Written evidence submitted by Vivienne Bath Solicitor (BFA0031)

Dear Sir/Madam:

I am making a submission in relation to your inquiry into the FCDO's role in blocking foreign asset stripping in the UK, with reference to the regulatory scheme laid in the *National Investment and Security Bill* and associated documents.

I am Professor of Chinese and International Business Law at the University of Sydney, and Associate Director (International) of the Centre for Asian and Pacific Law at the University of Sydney. Prior to joining the University, I was a partner in a major international law firm specializing in international investment and corporate law, particularly in China and the Asian region. I have published widely in the area of investment law in both China and Australia, with particular reference to the national security and national interest tests applied by both jurisdictions, and the general concept of screening.

The views expressed below are completely my own and do not represent or reflect the views of the University of Sydney.

Submission

Based on the Australian experience of screening (which is distinctly mixed and often criticized), there are a number of objectives: first, clarity, so that applicants and those affected understand how the regime is intended to work and what they need to do to obtain a quick and efficient resolution; consistency of results; certainty of outcome and flexibility for decision-makers.

As a drafting matter, the legislation is designed to ensure that most of the very difficult aspects of defining (roughly) areas or industry sectors which can be considered to be sensitive, the factors to be considered by the Secretary of State and definitions of qualifying entities and related matters are either delegated to subordinate legislation or relegated to a statement to be presented to Parliament by the Secretary of State. Much of this is due to relegation of various important matters (such as the sectors considered to be sensitive, the definition of qualifying entity and so on) to regulation, with the very important explanation of the factors and tests relevant to a call-in notice left to a document which is to be drafted and then presented to Parliament (the Statement) with the possibility of disapproval (ss3 and 4). Although the content of the Statement does not restrict the power of the Secretary to give a call-in notice (s1(8)), clearly its content will be very important for prospective acquirers and targets in considering their options under this legislation. In fact, the flowsheet published by the Department for Business, Energy & Industrial Strategy contemplates that parties will use the Statement as a basis for their decision to submit a notification.[1]

Section 3 provides only very general guidance, by setting out three areas which will be included in the Statement: sectors of the economy (with a proposed list of 17 sectors already made public); trigger events, qualifying entities and qualifying assets (that is, relating to the target) and "other factors" which the Secretary expects to take into account. It is the "other

[1] Process flow chart for businesses, 11 November 2020, https://www.gov.uk/government/publications/national-security-and-investment-bill-2020-factsheets.

factors' which will be important, particularly for persons considering whether to make a voluntary notification. A Policy Paper issued on 20 November 2020 provides some insight in current government thinking on the content of the Statement.[2]

Content of statement The Statement will need to include a high degree of specificity if it is to be useful in terms of providing clarity to potential acquirers, particularly if no attempt will be made to define "national security" or the "risk" of an event having an impact on "national security". In particular, in view of the "voluntary" process of notification in relation to proposed acquisitions, there needs to be guidance on how the Secretary will approach both the review of acquisitions in key sectors (and what those are) and what consideration will be given to acquisitions in sectors not currently considered to give rise automatically to the need for national security review. On the other hand, given the subjective nature of the concept of "national security" and the generally contested nature of any determination on national security which affects business transactions, it needs to provide considerable flexibility to decision-makers.

How much detail is required? There are a number of different approaches here. The recently issued Chinese Foreign Investment Security Review Regulations,[3] for example, require review of:

> *(1) Investment in military industry, military industry supporting facilities or other fields concerning national defense security, as well as investment in the surrounding areas of military facilities and military industry facilities; or*
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> *(2) Investments concerning national security in important agricultural products, important energy and resources, important equipment manufacturing, important infrastructure, important transportation services, important cultural products and services, important information technology and Internet products and services, important financial services, key technologies and other important fields concerning national security, in which actual control [as defined] of the investee enterprise is obtained. [Art 4]*

No criteria for the standard or nature of the review are provided – it is the responsibility of the would-be investor to form a conclusion as to whether there is a potential impact on national security, making a filing and provide a statement on whether the investment affects national security (Art 6). There is no appeal or judicial review of the ultimate decision.[4] The broad scope of the areas set out in Art 4(2) encompass, in most cases, areas in which foreign investment is permitted and, in some cases, encouraged.

The Australian practice in relation to foreign investment is, at least in theory, to allow all investment other than that which the Treasurer considers is contrary to the "national interest" (for example, *Foreign Acquisitions and Takeovers Act 1975* (Cth), s67). In practice, the

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[2] Department for Business, Energy & Industrial Strategy, "Policy Paper: Statement of policy intent," 20 November 2020, https://www.gov.uk/government/publications/national-security-and-investment-bill-2020/statement-of-policy-intent.

[3] Measures for Security Review of Foreign Investment [waishang touzi anquan shencha banfa], Decree No 37 of the National Development and Reform Commission and the Ministry of Commerce, issued 19 December 2020, effective 18 January 2021.

[4] Foreign Investment Law of the People's Republic of China [zhonghua renmin gongheguo waishang touzifa], promulgated 15 March 2019, effective 1 January 2020, Art 35.

Treasurer forms his/her opinion on advice from the Foreign Investment Review Board (FIRB) and government departments by considering a number of generally expressed factors, including national security, set out in Australia's Foreign Investment Policy,[5] which is issued by the government or the day and revised from time to time, mainly with reference to changes in government policy (for example, to lower the threshold for review of investments in agriculture) and to reflect Australia's commitments in relation to the admission of foreign investment in its Free Trade Agreements. The questions of what constitute "foreign" ownership, the definition of foreign government owned investors, the sectors and circumstances in which review is required and the financial thresholds relating to review, are laid out in some detail in the Act and the *Foreign Acquisitions and Takeovers Regulation* 2015, with all proposed investments by foreign government owned investors requiring scrutiny. This system has generally been considered to work reasonably well, although it has become increasingly complex in recent years, and there have been frequent complaints from investors that the system lacks clearly laid out criteria and requires long and tedious negotiations with FIRB before investments are formally notified. The Chinese government in particular has complained about the rejection of a number of proposed acquisitions on national interest or security grounds.[6]

As in the UK, from 1 January 2021, the legislation has been changed[7] to accommodate a perceived need for a higher level of scrutiny of acquisitions and investments which might raise national security concerns, and a new concept has been added to the existing "notifiable transactions" (which must be notified to the Treasurer) and "significant transactions" (which are not necessarily notifiable) to add the narrower category of "notifiable national security transactions" (which must be reported to the Treasurer for approval) and the very wide category of "reviewable national security transactions" (which may be called in for review or voluntarily submitted). This is in many ways similar to the scheme adopted in the Bill. In particular, a wide discretion is given to the Secretary of State, in one case, and the Treasurer, in the other, to review acquisitions outside the designated sectors on the basis of national security. In the Australian context, "national security" is clearly a sub-set of "national interest" and subject to a regulatory scheme set out in the same package of legislation. "Notifiable national security transactions" are related to "national security land" and "national security businesses," both of which are defined in the Regulation. In contrast, the "key sectors" which are fundamental to the UK system of review will be set out in the Statement, together with all of the criteria relating to review.

The difficulty of setting up an appropriate system relating to voluntary review (or call-in) is demonstrated by the comprehensive material issued by the FIRB attempting to explain how the new system is intended to work. Guidance Note 8 on National Security[8] sets out 29 pages of explanation and examples of sectors where mandatory notification is required or voluntary notification is recommended, suggesting a significant increase in the amount of screening of

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[5] The Treasury, "Australia's Foreign Investment Policy," 1 January 2021, https://firb.gov.au/general-guidance.
[6] Finn McHugh, "'Discriminatory': Beijing lashes Josh Frydenberg over rejected takeover bid," 13 January 2021, https://www.news.com.au/national/politics/discriminatory-beijing-lashes-josh-frydenberg-over-rejected-takeover-bid/news-story/daa820cde6b72377ce92120da366bee1.
[7] *Foreign Investment Reform (Protecting Australia's National Security) Act 2020 (Cth); Foreign Investment Reform (Protecting Australia's National Security) Regulations 2020 (Cth)*.
[8] Foreign Investment Review Board, Guidance Notes, National Security, https://firb.gov.au/guidance-resources/guidance-notes/gn8.

proposed investments that will be required. Mandatory notifications are required for investments in: critical infrastructure (including electricity generation of certain types and networks),[9] gas processing, storage and transmission pipelines of a certain size, telecommunications, defence goods or technology, storage of information of various kinds, land held by the Department of Defence or the intelligence community (if known), major ports, major water and sewerage operators.

The UK Policy Paper outlines a concept of target risk which divides the economy into 3 areas: core areas; core activities (primarily within the core areas) most likely to give rise to national security risks (mandatory filing), and the wider economy (unlikely to pose risks to national security). A tentative list of core areas has been made public. In many ways, this is similar to the Australian formulation. An issue here, however, is the assumption that core areas (and activities) can be listed with confidence, and that investments in the wider economy will be unlikely to result in a call-in notice.

The FIRB Guidance Note, in contrast, assumes that national security issues may well arise outside the scope of notifiable national security matters. It sets out a wide range of areas where it is recommended that investors seek approval even if not legally required to do so, in case an investment is considered to involve national security. These include banking and finance, telecommunications, broadcasting, domain names, certain types of commercial construction and commercial real estate, critical minerals, supply of critical services and technologies, less critical energy (gas or electricity) projects, liquid fuel, energy market operators, health sector, medicines and medical devices, higher education, data information and storage, sensitive network or operational information, extraction, processing or sale or uranium or plutonium, space technologies, ports not listed in the *Security of Critical Infrastructure Act 2018*, airports, cargo agents and aircraft operator businesses and major public transport operators. The Guidance Note sets out in some detail how and why it is anticipated that an investment or acquisition in a certain sector could constitute a threat to national security.

It is true that Australia is a small nation which receives a great deal of investment and therefore large investments may have a proportionately greater effect. Nevertheless, I do not think that it can be assumed that an acquisition outside a core area will be unlikely to have a potential national security impact. As the recent pandemic has shown, quite unexpected events may have a major impact (in relation, for example, to the supply of PPE).

The disadvantage of the Australian approach is that if potential acquirers respond to the lengthy list of matters which it is recommended should voluntarily be submitted for review there will be a substantial increase in the workload of the FIRB and the time it will take for an answer to be received. Unless the process is quick and efficient, it will potentially discourage investment in sectors which do not come within the scope of a "notifiable transaction" or "notifiable national security transaction". It seems to me that a prudent investor in the UK would similarly find it prudent to make a filing even in sectors outside the core areas. An option here would be to reinstate a financial threshold for small transactions or for transactions which are considered to be low risk in the Policy Paper.

[9] Subject to an expansion of categories if and when the *Security Legislation Amendment (Critical Infrastructure) Bill 2020 (Cth)* is passed.

Acquirer risk The Policy Paper looks (briefly) at "acquirer risk," with an emphasis on track record, existing holdings and criminal offences. It states that "national security risks are most likely to arise when acquirers are hostile to the UK's national security, or when they owe allegiance to hostile states or organisations. " State-owned entities and other entities affiliated with foreign states "are not inherently more likely to pose a national security risk." This is quite different from the approach which has historically been taken in Australia, where the government reviews all investments by government-owned entities and has begun to look more closely at the activities of political party-controlled entities in Australia.[10] I also note that the US takes the opposite approach and exempts from review investments from certain (friendly) states, including the UK and Australia. [11]

In relation to the UK approach, it may be true that national security risks in relation to defence are generally related to acquirers hostile to the UK's national security, but I do not think that this a very helpful formulation. An acquirer may come from a state which is not an ally of the UK, although not overtly hostile, but, nevertheless, because of its adherence to the interests of its own home state it may constitute a threat to UK national security (for example, by acquiring advanced technology for its own purposes). A state-owned enterprise may - or may not -operate as a purely commercial enterprise, but it is nevertheless, like any corporation, answerable ultimately to its shareholder and, where that shareholder is a state, it may well be obliged to pursue the interests of the state in making its investment or in subsequently operating the investment. This is particularly the case where senior management of state-owned enterprises and senior government officials have a closely interwoven career path or management is chosen by and answers directly to government or a political party. Confining review of acquirer risk to consideration of the acquirer's "affiliations to hostile parties, rather than the existence of a relationship with foreign states in principle, or their nationality" misses this point. In addition, it also unnecessarily raises the question whether a call-in is an indication that the acquirer is hostile (denied in the last sentence of the statement). Having a test which puts all government entities in the same category avoids the need for an individual examination of the risk associated with a particular state-owned entity.

I also note that, if the emphasis on acquirer risk is directed at hostile states, there is an argument for considering the role of friendly states, on the same basis as the US legislation.

Decision-making powers The Bill sets out a number of different criteria for decisions or determinations to be made by the Secretary of States. In s1(1), the test underlying the power of the Secretary of State in s1(1) to give a notice is if the Secretary "reasonably suspects" that (a) a trigger event has taken place *and* "the event has given rise to or may give rise to a risk to national security" or (b) arrangements are in process which will result in a trigger event taking place *and* "the event may give rise to a risk to national security". Similar language is

[10] *Foreign Influence Transparency Scheme Act 2018 (Cth).*

[11] Under the US Department of the Treasury, Office of Investment Security, 31 CFR Parts 800 and 801, (implementing certain provisions of section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA)) https://home.treasury.gov/system/files/206/Part-800-Final-Rule-Jan-17-2020.pdf , § 800.218 Excepted foreign state, investments from certain states, including the UK and Australia, will be exempted from some requirements of the rule. This is not the case in Australia, and I understand that the UK policy is that there will be no distinction made between foreign governments.

used in s23(8) in relation to the grant of an "additional notice period." In s23(9), however a voluntary period may be agreed only if the Secretary "is satisfied, on the balance of probabilities," that a trigger event has taken place or may take place and a risk to national security has arisen or may arise." In s 25, the Secretary may make in interim order if he/she "reasonable considers that the provisions of the order are necessary and proportionate." S26 adopts both of these tests.

Although it may be relatively easy to acquire reasonable grounds for suspicion, or satisfaction on the balance of probabilities, that a trigger event has taken place, there is in the legislation no indication at all of what would constitute a reason for developing a reasonable suspicion, or achieving a degree of satisfaction on the balance of probabilities that the trigger event has given rise to, or might give rise to, a risk to national security. There is, for good reason, no definition of the concept of "national security" in the legislation although some guidance relating to what might constitute a "risk" to national security can be obtained from the Statement. In these circumstances, I would suggest that the best that can be expected is that the Secretary consider all of the available material and make a good faith determination and that the legislation should reflect that.

Yours faithfully,

Vivienne Bath

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