, during the pilot programme that it did, that that captured a lot of things that it did not necessarily need to capture, and it did miss some things that it wanted to catch, so it has moved towards a system now that is based and focused more on export control laws to define those areas.

Using a pilot programme might be something that the Government might wish to consider as they monitor these sectors. They probably will evolve over time, but it is a good starting point.

Q5 **Charlotte Nichols:** Ms Kar, would you say that you were satisfied with the sector definitions?

Nicole Kar: Thank you to the Committee and to the Chair for inviting me to give evidence today.

The ISU and BEIS generally took on quite a lot of feedback after the first round of consultation on the regulation. The communication sector, for example, was substantially narrowed in scope, which was a huge relief to many in the sector. BT alone said that it would file 1,800 notifications if it had not been narrowed. There are interpretation points that could be further refined. With synthetic biology, for example, you require a synthetic biology degree to work out whether you fall within the sector. What happens in practice is that acquirers push a very detailed questionnaire across to a target to have to answer all kinds of areas of its activity, which contributes to transaction friction.

The other thing is the sectors. Some of them are very broadly defined. We found ourselves considering notifying a recent deal involving a retail bank, because it uses algorithms in its daily functions, as do many businesses, and was captured by the algorithms definition, at pain of criminal consequences and automatic share invalidity if it did not file a notification. There are still glitches, as you would probably expect, and the regulations will benefit from further consultation and streamlining as there is greater experience.

Will Jackson-Moore: Thanks for the opportunity to give evidence today. I would agree with my fellow panel members in terms of the comments. We are finding that, because of the broad definitions, a significant number of transactions and investments are being notified. In the report, it was 222. There is no clear market statistic as to what the overall volume of transactions and investments is, but it is somewhere between 400 and 1,200 in that same period, which therefore indicates that a significant proportion are being notified because of the severity of the penalties if you fail to comply with the Act, but the fact that only 17 have been called in indicates that it has been broad in its drafting.

We would understand that, because many of these areas are very fast moving and emerging. I agree that the definition will need to be updated, but, in the meantime, you need to have a broad definition in order to capture emerging areas of national security.

Q6 **Charlotte Nichols:** Before the National Security and Investment Act came into force, the Business Secretary had powers under the Enterprise Act 2002 to intervene in certain mergers on public interest grounds. The Secretary of State is still empowered to intervene in acquisitions on public interest grounds under the Enterprise Act, as he was before, although the associated powers are more limited. Do you anticipate any friction between these two regimes under the Enterprise Act and the NSI Act?

Will Jackson-Moore: I probably do not have enough insight into the drafting in order to comment on that, so I may hand over to my legal colleague to comment on that part.

Nicole Kar: I am happy to comment on that. There is a bit of friction between the two pieces of legislation being concurrent in their application. My understanding is that only the public security aspects of the Enterprise Act are superseded by the National Security and Investment Act, so you could still be reviewed under the Enterprise Act. There are a couple of ongoing reviews that could relate to previous to the 4 January implementation date. NVIDIA/Arm was under the previous piece of legislation.

The health head of review, which was implemented during the Covid lockdown periods, and media mergers, for example, and other forms of review can still take place. That does lead to friction in the sense that, if you have a healthcare company, you are wondering whether the Enterprise Act will apply with open-ended deadlines and no real filing form, waiting for the Secretary of State to serve a notice on you, or whether the NSI Act should apply. That applies only if you are in the synthetic biology sector or you trigger otherwise some of the other 17 heads.

There is some process friction and confusion, I would say, in the market about which piece of legislation can continue to apply. Of course, the Government can continue to add new heads of intervention, as they did with the Lloyds/HBOS merger, when they added financial stability to the list of heads of intervention, so there is always scope to supplement if there is felt to be a detriment to the NSIA mandatory coverage with the Enterprise Act. It is quite a confusing state of affairs.

Dr Lenihan: That was an excellent overview of the issues from my fellow panellist there. It was heartening in the memorandum of understanding that there is a recognition of those issues and a desire to co-ordinate timelines, but any greater clarity that could be offered would be extremely helpful, especially for those areas of overlap around digital and the public healthcare sector.

Q7 **Chair:** Ms Kar, can I just check something? If a transaction is notifiable under the National Security and Investment Act, but also reviewable under the Enterprise Act at the same time—maybe it is a question of media plurality and who owns the media company from a national security perspective—does one Act have precedence over the other?

Nicole Kar: No, they are both primary pieces of legislation. The way that practitioners would approach it is that you have a mandatory obligation to notify people in the 17 sectors, so of course you would use the NSI Act and notify in that way, rather than wait to be called in, but it is more in the non-mandatory area. I gave a healthcare example, because the Covid head of intervention, if I can put it that way, is very broadly drafted. It can cover the acquisition of a supermarket, for example, or important IT or supply chain companies, and then, of course, healthcare companies.

You have a bit of an issue about how you should approach the issue when it is a voluntary filing or the Government could call you in on the Enterprise Act, and there is no primacy as between two pieces of primary legislation, unfortunately.

Q8 **Mark Pawsey:** There are two principal objectives of the Act. The first one is to protect the UK's national security, and we have had an overview. Ashley Lenihan, does the Act do that satisfactorily? Is it too early to tell? You told us about some areas that were not terribly clear. Is it going to do what Government wanted it to do from the perspective of national security?

Dr Lenihan: The thing is that the definition of national security is going to continue to evolve. It is critical that national security is not defined in the legislation. I have looked extensively at 18 similar regimes and have yet to find one that does define national security.

This Act is very broad and flexible in its scopes and powers. It provides a hybrid regime with these three elements of mandatory notifications in specific sectors to capture the issues of greatest concern, but also still provides a voluntary cross-sectorial notification system and call-in power for the Secretary of State that allows transactions for entities and assets to be reviewed in greater depth that might fall outside of those sectors but still be of concern for national security. The Act is flexible enough to allow the Government to do what is needed.

What is going to be critical and what is yet to be seen, and what I believe is the purpose of this Committee, is to ensure that its implementation over time is effective.

Q9 **Mark Pawsey:** Therefore, is the UK population safer because this Act is in force?

Dr Lenihan: I think so. It allows the Government to deal with a number of transactions that, historically, they were not able to in the past.

Q10 **Mark Pawsey:** I am going to come on to that with Mr Jackson-Moore.

We are the Business Committee, and businesses like certainty. Does this Act give businesses sufficient certainty? You have told us about some poor definitions and about a whole load of cases being notified that perhaps did not need to be notified because the requirement to do so is pretty onerous. Is this making life better for business?

Will Jackson-Moore: Just to clarify, I said that the definitions were broad rather than poor.

Mark Pawsey: Sorry, Nicole Kar said poor. Forgive me.

Will Jackson-Moore: In terms of business, our focus is on efficient capital markets and the ability of UK enterprises to attract capital. As Ms Lenihan said, all major developed economies have equivalent legislation, albeit different in most cases in terms of the detail.

In terms of a level playing field, if you are trying to attract capital into the UK as a businessperson, are you disadvantaged relative to other nations? Broadly, no. The key from a business perspective is the application of it. Yes, a large proportion are being notified, and that may be clarified over time.

Q11 **Mark Pawsey:** Is it a good or a bad thing that such a large proportion are being notified?

Will Jackson-Moore: For national security, it is a good thing. For individual businesses, it does add additional legal burden, and that is broadly how it is seen. The key thing from a business perspective is not whether you have to notify, necessarily, but whether you get the answer quickly and in the timescales that you are expecting. The first quarter's report suggested that the timescales were broadly being met, which from a business perspective gives you a degree of certainty that you are going to get your answer.

We are not hearing a lot of negative noise from organisations around the Act. Yes, it has had an additional burden, but it is not disrupting the capital markets so far, because the answers are coming back relatively quickly.

Q12 **Mark Pawsey:** I wonder if I can go back to what happened before the Act. Prior to that, there were some high-profile acquisitions and attempted acquisitions. A good example is the defence manufacturer Cobham. What would have happened if this Act had been enforced then?

Will Jackson-Moore: Maybe I will hand that one over to Ms Kar, who is probably in a better position to comment in terms of how it would have been captured in the legislation.

Nicole Kar: It probably would have had the same results. There is a question about whether Arm would have been waved through as a sale to a foreign buyer. That is a valid question.

Q13 **Mark Pawsey:** There are transactions that took place prior to the

implementation of the Act that would have been captured by it.

Nicole Kar: There are transactions that would have been captured by it and that may have had a different outcome, given the current political mores.

Q14 **Mark Pawsey:** Would there have been a better outcome?

Nicole Kar: It depends who you ask, but many people saw Arm as a real crown jewel of UK technology and would not have wanted to see it fall into foreign ownership, no matter how benign the foreign owner was. I do not think that anyone disputes that SoftBank was a good caretaker, but there are some assets now viewed that Government wish perhaps they had retained and brought British investors into. Cobham, as an example, would have had the same outcome. There was a lot of political and media noise around Cobham, which seemed to be resolved with undertakings, and the same approach would apply today under the NSIA.

Dr Lenihan: Just to follow in on that, Cobham would have probably had the same result. I wonder if the mitigation agreement would have been perhaps better for all parties if it had taken place under this Act as opposed to the other.

Q15 **Mark Pawsey:** Was that in some way lacking in your view?

Dr Lenihan: This is classified and not public information, so this is speculation on my part. One of the benefits of an Act like this, which is a regime focused purely on national security, is that, when it comes to agreements or transactions like that, which can be mitigated to protect national security, if you have a regime that is dedicated to it and that has experts feeding in regularly to it, one of the biggest challenges for most western economies at the moment is how you do mitigation agreements well.

If you have a focused regime like this, the trend seems to be that more experts are brought into the process sooner on both sides, that that conversation happens sooner, that the outcomes are usually better for all parties, and that the future monitoring process is easier, because you have a regime that is focused and can focus on compliance and monitoring in the long term.

There are a number of transactions that would have been captured under this regime that could not have been under the Enterprise Act, such as investments in Hinkley Point C, initial foreign investments in graphene, for example, a number of smaller transactions of Huawei, and purchases of small, emerging and really interesting companies in the UK.

Q16 **Mark Pawsey:** Are we shutting the stable door after the horse has bolted, in that case?

Dr Lenihan: They are not going to be captured now, because these happened a long time ago.

Q17 **Mark Pawsey:** The question that I am asking is whether we should have had this legislation in place beforehand. Are we too late in bringing this forward? Has the danger already happened?

Dr Lenihan: Absolutely not. What you have done is you have brought it in at the right time, when most other countries, including your allies, are bringing it in, in a changing global context of increasing uncertainty, with far more strategic investments taking place than we have ever seen before, and for politically motivated reasons.

Q18 **Mr Ellwood:** Just following on from Mark's point, I am interested in the trends that are taking place, but also the learning curve that the Government are on. Huawei was mentioned. It took a number of Back Benchers to make a lot of noise before the Government were prepared to move, and they moved because there was noise here, not because they saw any dangers coming over the horizon. In retrospect, they now recognise that that was the wise decision to take.

Where this leads to is the comment about shutting the door after the horse has bolted. What is the trend that you are seeing, particularly in my area of military capabilities? From where I sit, we are seeing a flight, if you like, of ownership away from here to, in fact, some of our closest allies. It seems that the strategic approach by the United States is to become more self-sufficient and independent, and that is to our detriment. We are then suffering because of its strategy.

Dr Lenihan: In terms of broad trends for NATO allies or the UK's other close allies, the issue with strategic investments—I have looked at this from a broad historical perspective of over 100 years—is that, at the moment, there are concerns with certain countries. It is important to say, though, that those countries will change over time.

Countries like China have stated policies of using investment subsidies and outward foreign investment to gain strategic advantage in areas of competition, so this type of legislation is important for the future. What is key and what is good in the legislation, and something to monitor in terms of how it is implemented in the future, is the co-ordination among western countries as to the sharing of intelligence and information around these types of strategic investments. The Act, the US Act and the EU framework directive allow for intelligence sharing.

Q19 **Mr Ellwood:** Forgive me, but my question was focusing on what the trends are that are taking place. Are we a net beneficiary of intellectual property at the moment, or are we losing out, both to our adversaries, with China taking a subtler approach to, as you say, gaining leverage inside businesses and so forth, and indeed to the United States, which has, from my perspective, a very clear vision that it needs to become more independent? That means gaining ownership of some of our cleverer assets here in the UK.

Dr Lenihan: Sorry, I see what you are saying. I do not see that particular trend. There is a concern in the US that intellectual property

and certain key advanced technologies and manufacturing capacity remain among its allies. I do not think that the desire is to become completely self-sufficient. The decisions that we have seen in CFIUS, with mitigation agreements that allow for cross-border deals among allies to happen easily, with some modifications to assure supply chain resiliency and other things in times of critical danger or war, really help solve that problem.

If mitigation agreements are used well among the allies, intelligence is shared and there is a co-ordinated effort to deal among the defence industry and among the NATO regimes, for example, on certain issues, whether that be 5G semiconductors or other things, then I do not think that you are going to see a flight of intellectual property away from the UK. That has not happened in other countries that have adopted these types of legislation. You certainly have not seen it in Germany, for example, with the reforms that it has done.

Nicole Kar: I have just a brief but important point. The wider trends are important here, because national security is just one part of the jigsaw puzzle. What we are agreeing, at least from the practitioner community—Mr Jackson-Moore and myself—is that the Act does not seem to have had a chilling effect on investment coming into the country, but it is just one piece of a wider question about whether UK capital markets support the kind of innovation that you need to see in the defence sector, and whether research and university bodies are developing the intellectual property necessary.

I would not say that there is a flight, but there is a wider trend that you have correctly identified of countries onshoring their domestic defence capabilities, which will continue. We are going through a different geopolitical and deglobalisation shift that many have spoken about. There is really a question that goes hand in hand with the national security question and whether the Act deters investment, and that is whether we are doing sufficient to incentivise investment and to make sure that companies want to come here and list here. The Kalifa review and various others have commented on that, but that piece is really quite important for the defence sector more generally.

Q20 **Richard Fuller:** Just to cap this point about investments, this question is to Mr Jackson-Moore and maybe also to Ms Kar. Have you seen or do you foresee any change in the beta applied to capital investment decisions in the UK as a result of the NSI regulations due to enhanced or assessed political risk?

Will Jackson-Moore: As we have said earlier, if other developed nations did not have equivalent legislation, then yes, we would, but, because other nations do have equivalent legislation, I do not think that it does move the overall risk relative to our peer nations. I do not see that as a major issue for investors or for people raising capital.

Q21 **Richard Fuller:** So in your modelling at PwC for these sorts of decisions,

you have not changed the beta as a result of this Act.

Will Jackson-Moore: I am not sure that we would specifically have a model that covers that, but in terms of our dialogue with organisations looking to make investments, it has not changed the context of those conversations.

Q22 **Charlotte Nichols:** Again, just to further drill down into this point, Ms Kar, as well as requiring that acquirers notify the Government about qualifying transactions in the 17 sensitive sectors, the Act gives the Government the power to call in and, if necessary, unwind qualifying transactions in any sector up to five years after they have been concluded. This is a potentially significant power, but do you think that this is likely to have an impact on foreign and domestic investment within the UK?

Nicole Kar: It will. The answer that I would have given to the previous question is that the proof is in the pudding on implementation, and it is too soon to tell. There are 17 cases, according to the annual report published last week, that are still in motion, where mitigation could result. There is one case in which an interim order has been imposed to stop the parties integrating before the outcome of the review. There is a potential deal—the Newport Wafer Fab deal—which did take quite some prodding for Government to take a look at, but is apparently under review, which has been completed, and so could be unwound.

Whether a beta gets applied to UK investments really depends on how the ISU applies intervention, and we have not really seen that yet. We will see, in a few weeks, some transactions that are in play at present, and what might surprise investors is that economic as well as national security commitments are being taken by the Government. The Act was adamant that this is about national security, not national or economic interest. These are very important signals to investors. Is this about the political mores of the day? Is it a politicised process or is it really about national security?

On defence deals, there is a well-trodden path, with the MoD taking well-defined mitigation to impact that and to protect our security capabilities. In other sectors, it was interesting to read the reports that AI and foundational technologies are all coming up as high-notification sectors. How the Government approach that is the key question, and that is a key signal for the investment community.

Q23 **Charlotte Nichols:** Ms Lenihan, just to go back to your earlier points around an international comparison, the Government have said that their use of the Act will be strictly limited to considerations of national security and not the wider public interest. However, other countries, such as the US, are increasingly arguing that national security means protecting a wide variety of domestic industries. Do you expect to see the Act being used in this way and would you welcome this?

Dr Lenihan: There are two pieces of that question, and I am going to do my best to answer it, but tell me if I miss the mark. It is extremely important not to conflate economic security with national security. Economic security is very broad and covers a lot of things, and can be extremely protectionist at one end of that spectrum—for example, protecting jobs in mitigation agreements. That would be something that I really hope we do not see in the application of this Act, because doing things like protecting jobs under the guise of national security, when it is really talking about economic security and protectionism, is seen as a red flag signal to investors that this Act might be implemented in a way outside of its legal powers and scope.

That being said, I understand that, in the US, there is concern about economic security broadly across Congress, by our President and by many other actors, but the implementation of FIRRMA through CFIUS—the Committee on Foreign Investments in the United States—is extremely narrow in its scope.

If you go, for example, back to the last question and the reason why the US has a system where there is no cap on retroactive reviews and no time limit under FIRRMA, that has not posed an issue to incoming investment, because that power has been used discretely, proportionately and very narrowly for the purposes of national security—for example, retroactively unwinding an investment where a Venezuelan state-affiliated company had purchased a US voting machines company, or retroactively unwinding a case where Huawei had been found to have purchased bankrupt assets of a company named 3Leaf Systems, where those bankrupt assets involved source code that was used by the Department of Defense. It is a very narrow interpretation.

The key for this piece of legislation—and I have to echo what my esteemed fellow witness said—is going to be its implementation and how it is applied narrowly to national security over time. If that is done, and done well, it does not matter what the time period is for retroactive review. It is not going to be a red flag signal to investors. It is not going to deter foreign investment. If it bleeds into the area of the economic protectionism, it will be an issue.

What is tricky and what you are noting, which is going to be a very difficult area for the future and an area for this Committee to follow, is those areas of national security that are critically tied and inextricably linked to the economy, including certain defence sectors and certain supply chains. In that area, maybe we need to come up with a new term to talk about it publicly. Maybe in the integrated review, instead of saying "economic security", it would have been better to say "national security of the economy", or something along those lines, but maybe there is a new term of art that we need to find, because conflating those two big issues can be an issue.

Q24 **Charlotte Nichols:** Hypothetically, a hostile entity could harm the

welfare of many people in the UK by damaging parts of our economy—for example, restricting access to key products or putting large numbers of people out of work. Are you arguing that we should not use the powers within this Act to make sure that we do not open ourselves up to that risk?

Dr Lenihan: Broadly, national security is understood to be that which seeks to maintain the survival of the state and to preserve its autonomy of action in the international system. I know that we do not define these things in law, but, broadly, that is what we are talking about. While the loss of jobs in a sector like the steel industry, for example, would be rough on the UK and on the economy, it is not necessarily an issue of national security, because it is not threatening the survival and autonomy of action of the state within the international system.

If you are looking at something like a transaction that would allow an authoritarian regime to potentially hack into, surveil and gain access to private data of Government workers for the future purpose of espionage and exploitation, that could have a deep impact on the future survival and autonomy of the state.

One that is a little harder, murkier and in the middle is some of these areas of emerging and foundational technologies, where we are not quite sure yet how critical they are to the future autonomy and survival of the state, and they do play a critical role in the economy. That is an emerging area for us to watch, and we just have to be careful, as Ms Kar said, in terms of our implementation, to make it clear that our actions are about national security and not about protectionism more widely. Does that help? Does that answer the question?

Q25 **Charlotte Nichols:** Yes, thank you. Ms Kar, is there anything that you would like to add before I go back to the Chair?

Nicole Kar: No, that was a perfect and very fulsome answer.

Q26 **Alan Brown:** The Government have promised that the enforcement of this Act will be strictly limited to national security considerations, but, at the same time, the Government have specifically rejected recommendations to define what they mean by the term "national security". The Government claim that this ambiguity is necessary to preserve their freedom to act. Ms Lenihan, you said earlier that it is critical that it is not defined. Mr Jackson-Moore, do the Government's assurances on their objectives provide enough predictability for business, or does ambiguity around the definition cause uncertainty for businesses?

Will Jackson-Moore: Certainty is the key thing here. Business needs to know when it is going to get decisions and what the likelihood of those decisions is going to be. Anything in terms of the application of the Act that reduces uncertainty is going to be helpful. In particular, retrospective call-ins, in my view, should be done in truly exceptional circumstances, because it will create a lot of uncertainty if we start to see that happening on a regular basis. Anything that can be done to do things

speedily and clearly—and Ms Lenihan commented on disclosures around how the decisions are being made—would be helpful.

The other side of it is the appeals process, which I understand is a judicial review. I am not a lawyer, but, as an educated layperson in this area, the thought of going through a judicial review to challenge an outcome seems very onerous and expensive to a businessperson. That would be the other comment in terms of clarity around that appeals process as well.

Q27 **Alan Brown:** Ms Kar, the Foreign Affairs Committee has warned that, in its opinion, the lack of a clear definition of "national security" risks politicising decision making. From earlier comments you made, do you agree with the Foreign Affairs Committee? Is there any indication of that happening so far?

Nicole Kar: I should declare an interest, which is that I was a special adviser to the Foreign Affairs Committee, and we tried very hard to get not a definition but a list of factors that needed to be had regard to into the Act or, failing that, into the guidance. We failed spectacularly, and so you might take what I say with a pinch of salt or in that light.

I have the greatest respect for Dr Lenihan and she is exemplary in this area, but I think that it is possible to enumerate a list of factors, and that is all to the good in terms of enhancing investors' confidence and understanding what will be had regard to. At the moment, if you try to advise on the Act, the most that you will get on what the Government are worried about is paragraph 17 of the statement of the use of call-in power.

Effectively, that says that Government can use it where there is a potential for immediate or future harm to UK national security. That could include risk to Government and defence assets, disruption or erosion of military advantage, the potential impact of a qualifying acquisition on the security of the UK's critical infrastructure, and the need to prevent actors with hostile intentions toward the UK from building defence or technological capability that may present a national security threat to the UK.

It is very hard, against that background, to tell an investor whether a dual use or a use case that it is not aware of in relation to a technology that it has developed is going to be a problem from the national security perspective. What would be really important is, as I say, the signals that these couple of mitigation cases that are coming through the pipe send to the investor community. What will be somewhat concerning to people is that, when they see economic commitments being taken by BEIS on the one hand, and strictly defence or security commitments being taken by the NSIA, there will be confusion about what the Government are really trying to protect. Are they trying to protect UK jobs, UK industry from an industrial strategy perspective, or security?

It is a little bit too early to say whether we are in dire need of a definition or have really departed from the spirit of at least the explanatory memoranda that talk about national security, not national interest, but I for one am of a school of thought that listing the factors is the only way that you could have effective judicial supervision.

I don't think that there will be a wave of litigation. Everyone in the trade community knows that you cannot review a Government on national security decisions. That is an area where a court defers entirely to the discretion of a Government. What you can judicially review a Government on is irregular process, such as being out of time—for example, when Saudi investors bought into the *Evening Standard*, Government was out of time in intervening—procedural irregularities, or requiring mitigation that has nothing to do with national security.

Sorry, that is a long way of saying that a list of factors is really quite important, but the proof will be in the pudding when we see these mitigation cases and whether they have stuck to the spirit of the legislation. Sorry, Dr Lenihan.

Dr Lenihan: If I could jump in, I actually want to agree. I do not think that you can define national security in the Act. From looking at these regimes, the list of risk factors and potential considerations is rarely included in the primary legislation, because of that need for flexibility. If you look at the OECD guidance of best practice in this area, it does not suggest defining or listing these factors in the primary legislation, but it does recommend having good, clear and transparent guidance in regulation that can be amended more easily and is more flexible, in order to help increase that transparency about what type of factors are going to be considered when assessing risk.

We have seen these secondary regulations come out that talk about, for example, acquirer risk, control risk and target risk. That is helpful, but, in the US, for example, along the lines of what Ms Kar suggested, there is, in regulation, a lengthier list of national security considerations, and factors more than risks, that are considered or are likely to be considered in the assessment process. It is clearly not exhaustive. Other countries have done this as well, saying that these are not exhaustive lists but providing guidance. From what I have seen, that has been very helpful for investors.

Q28 **Alan Brown:** Did I pick you up wrong? When you were answering a previous question, I thought that you had made the statement that it is critical that national security is not defined.

Dr Lenihan: Yes.

Q29 **Alan Brown:** So are you just saying that, for you, it is critical that is not the primary bit but still needs greater clarity?

Dr Lenihan: It is critical that national security is not defined, because you need to maintain flexibility, because concepts, understandings and

risks around national security evolve constantly, quickly and unexpectedly. That cannot happen in primary legislation, and definitions should not happen in regulation either.

What you can provide is guidance that provides examples of factors that are most commonly considered when assessing national security risk. That is something, for example, as I said, that the US and several other countries do. Those examples of factors, as Ms Kar said, more than examples of specific illustrative cases that were given in the current regulatory guidance, can be very helpful to investors in terms of navigating the process, without binding the UK to a specific definition that could leave it in a vulnerable position.

Q30 **Chair:** Ms Kar, I want to ask you a couple of operational questions. On this point on judicial review, should there be another appeals process that is not JR?

Nicole Kar: Personally, I think not. There are possibly two avenues for an investor thinking about challenging a Government decision. One is judicial review, but I do not think that it gets you very far, and there are really only three heads. In terms of error of law, you have acted illegally—and it is and will be hard for investors to tell whether Government have acted illegally, because they will not have access to classified information.

Secondly, on a procedural process failing or unfairness, I think that these cases will be few and far between. The Saudi investors in the *Evening Standard* are really the only example that you could point to in the UK at present, where, effectively, Government were timed out and did not intervene within the four-month period.

The other avenue is bilateral investment treaties. For example, with China, we saw Huawei take action against Sweden for breach of a bilateral investment treaty. I really do not think that an avenue of a merits appeal—"Are the Government right or wrong?"—makes sense in this context, and you do not really see that analogue anywhere in other jurisdictions. This is an area where most of us can agree, and Government say, that a nation's first duty is to the security and safety of its citizens. There is considerable Government discretion. Therefore, the guidance and the signals to investors are all the more important, in terms of them hewing to their core purpose of national security.

Q31 **Chair:** In terms of your interaction with the ISU so far, how easy has it been engaging with the ISU? Do you feel that it has enough staff, resource and skill capacity to be able to interact with you when you are managing transactions?

Nicole Kar: It is hard to tell how many people there are in the ISU. It seems to be a closely guarded secret. It was very helpful in the lead up to 4 January, and many people, including me and colleagues, submitted briefing papers letting the Government know about deals, because we

were mindful of the five-year call-in, and investors really did not want a nasty surprise and to get called in after a deal had been done.

Since 4 January, the ISU has been very focused on making the system work well and clearing transactions quickly, which it has done a fantastic job of, but it has been perhaps less able or willing to give guidance. These market guidance notes that it flagged it will issue will be very important. Many of us have had guidance that is not market-wide, so you spend time arguing with lawyers on the other side of the deal about what you understand the position to be.

There are important interpretation questions. There are many areas where the legislation does not seem very intuitive—capturing UK domestic transactions, as Dr Lenihan said, but also internal reorganisations. There are no safe harbours. There is no de minimis threshold. You spend a lot of time explaining to clients why, if you are a Singaporean company buying a French company that sells product into the UK, you have a UK national security filing.

There are many interpretive points and areas of clarity and certainty that could smooth the legislation to where the ISU's voice is quite important, but it has probably been very focused on the operational knitting, at least for this first four-to-five-month period.

Q32 **Chair:** Is it your view that the Act can capture UK funds investing in assets or companies overseas, as well as inward investment into the UK?

Nicole Kar: Yes is the short answer. The territorial nexus is a pretty limited one, so you need to have activities or sell goods or services in the UK, and then there is some guidance given on what that involves, but that does mean that a UK company buying a UK company is subject to review. As Dr Lenihan said, it is wrongly described as foreign investment screening legislation. It is not foreign investment screening. It is investment screening. You could be an offshore company buying another offshore company that has some UK activities and be caught by the Act, yes.

Q33 **Alan Brown:** When the Bill was debated in Parliament, we considered whether BEIS was actually the right Department to house the ISU, just because there were concerns that the investment scrutiny would conflict with the Department's mission to encourage foreign investment. Ms Kar, you had mentioned politicising decisions before, so are you actually seeing this conflict emerge now that the Act is in force?

***Nicole Kar*:** We have not yet. It has been too soon to draw any conclusions. It is really the mitigation agreements and the interventions that are going to send the signal to the market on this. I think people did feel it was slightly unusual. It is common with many other European jurisdictions that the investment screening capability is housed within the Ministry of Economy or the Business, Energy and Industrial Strategy

equivalent. That probably is somewhat accepted in Europe. It is different from the Australian position or the US position, for example.

Some of us advocated that there be a committee that advise the Secretary of State, drawn from the intelligence community, defence community and security community. That would de-politicise the process, because you could then have the Secretary of State acting on advice. I still think that is the better model, but we are where we are.

Housing it within the investment auspices of Government has not yet been a problem, and it has definitely led to a business-friendly process of turnaround and timing, which is absolutely important, but it is the intervention that will matter, and we have not seen those yet.

Q34 **Alan Brown:** We have already heard about warnings about the extra burden on small businesses, but there was actually a particular concern about microbusinesses that rely on share offerings for capital or venture capital funds that are sometimes a bit complex in terms of share allocations. Mr Jackson-Moore, how easy are businesses finding it to navigate these regulations?

***Will Jackson-Moore*:** As I said earlier on, it clearly is an additional burden for small businesses, and, as you said earlier, there is no de minimis limit. It does create extra paperwork. It is an extra legal burden from them as they are going through, but that is not an unlevel playing field with equivalent organisations overseas generally. It may actually create an opportunity for UK pension funds to deploy more capital into those types of businesses. There has been a lot of debate around the allocations that UK pension funds make into private markets and start-ups in the UK.

Looking at it through a positive lens, this might be an opportunity for UK pension funds to deploy more capital into those exciting, fast-growth areas as well, and presumably have an easy clearance process as a result.

Q35 **Alan Brown:** Is it too early to say if there is any evidence of that happening?

***Will Jackson-Moore*:** It is an opportunity. It is too early to say at this stage, but it is a good opportunity for UK pension funds to invest in potentially exciting areas.

Q36 **Mark Jenkinson:** Dr Lenihan, you and others have called for greater transparency and an institutionalisation of the organisational processes behind the proposed regime, including clarity about how monitoring will be conducted and who will feed into the screening and review process. How well understood do you feel that review process is?

Dr Lenihan: As somebody who studies this across many countries, I find it difficult, from the outside, to fully understand the processes behind the assessments. Because I understand how these assessments are done

well in NATO countries, I get the guidance on the risk factors that will be included in terms of acquirer risk, control risk and target risk. That makes sense and is helpful. In terms of the actual process that is being followed and who is feeding into that process, how often they are feeding into that process, when they are feeding into that process, when they are being called into it and how they are giving advice, that is incredibly opaque.

If you look at a system like the US, where, although there have been a couple of cases, in general politicisation of these cases is quite rare, and where the application has been, with a few great exceptions, fairly narrow, the reason for that has been that you have the Committee on Foreign Investments in the United States, with multiple agencies feeding into it. Everybody knows who those agencies are. Those agencies are staffed up to feed into that process before it even gets to the committee. As Ms Kar said, the committee then makes a recommendation, based on their assessment, to the President, if it goes to the question of having to veto.

It can be incredibly powerful to have an institutionalised system, because then not only do we see that cases are being given all the detailed level of expertise that they require to be effectively assessed and effectively mitigated, but you have this feeling on the part of investors that this is not a political process and that these experts have been consulted. If they know who they are, they can often consult those smaller departments, as well as CFIUS. That lends a lot of credence to it. It also helps protect in judicial review processes as well, in terms of how these decisions are made.

Going forward, that is going to be really important. There is no national security risk to saying who is feeding into the process on a regular basis. It does not restrict you from consulting others. It just provides assurance about the process and a level of transparency and predictability for investors and even for other countries. There is not a downside to it.

It feeds in a little bit to the previous question about microbusinesses and small and medium enterprises. In terms of the transparency of process and the ISU, if I am a microenterprise in the UK, I am not necessarily going to be able to afford the services of Ms Kar. I am going to have to navigate this process on my own. Right now, all of the information about this Act and the ISU lives on one site, the gov.uk website. It is incredibly difficult to find if you do not know what you are doing, much less if you do not know about the information ahead of time. That is another issue of transparency.

A lot of other countries—for example, the US, Australia, Canada, Germany and France—have dedicated hubs and sites within the departments that lead these investigations. They have all the information an investor needs that is public about those processes. That is again helpful.

Institutional capacity is big and process is big, but really getting this regularised feeding nailed down and making clear who is feeding into that process would be exceptionally helpful to the long term, as would regularising the process for the ISU. From the outside, in terms of public information, it is unclear when experts are being brought into the process. The security clearance level of those in the ISU is unclear, as is their knowledge and expertise in some of these really specific areas. It would be incredibly helpful to the long-term implementation of the Act.

***Nicole Kar*:** I agree. The accountability of the ISU to Parliament is also really fundamental. I pointed out some of the issues with JR. A judicial review is really not a remedy for most situations that are not procedural breaches in this area. The idea that someone is reviewing a case load and that someone understands why decisions are taken, who is consulted, et cetera, is really important.

There is a challenge, and parties understand that this involves the highest level of classified information that you can obtain, but there is an issue at the moment that you go into a second review process, and you are given very little information. You do not know if there is a problem, what the problem is and how you should solve it. The idea that the Business Committee has oversight of the ISU is very important for accountability and democratic processes.

***Will Jackson-Moore*:** I would agree with Ms Kar on that point. I do not have anything else to add.

Q37 **Mark Jenkinson:** The Business Secretary has indicated that he will consider whether acquirers have links to hostile entities when deciding on an acquisition, but experts have warned that any foreign investment can present a security risk if the foreign direct investment regime of the country in question is overly open. How can we guard against this?

Dr Lenihan: When assessing acquirer risk, it is critically important to look at the connections to hostile powers. That being said, historically, these regimes in a number of countries have also captured and mitigated national security risks that can come from transactions involving close allies. For example, there have been a number of cases in the US and the UK, under the old BERR and the Enterprise Act, some cases that have been mitigated between allied investors, let us say, for the purposes of protection of national security, either when it has to do, for example, with supply chain issues or overly open countries, as you say, that might be lax about their enforcement of our export control laws.

In those cases, especially if an investment is being sold on and that asset, for example, might move to another country, it might make sense to mitigate that investment to ensure that export control laws are adhered to in the future, that, if they are not, then that investment might be able to be unwound or be reviewed, or that, for example, that asset is not then sold on to a hostile power. Those are the kinds of things that you might be concerned about, from what you might say are overly open

regimes and investors. Concerns can happen at the other end of the spectrum as well.

***Nicole Kar*:** In terms of what you can do about it, it is a little bit about international co-operation in terms of best practice on foreign investment. As Dr Lenihan said, the OECD has been an important forum for that.

The other option is you mitigate. If there is an on sale to an investor where there is lax foreign investment in that jurisdiction, there are protections for Government to obtain information about supply chains and supplier lists, to potentially terminate contracts, if necessary, particularly in the military space.

This is not a multilateral treaty or any form of multilateral co-operation at present. It is very much a discussion point between Governments, depending on whether they are allies or not, and then making it an issue of trade or mitigation, practically, as a mechanism.

Q38 **Mark Jenkinson:** In important sectors, such as defence, does this regime potentially put smaller businesses at risk? If you do not have the capacity to deal with this regime, does that mean we might risk ending up with only huge defence contractors and lose some of the smaller supply chains, particularly the ability of the Secretary of State to intervene in transactions between non-UK companies, for example, if they carry out activities in the UK? Does that make sense?

Dr Lenihan: Just to take an initial stab—I would love to hear what my fellow witnesses have to say on this issue—here is where transparency and responsiveness of the ISU will be critical. It needs to be really transparent and easy to get hold of. At the moment, there is one email to a general email box. There could be more points of contact, for example, for small and medium microenterprises to get in touch with the ISU when they do not have access to large legal teams. Transparency is critical.

Going forward, ease of access and multiple points of contact will be important, and that responsiveness, as Ms Kar mentioned, to inquiries and guidance from small businesses and micro and medium-sized enterprises, to know whether or not they need to engage in the process, because they likely will not be able to afford lawyers.

If those three things happen, there will not be a risk to that wider system. If there are stoppages or a critical juncture point at which those do not happen, that might cause some problems long down the road.

***Nicole Kar*:** I can only agree. There really is an issue of the Act for venture capital and microbusinesses. There is a lot of transaction friction, navigating it, advising, negotiating agreements, et cetera. The particular nature—maybe Mr Jackson-Moore can comment further here—of venture capital and investment rounds means you often acquire the rights that are caught by the Act. Of course, you have to think about the application

of the Act on exit. Frankly, I do not find venture capital get a lot of legal advice, just in terms of their core fundraising documents, let alone thinking about tangential issues of whether the National Security and Investment Act might apply to them.

There is a real need for a sherpa system within the ISU that helps microbusiness manage through and gives some interpretation assistance to microbusiness, because I do think it is not able to navigate the Act in the way big business can.

***Will Jackson-Moore*:** I would completely agree. Anything that we can do to support and reduce the friction for very small businesses would be very helpful.

Q39 **Chair:** Dr Lenihan, my final question is to you. I am interested in how other countries might lean on the UK Government around the interpretation of national security risk here. We are going to need to do some work about how the ISU is structured and what the processes are, who is advising who and how all of that comes together, but is there a risk here that, for example, the Americans could call the Business Secretary or the Prime Minister and say, "We are really concerned about this entity and this transaction. Here is some information that we have. We would really like you to stop this from happening"? Could that happen?

Dr Lenihan: This ultimate decision is a truly sovereign right, and the UK has set itself up well to make the decision on its own. What can happen, and what has happened in the past—it is one of the reasons for these intelligence-sharing provisions that you see now in a lot of third-generation mechanisms of these types—is that it is really difficult, given the volume and complexity of the case loads of strategic investments that review mechanisms are seeing, to, first, capture everything, and, secondly, to actually determine sometimes who the beneficial owners are, or who those are with material influence over certain entities and persons.

What we may see, and what we have seen in the past with a couple of specific instances, is leaders from countries such as the US, but also others, reaching out to their allies and saying, "Oh, did you know, by the way, that that entity that you think is fairly benign is materially influenced by X, Y and Z, and that might pose a problem, not only for you but for our supply chains and for our mutual defence?"

That is possible to happen, but that is something that would likely be welcomed by Governments. Now that we have these regimes across, for example, NATO allied countries, I hope that we see it in all directions. I think the UK can withstand the pressure to not veto something that it does not want to veto, but it might give a good indication of when something might perhaps be mitigated that they might not have otherwise been aware of.

***Nicole Kar*:** Outreach is a really positive thing, and in particular the US has done quite a lot of outreach recently with the UK to point out some of the backdoor issues they are finding on weak supply chains, where people are contracting with Belarus—IT consultants and various other examples.

In terms of your core question, you can see that playing out publicly right now with the Newport Wafer Fab case, where members of the US Congress have apparently directly written to various officials in the UK, complaining about the lack of intervention in relation to that company.

Inevitably, national security is a topic that attracts and garners political heat. That is shared across various countries, and there will be pressure placed on the UK. There was a conspiracy theory that the UK only passed its investment screening legislation as a result of Brexit tensions and a need to agree a US trade deal. That is clearly not the case, but the need to have investment screening is a pressure placed upon countries by other sovereign states because it is almost a condition of doing business.

Chair: Thank you so much, Dr Lenihan, Ms Kar and Mr Jackson-Moore, for your contributions this morning. We will be doing some more work on this on an ongoing basis, and no doubt we will be in touch with all of you in due course. For the purposes of today, I will bring the session to an end.