

**Written evidence submitted by the LSE IDEAS Global Strategies Project/ LSE Economic
Diplomacy Commission (BFA0001)**

The Foreign Affairs Committee has asked four questions on how the Foreign & Commonwealth Office (FCO) should be involved in the UK's oversight of the national security implications of foreign investments:

1. What role should the FCO play in guiding UK Government decisions on intervening in foreign takeovers of UK companies, where there may be national security risks?
2. How does the FCO assess whether a potentially hostile party is seeking to secure significant influence or control over a UK company?
3. In what circumstances should the FCO seek to intervene in decisions on takeovers on the grounds of the impact on bilateral relations or the UK's geopolitical interests?
4. What safeguards are required in the forthcoming National Security and Investment Bill to ensure that the FCO has a full role in the decision-making process in relation to interventions?

As outlined in the July 2018 White Paper on National Security and Investment (the White Paper), these questions are considered here on the basis of any proposal for a foreign party to obtain actual or potential control over, or significant influence in, a UK entity (a company or tangible or intangible asset) that could pose a threat to the UK's national security. The discussion here is not confined to takeovers of companies.

Summary

- The FCO will – depending on the case under review - have a substantial role in informing UK Government decisions on sensitive foreign investment proposals. This is because the new regime will locate such decisions more clearly in the context of power relations between the UK and its adversaries and allies.
- In assessing whether a hostile party is seeking to secure significant influence or control over a UK entity, the FCO will need to draw on its worldwide knowledge of the policies and ambitions of other powers.
- The extension of the Government's powers to review foreign investment proposals will bring the UK's policy on foreign investment into a much closer relationship with its bilateral diplomacy. The FCO will need to weigh the national security implications of certain proposed foreign investments against other policy objectives.
- Decisions on sensitive foreign investments under the new regime will need to draw on expertise from across Government, including the FCO. This process is therefore well suited to the "Fusion" approach to pursuing national security objectives.

1. Role of the FCO in UK Government decisions on whether to call in a proposed investment for review

The FCO will need to have a role in the decision to call in investment proposals under the planned new regime. This arises from two sources of expertise: the FCO's knowledge of foreign economies and governments, and its understanding of the implications for bilateral relations of a decision to impose conditions on, or to bar, an investment in the UK by an entity domiciled in or connected to a foreign country.

Decisions on whether to call in a proposed investment for review will depend in the first instance on the Government's assessment of three risks. The first is the risk that the nature of the target of the investment – a company, or even a piece of software – could be sensitive with respect to national security. The second risk concerns the possibility that the structure of the investment proposal itself could threaten national security by delivering control or influence over a sensitive target to a foreign party. The third risk concerns the identity of the foreign investor, and whether the investor could be motivated to use its influence or control over a sensitive target to undermine the UK's national security.

With respect to assessment of the third risk, in particular, the FCO may – depending on the nature of the case – have relevant expertise, though the Foreign Affairs Committee may wish to look into the strength of the FCO's information gathering on business and finance in key foreign posts. The FCO's contribution could include its access to knowledge of foreign acquiring entities, e.g., their sources of finance, the identity and loyalties of prominent entrepreneurs, and the behaviour of private and state-connected enterprises. This could supplement information available to the Department for International Trade, the Department for Business, Energy and Industrial Strategy, the Ministry of Defence, and the Treasury.

The FCO could also contribute to information available from elsewhere in the UK Government on actual or potential links between the foreign investing entities and foreign governments. These can take a wide variety of forms, from open to covert state ownership, personal relationships and leverage including coercion, state financing or guarantees, or laws or extra-legal powers that enable the foreign state to assume control over the investment.

The FCO should also be able to contribute information on the motivations of foreign powers. This understanding of the broader context of the investment proposal may include areas such as a foreign country's industrial strategy, its policies for technological development, and its ambitions to acquire or take control of technology for other than purely commercial purposes.

Any intervention by the UK Government to review and possibly to limit or prevent a foreign investment, will have implications for the UK's bilateral relations with the country to which the investor is connected. The FCO is best placed to provide analysis of the bilateral impact as the review decision is considered.

2. Means of FCO assessing whether a potentially hostile party is seeking to secure significant influence or control over a UK entity

The White Paper suggests that national security could be put at risk through a foreign investment by a hostile party in a UK entity in three different ways.

First, the investment could give the investor or the investor's home government a greater opportunity than they would otherwise have had to undertake disruptive or destructive actions. Examples here could include access to, and subsequent misuse of, software or biomedical technology.

Second, the investment could increase access (to businesses, physical assets like land, people, operations or data) and enhance the ability of a foreign power to undertake espionage.

Third, through the investment, a foreign power could obtain the means of exerting inappropriate leverage in other negotiations.

The hostile intent could arise directly or indirectly, either immediately or subsequent to the investment. The investor themselves – for example, as an organisation owned or directly controlled by a hostile foreign state – may plan the investment with any of the above three purposes in mind. Alternatively, while the foreign investor may act on a commercial basis, they could be subjected to influence or coercion by their government, possibly only at a later date.

Assessing whether a potentially hostile party is involved in an investment proposal will therefore require detailed knowledge and judgment about the motives and activities of foreign powers, particularly in relation to areas of economic activity that are recognised as being sensitive for national security.

The information required to make such assessments will not, however, come exclusively from foreign posts, and, as noted, it would be useful for the Committee to seek an update from the FCO on its capabilities in gathering such information. The FCO's expertise, though important, will need to be supplemented by information generated inside the UK concerning, for example, the identity and behaviour of early-stage venture capital investment vehicles that are demonstrating an interest in certain key technologies in this country.

The new regime for review of foreign investment proposals will rely principally on voluntary notification. It is expected that substantially all such investments will be notified to the UK Government, even in situations where a potentially hostile party may be involved. This should be ensured by powers that the UK Government will have under the new regime to intervene *ex post* in investments that were not appropriately notified.

However, a clear understanding of the broader context in which an investment proposal is being made will be critical to reaching decisions that protect the UK's national security. The FCO will need to supply part of that broader understanding.

3. Circumstances in which FCO may seek to intervene in decisions on foreign investments on the grounds of the impact on bilateral relations or the UK's geopolitical interests

The extension of the Government's powers to review foreign investment proposals will bring the UK's policy on foreign investment into a much closer relationship with its bilateral diplomacy. The necessary transparency of the planned review process will magnify the potential impact on bilateral relations of calling in an investment proposal for review, and of a subsequent adverse finding.

Transparency is critical in order to retain a rules-based approach and to minimise the impact of the new foreign investment review regime on the UK's role as the world's third largest destination for foreign direct investment. The White Paper clearly recognises the risk that the new powers could, if misused, become a vehicle for indiscriminate economic nationalism.

To ensure that the new regime focuses solely on national security, and not on broader premises including the public and national interest, the draft procedures make clear reference to hostile actors, possibly acting on behalf of, or affiliated to, foreign states that may themselves be hostile. A decision to impose conditions on, or to bar, a foreign investment will make an explicit presumption that any state linked to such an investment proposal will be deemed to be hostile. This will have an impact on the UK's bilateral relations with that state.

The UK's bilateral relations with each of the major powers embrace multiple interests. The FCO is bound to consider the impact of a decision on a particular foreign investment on other aspects of relations with the power concerned. As the discussion over Huawei illustrated, relations with allies may also become relevant.

Although the review procedure will be transparent, the basis for the final determination on national security grounds is expected to remain confidential. The White Paper and the accompanying draft Statement of Policy Intent offer no definition of national security beyond the statements made in the 2015 Security, Defence and Strategy Review. The 2015 Review listed three national security priorities, of which the first was "Protect our People", and the third "Promote our Prosperity".

Prosperity – underwritten by the UK's openness to foreign investment – will continue to be part of each decision on the national security implications of foreign investment.

What will be distinctive about the new regime envisaged by the White Paper is that it will locate decisions about investment and national security in the context of power relations between the UK and its adversaries and allies. The FCO will necessarily be at the centre of this calculus.

4. Safeguards in the National Security and Investment Bill ensuring the FCO a full role in the decision-making process

A whole-of-government approach to administering the new oversight of foreign investment, due to be implemented in the National Security and Investment Bill, will be essential. The Cabinet Office machinery is likely to be needed to ensure this, and the FCO is accustomed to operating in this way.

Decisions on whether to call in an investment proposal that has been notified, and on the national security implications of such a proposal, will need to draw on expertise from across Government, including the Department for International Trade, the Department for Business, Energy and Industrial Strategy, the Treasury, the Ministry of Defence, the FCO, the Cabinet Office and the intelligence services. Decisions on sensitive investments are therefore well suited to the “Fusion” approach to pursuing national security objectives.

The Government will need to consider where leadership of foreign investment review decisions should be located.

The Committee on Foreign Investment in the United States (CFIUS) might warrant some consideration. CFIUS is a US federal inter-agency committee, chaired by the Treasury Secretary. Members include the Secretaries of Commerce, Defense, Energy, Homeland Security, Labor and State, as well as the Attorney General, Director of National Intelligence, US Trade Representative (USTR), and Director of the Office of Science and Technology Policy. Other federal agencies hold “observer” status.

The day-to-day functions of CFIUS are carried out by the Treasury. CFIUS is a group of departments and agencies, so although it is administered by the Treasury, the final determination is achieved through consensus and not by the economic body.

CFIUS has a broader remit than the powers envisaged for the UK Government in the White Paper. It can review “any merger, acquisition, or takeover... by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.” CFIUS evaluates whether there is an impact on US national security. If it does, then the President of the United States may suspend, prohibit, or impose conditions on it.

April 2020