

## Written evidence submitted by Dr. Ashley Thomas Lenihan (BFA0004)

\* This submission is made in an individual capacity. [Dr. Lenihan](#) is a Fellow at the [Centre for International Studies](#) at the London School of Economics and Political Science (LSE), and an Associate at [LSE IDEAS](#). She is also the author of [Balancing Power without Weapons: State Intervention into Cross-Border Mergers and Acquisitions](#) (2018, Cambridge University Press), which examines the relationship between foreign investment and national security quantitatively across 200 cases and qualitatively across 10 critical cases of specific transactions in the US, EU, Russia and China. The book also discusses national security review mechanisms for FDI across the globe, and is available open access at: <https://doi.org/10.1017/9781316855430>.

### KEY MESSAGES

The UK government's intent to reform its powers in relation to national security and investment, as outlined in its July 2018 [White Paper](#), is welcome and comprehensive. In order to work, however, it must be properly implemented, and this will mean making some adjustments in order to create a truly robust and reliable mechanism for the screening of foreign investment to protect national security, without jeopardising the UK's well-earned reputation for openness to foreign investment and ease of doing business. Having surveyed best practice in this area across the globe, I would argue that this includes:

- Ensuring greater transparency and institutionalisation of the *organisational processes* behind the proposed regime, including clarity about how monitoring will be conducted and who the actors are that will feed into the screening and review process;
- As part of this, the government must ensure a proper and formal role for the Foreign & Commonwealth Office (FCO), and other government bodies, to provide input into the national security reviews of foreign investments in the UK.

***It is recommended that a review panel, constituted of representatives from relevant statutory and regulatory bodies and government offices (necessarily including the FCO), is formed to report to and assist the Senior Minister and his team. Proper investment will be required to achieve this.***

In relation to the FCO in particular, it is recommended that:

- They are given a formal role in *monitoring* foreign investments and in *reviewing* those investments.
- The FCO's knowledge-base and access to information means that they may have unique understanding of acquirer risk and the context behind both target and trigger event risk.
- Their advice should thus be sought beyond the foreign policy and economic diplomacy considerations of a transaction, as and when they possess other information pertinent to the assessment of national security risk.
- As some foreign investments can pose a national security risk even when they originate from allies (i.e. – not just from hostile actors), the FCO can play a particularly helpful role in determining acceptable and proportional mitigation measures to certain proposed foreign investments, in concert with other elements

of government, in order to lower their risk to national security while maintaining bilateral relationships.

## **BACKGROUND**

1. As the struggle for power among states is increasingly played out in the economic realm, there is clear evidence that some states try to use the market – and the companies or entities over which they have control or influence – to gain economic and even military power through foreign investment.<sup>1</sup> During times of economic downturn or crises like the current pandemic, when some equity and asset prices are low, the opportunities for such behaviour increase. And while the majority of FDI *is* undertaken by market-driven actors with only capitalistic intent, states must remain vigilant in assessing the national security risks associated with certain investments, and to be aware that some investments can jeopardise national security even when they do not come from hostile actors. Much of the concern over FDI and national security has focused on China, but it should also be understood that over the history of foreign direct investment (FDI) many countries have been known to use state-backed investments for strategic and political gain.
2. As a result, numerous states have overhauled their national security review processes for foreign investments in recent years, recognizing both that the nature of national security is changing, and that other countries may seek to use such international investments to their political advantage. A 15 May 2020 [OECD report](#) shows that 77% of the 62 national and supra-national jurisdictions it surveyed had at least some form of dedicated policy in place to manage the security risks related to foreign investment, but it believed that only 44% had relatively well-developed mechanisms in place (or in process).<sup>2</sup> Many jurisdictions have undertaken significant reforms since just 2017,<sup>3</sup> such as the 2018 update of such rules in the United States (with the [Foreign Investment Risk Review Modernization Act](#), FIRRMA) and the EU's new 2019 [FDI Regulations](#). And since the advent of the Covid-19 pandemic, a number of jurisdictions including Spain, Germany, Canada, Australia, and the EU have sought to strengthen their review mechanisms even further, to either more clearly recognise the relationship between the health sector and national security, or to protect themselves from the strategic attempts by foreign state-owned or influenced entities to snap up vulnerable sensitive companies and/or to strip sensitive assets of their value.<sup>4</sup>
3. The UK government's intent to reform its powers in relation to national security and investment, as outlined in its July 2018 [White Paper](#), is thus both welcome and comprehensive. It presents a clear understanding by government of the recurring, new, and emerging threats to national security, and shows a heartening recognition of the distinction between national security and the national interest or public security, combined with a clear desire for a transparent and proportional interventions. If properly implemented, with some minor adjustments, it should create a robust and transparent mechanism for the screening of foreign investment in order to protect national security, without jeopardising the UK's well-earned reputation for openness to foreign investment and ease of doing business. As will be discussed below, it is recommended the government follows the best practice of other countries in this area and form a review panel, constituted of representatives from relevant statutory and

regulatory bodies and government departments (including the FCO), to report to and assist the Senior Minister and his team. While this submission will focus in particular on the role of the FCO, it is hoped that the wider issue of input from other departments will be raised by the Foreign Affairs Committee as well in their discussions with government.

## INQUIRY QUESTIONS

### ***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?***

- 4. The FCO should be given a formal role both in *monitoring* foreign investments (to assess whether or not they should be ‘called-in’ for a review of their national security risks) and then in *reviewing* those investments (to determine whether or not they pose an actual risk to national security). Given the available expertise of their staff, such advice should arguably go beyond advice on the foreign policy and economic diplomacy considerations of a transaction, where they have other information pertinent to the assessment of national security risk.**
5. Currently, limited provisions are made for the UK Government to intervene in mergers and acquisitions (M&A) on national security grounds under the Enterprise Act 2002. The Secretary of State recently stated that the FCO already ‘plays an important role’ in the ‘cross-Whitehall investment screening and review process’ under the existing regime, by providing expert advice ‘to ensure foreign policy and economic diplomacy considerations form part of the basis on which decisions are taken.’<sup>15</sup>
  - 5.1. From outside government, however, there is little transparency about this process, and it is difficult to tell what its standard operating procedures are. One would hope the FCO is always included in reviews occurring under the existing regime, but it is for example unclear how much weight is given to concerns that may raise outside their normal remit of the ‘foreign policy and economic diplomacy’ considerations related to a given transaction.
6. The 2018 [White Paper](#) setting out the UK’s new proposed regime on FDI and national security is far more comprehensive in its grounds and provisions for intervention by government, but it is less clear on the institutional framework that will sit behind this, and on how different elements of government will be called upon to support it.
  - 6.1. For example, the White Paper points out that in determining whether to ‘call-in’ a proposed transaction (or *trigger event*) for a national security assessment – or whether to subject a trigger event of which they have been voluntarily notified to such a review – the Senior Minister should consider three types of risk. These are: 1) the *target risk* (whether there is something inherent about the targeted asset/entity that means its acquisition or significant foreign influence and control could endanger UK national security; 2) the *trigger event risk* (whether there is something about the proposed transaction itself that could give the acquirer or entity gaining influence and control the means/ability to undermine UK national security); and 3) the *acquirer risk* (whether there is an indication or possibility the

acquirer might 'seek to use their acquisition of control over the entity or asset to undermine the UK's national security.'

- 6.2. **However, it is clear that in order to properly assess any proposed transaction for call-in and/or a national security assessment, the Senior Minister must first (1) actually be made aware of a 'trigger event' and (2) be provided with as much information as possible on the target, the acquirer, and the proposed transaction to make such a determination.**
7. **Being made aware of potential trigger events in the first place is not as easy a proposition as some might suppose and will require properly resourced institutional capacity and feed-in from across a number of government departments, including the FCO.** While it is assumed that there will be a primary monitoring team within the Department for Business, Energy and Industrial Strategy (BEIS), this alone will not be enough to catch all potential transactions that truly pose a risk to UK security.
  - 7.1. The systems that monitor global mergers and acquisitions (M&A) activity (such as Thomson One or Zephyr) are complex, requiring specialist knowledge and training to use accurately and efficiently. According to Zephyr, there were over 3,000 basic mergers and acquisitions announced and/or completed involving UK targets or vendors in 2019, which are included in the almost 10,000 overall transactions for that year covered in the database that could potentially give rise to a trigger event (such as minority acquisitions or management buy-outs).<sup>6</sup>
  - 7.2. Not only is this a lot of ground for one team to 'screen' but (and more importantly) such databases do not effectively track a number of different forms of asset acquisitions – such as the purchase of bankrupt assets or real estate transactions – which have been known to give rise to trigger events in other countries.
  - 7.3. The FCO should be one of the most crucial players in raising the flag on potential 'trigger events' that may not necessarily appear on the government's radar through the monitoring of traditional databases and repositories. One cannot therefore overestimate the importance of built-in redundancy when it comes to catching investments for call-in and review. The FCO in particular will be well placed to help monitor for such 'trigger events' as a result not only of its consular activities and foreign post intelligence, but also from its own investment and trade related activities.
    - 7.3.1. There have been significant instances in the US, for example, where a member of a government agency contributing to the US Committee on Foreign Investments in the United States (CFIUS) caught a suspect investment that had not been brought before the Committee through the voluntary notification process. For example, in May 2010 the Chinese company Huawei (now [banned](#) from doing business in the US), acquired advanced computing technology assets (including patents for software and chips) and staff from the then bankrupt 3Leaf Systems. The parties did not voluntarily notify CFIUS of the transaction, despite the clear sensitivity of the assets. Instead, it is understood that the transaction was brought to CFIUS' attention by an astute US government employee who, after the deal had been completed, noticed that

one of 3Leaf's founders' status on LinkedIn had changed and that he was now listed as a consultant to Huawei.<sup>7</sup> CFIUS retroactively reviewed the transaction and found it posed a risk to national security, and in February 2011 effectively forced Huawei to divest the computing technology assets it had acquired,<sup>8</sup> though arguably after the bulk of the damage had been done.

7.3.2. The FCO's active networks and knowledge of foreign actors should be utilised to help raise flags in such cases.

**8. The FCO can and should also play a clear role in the national security assessment reviews of potential transactions. Without question they should have a regularized and clear role for raising the foreign policy and economic diplomacy considerations raised by any transaction under review – as they may currently. However, their role should arguably go further due to the specialised knowledge their department can bring to achieving a full understanding of target-, trigger event-, and acquirer-risks to UK national security.**

8.1. The FCO's knowledge of national strategy and understanding of (and ability to read) the potential political motivations behind foreign investment in the context of global politics and power dynamics (including around scarce resources and new technologies), will provide special insight into *target risks*.

8.2. In terms of *acquirer risk*, the FCO's in-country knowledge of other states and foreign actors, detailed understanding of international power dynamics, knowledge of the foreign and economic policies of other nations, and outpost monitoring of foreign language news sources, will make them aware of acquirors likely to present an '*acquirer risk*' – allowing them to monitor these acquirors and to help assess the potential impact of their participation in trigger events. Not only will they have an acute understanding of the actors involved, but their knowledge of foreign trade and investment activities means that they will also have a keen understanding of other countries' experience with those actors.

8.3. If properly and regularly involved in the national security assessments of individual trigger events, the FCO will not only be able to help assess these target and acquirer risks but, for all of the reasons enumerated above, will also be able to provide invaluable insight and context to the Senior Minister's understanding of the risk surrounding the transaction (*trigger event risk*).

8.3.1. For example, it would be reasonable to assume that if properly integrated into national security assessments in the future, FCO staff would be able to perhaps more effectively flag concerns around potential acquisitions – not just on the basis of whether intervention into (or approval of) a particular transaction will impact UK foreign policy, but on the basis of their knowledge of the actors involved, the laws and political influence that the acquirors are potentially subject to, and the experiences other countries have had with them.

8.3.2. Where the FCO does not already have knowledge of the actors involved and their motivations, they will have the ability to assist in a proper screening of them through in-country contacts, and knowledge of local languages, laws, and regulatory regimes.

***II. How does the FCO assess whether a potentially hostile party is seeking to secure significant influence or control over a UK company?***

**9. The FCO can contribute to this process by providing context to a foreign entity's proposed actions through their unique knowledge base and access to information –** for example of relevant foreign languages and databases needed to trace the ultimate ownership of the acquiring entity, the origination of loans, and related news and foreign chatter around a particular transaction.

9.1. FCO embassies also regularly produce 'Commercial Regulatory' updates that assess domestic changes to foreign investment and trade regimes, and they will therefore have a key understanding of foreign government policies and support for different actors within such markets.

9.2. The FCO also often has knowledge of local laws that may be relevant for assessing trigger event risk – for example, laws that allow for the nationalisation of property or which require corporations to comply with government demands for information.

**10. It should also be noted that some foreign investments can pose a national security risk, even when they originate from allies.**

10.1. For example, not all UK allies adhere strictly to export control regimes, and the UK may choose to carefully assess whether certain acquisitions by these allies should be allowed, or allowed to occur without some form of mitigation. For example, despite the extremely close relationship of the US and Israel, tensions over Israel's ability and willingness to adhere to US export control laws around technology led the US to block the attempted takeover of an American security software company (Sourcefire, which provided software to the US government) by the Israeli company Check Point Software Technologies in 2005.<sup>9</sup>

10.2. In other instances, the maintenance of defence industrial supply chains and security can be a cause of concern, even among deals involving allies, as UK history shows. For example, the UK intervened in the 2005 takeover of BAE Systems' avionics and communications businesses by the Italian aerospace and defense company Finmeccanica on national security grounds. In that case, the then UK Secretary of State determined the deal raised concerns around 'the maintenance of strategic UK capabilities and the protection of classified information'<sup>10</sup> – concerns dealt with through a negotiated mitigation agreement and measures.<sup>11</sup>

***III. 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?***

**11. The FCO is the best placed government department to provide evidence about whether or not a proposed transaction could positively or negatively impact the UK's**

**foreign policy or economic diplomacy, both in terms of its bi-lateral and multi-lateral relationships. In cases where such considerations pose a genuine risk to national security, the FCO should undoubtedly raise them.**

- 12. However, if a decision of whether or not to intervene in a transaction is taken truly on the basis of national security, rather than on economic nationalism or public interest grounds, then such decisions should not necessarily negatively impact bi-lateral relations or dissuade future investment.**

- 12.1. In looking at over 200 cases of cross-border M&A transactions in my research, I have found that even when states intervene in foreign takeovers for the 'high politics' reason of national security, the act is largely perceived (beyond the hype of some newspapers) to occur in the 'low politics' realm of bureaucrats and businessmen.

- 12.2. This especially true when care is taken to maintain a transparent and institutionalised system for intervention, when mitigation techniques are used wherever possible over vetoes, and when care is taken not to politicise individual transactions.

- 12.3. In many cases, this perception can help maintain a positive bi-lateral relationship with the acquirer's home country. Even when heads of state (or very 'Senior Ministers') do become involved in a foreign takeover process, the professed desire to protect companies, resources, and technology deemed vital to national security is so old and inherent under international law that it is rarely taken as being an 'antagonistic' act by other states. And on those occasions where an acquiring company's host state is offended, its government may find it difficult to express that offense at an official level without risking constraining or limiting its own future breadth of action.<sup>12</sup>

- 13. That being said, the FCO can play an important role is ensuring that the government does not 'over-react' to an identified or perceived national security risk that may be raised by an individual transaction.**

- 13.1. Across all of the cases I have examined in my research, the only one that directly impacted the overall bi-lateral relationship between two of the countries involved was the United States' intervention into the 2005/6 takeover of the Peninsular & Oriental Steam Navigation Company (P&O) in Britain by Dubai Ports World (DPW) of the UAE. Few concerns were raised in the UK about the deal, and few were originally expected from the US (an ally of the UAE in the then Global War on Terror). Yet, the deal – which involved the transfer of five US container ports from P&O to DPW – became heavily politicised due to the actions of a few US lawmakers and pundits, eventually resulting in a surprising "70% of all Americans...opposed" to the transaction.<sup>13</sup> Faced with the possibility of the deal being blocked by US lawmakers, and concern over optics in the UAE, P&O eventually offered to divest the ports in question, and later sold them to the American International Group (AIG), allowing them to remain under US control.<sup>14</sup>

- 13.1.1. This case, was a rare instance of 'overbalancing' of threat from FDI, and arguably occurred because some US lawmakers held different views about the

US relationship with the UAE than the US State Department and Pentagon (which viewed the UAE as an important ally) and sought to block the transaction as a whole, when a myriad of different mitigation techniques would have been sufficient to address any national security concerns if needed.

13.1.2. The result was a temporarily negative impact on the bi-lateral economic and political relationship between the US and UAE, including a postponement of trade talks at the time. Though the relationship between the two countries was strong enough to overcome some of these negative impacts in the long run, it demonstrates the importance of avoiding both the politicisation of individual transactions and of overbalancing threats of this nature.

14. **It will therefore be important to ensure a role for the FCO in contributing to decisions about how to best address identified national security risks posed by a potential foreign investment. The FCO should be able to (in concert with other departments) identify when *mitigation* of security risks are possible and would be more appropriate, rather than a veto of that investment.** The FCO should work with departments like the MoD to ensure that the mitigation measures taken are proportional to the threat assessed.

***IV. 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?***

15. **There are distinct benefits to FDI national security review regimes that have higher levels of institutionalization and feed-in from across government, especially by such offices as the FCO.** Research on FDI and national security and national security has shown, for example, that such institutionalization helps states to find alternative solutions to national security concerns, beyond simply prohibiting a deal or evidencing such overwhelming opposition that the proposed acquirer voluntarily withdraws from the process – and that this ability to use mitigation measures in a proportionate and responsible way helps maintain bi-lateral relationships and a reputation for being open to foreign investment.<sup>15</sup>

16. For example, the US system for screening FDI for national security risks is one of the oldest and most institutionalized in the West.

16.1. The Committee on Foreign Investments in the United States (CFIUS) was originally established by Executive Order 11858 in 1975. While still chaired by the Secretary of the Treasury, membership in (and observer status on) the Committee has grown to reflect the many different aspects of national security risk that can be raised by individual transactions.

16.1.1. Official CFIUS members include the Department of the Treasury, Department of Justice, Department of Homeland Security, Department of Commerce, Department of Defense, Department of State, Department of Energy, the Office of the U.S. Trade Representative, and the Office of Science & Technology Policy;



with the Director of National Intelligence and the Secretary of Labor being ex-officio members. Regular observers also include a number of White House offices, including the Office of Management & Budget, the Council of Economic Advisors, the National Security Council, the National Economic Council and the Homeland Security Council. Moreover, given the ever-increasing number of notifications and filings, CFIUS also has a Staff Chairperson in the Department of Treasury, known as the Director of the Office of Investment Review and Investigation, who helps coordinate everything at the staff level.

16.1.2. CFIUS therefore has a relatively high level of institutional resources and capacity available to assist with monitoring and assessments, in a country with traditionally high levels of FDI. In the years from 2010 to 2018, this regime was able to process 1,343 notifications and undertake 694 national security investigations, with only 4 of them leading to presidential decisions.<sup>16</sup> (The number of transactions mitigated is unknown).

16.2. The relative transparency of the CFIUS *process*, and its *regularization* allowing parties multiple contact points for advice to navigate that process, is arguably one of the reasons why foreign investment into the US has not been negatively impacted by US intervention into individual transactions to protect national security.

**17. Ensuring greater transparency and institutionalisation of the *organisational processes* behind the proposed UK regime, including clarity about how monitoring will be conducted and who the actors are that will feed into the screening and review process, is thus of vital importance.**

**18. As part of this, the government must ensure a proper and formal role for the Foreign & Commonwealth Office (FCO) – and other government bodies – to provide input into the national security reviews of foreign investments in the UK.**

**19. *It is thus recommended that the UK create a formal review panel, constituted of representatives from relevant statutory and regulatory bodies and government departments (including the FCO), to report to and assist the Senior Minister and his team. Proper investment will be required to achieve this, but it is important that a transparent and consistent institution is put in place to support the powers for review proposed in the government's White Paper.*** Such a body does not need to be as comprehensive in membership or scale as CFIUS, but it should include named regular contributors, and its member bodies should have staff members dedicated to assisting with the monitoring and review process. In the long term, this will actually help preserve the UK's reputation for openness to foreign investment, while also protecting its national security.

## NOTES

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<sup>1</sup> Lenihan, A. T. (2018). *Balancing Power without Weapons: State Intervention into Cross-Border Mergers and Acquisitions*. Cambridge University Press: Cambridge (available in print or open access at: <https://doi.org/10.1017/9781316855430>).

<sup>2</sup> <http://www.oecd.org/investment/OECD-Acquisition-ownership-policies-security-May2020.pdf>

<sup>3</sup> <http://www.oecd.org/investment/Current-trends-in-OECD-NatSec-policies.pdf>

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<sup>4</sup> See, e.g.: <https://www.srz.com/resources/national-security-foreign-investment-regulation-and-covid-19.html> or <https://www.lexology.com/library/detail.aspx?g=8afcf9d-e6ef-4d57-b204-8779b1a51a26&g=8afcf9d-e6ef-4d57-b204-8779b1a51a26>

<sup>5</sup> <https://committees.parliament.uk/publications/884/documents/6228/default/>

<sup>6</sup> According to the Zephyr M&A database, there were 9,959 announced and/or completed M&A transactions with a UK registered target or vendor between 1 January and 31 December 2019. Deal types covered in the database include: acquisitions, IPOs, institutional buy-outs, capital increases, joint ventures, management buy-ins and buy-outs, mergers, demergers, minority stakes, and share buy backs. See: Zephyr M&A Database. Bureau Van Dijk Electronic Publishing (BVDEP), accessed May 2020. Available at: <https://www.bvdinfo.com/>.

<sup>7</sup> See, e.g.: Kirchgaessner, A. and K. Hille. (2011). Huawei stand-off raises questions over US-China relations. *Financial Times*, February 16.

<sup>8</sup> See, e.g.: Raice, S. and A. Dowell. 2011. Huawei Drops US Deal Amid Opposition. *Wall Street Journal*, February 21; and Jackson, J. K. 2016a. The Committee on Foreign Investment in the United States (CRS Report No. RL33388). Washington, DC: Congressional Research Service (February 19).

<sup>9</sup> Lenihan (2018). *Balancing Power without Weapons*, pp. 134-140.

<sup>10</sup> Boys, P. 2005. Anticipated Acquisition by Finmeccanica Societa Per Azioni of BAE Systems PLC'S Avionics and Communications Business. A Report to the Secretary of State for Trade and Industry Pursuant to Article 4(2)–(5) of the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003, March

14. <http://webarchive.nationalarchives.gov.uk/20090609003228/http://www.berr.gov.uk/files/file32731.pdf>.

<sup>11</sup> For more on this case, see: Lenihan (2018). *Balancing Power without Weapons*, pp. 211-212.

<sup>12</sup> Lenihan (2018). *Balancing Power without Weapons*, pp. 31-69 (Ch.1).

<sup>13</sup> Frum, D. 2006. The High Price of the Dubai Ports World Debacle. *Financial Times*, March 16.

<sup>14</sup> Wright, R. and S. Kirchgaessner. 2006. DP World Sells Us Ports to AIG. *Financial Times*, December 11.

<sup>15</sup> See, e.g.: Lenihan (2018). *Balancing Power without Weapons*, pp. 52–53, 201, 202, 203, 214; and

Wehrlé, F. and J. Pohl. 2016. Investment Policies Related to National Security: A Survey of Country Practices. OECD Working Papers on International Investment (2016/02). Paris: OECD Publishing (June 14). <http://dx.doi.org/10.1787/5jlwrrf038nx-en>.

<sup>16</sup> <https://home.treasury.gov/system/files/206/CFIUS-Public-Annual-Report-CY-2018.pdf>, p. 4.

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