

# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT  
GENERAL COMMITTEES

## Public Bill Committee

# NATIONAL SECURITY AND INVESTMENT BILL

*First Sitting*

*Tuesday 24 November 2020*

*(Morning)*

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### CONTENTS

Programme motion agreed to.  
Written evidence (Reporting to the House) motion agreed to.  
Motion to sit in private agreed to.  
Examination of witnesses.  
Adjourned till this day at Two o'clock.

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**not later than**

**Saturday 28 November 2020**

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**The Committee consisted of the following Members:**

*Chairs:* SIR GRAHAM BRADY, † DEREK TWIGG

- |  |   |
|--|---|
| † Aiken, Nickie ( <i>Cities of London and Westminster</i> ) (Con)  | † Onwurah, Chi ( <i>Newcastle upon Tyne Central</i> ) (Lab)   |
| † Baynes, Simon ( <i>Clwyd South</i> ) (Con)                       | † Tarry, Sam ( <i>Ilford South</i> ) (Lab)  |
| † Bowie, Andrew ( <i>West Aberdeenshire and Kincardine</i> ) (Con) | † Tomlinson, Michael ( <i>Lord Commissioner of Her Majesty's Treasury</i> )                                     |
| Fletcher, Katherine ( <i>South Ribble</i> ) (Con)                  | † Western, Matt ( <i>Warwick and Leamington</i> ) (Lab)   |
| Flynn, Stephen ( <i>Aberdeen South</i> ) (SNP)                     | Whitehead, Dr Alan ( <i>Southampton, Test</i> ) (Lab)   |
| † Garnier, Mark ( <i>Wyre Forest</i> ) (Con)                       | † Wild, James ( <i>North West Norfolk</i> ) (Con)   |
| † Gideon, Jo ( <i>Stoke-on-Trent Central</i> ) (Con)               | † Zahawi, Nadhim ( <i>Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy</i> ) |
| † Grant, Peter ( <i>Glenrothes</i> ) (SNP)                         | Rob Page, Yohanna Sallberg, <i>Committee Clerks</i>   |
| † Griffith, Andrew ( <i>Arundel and South Downs</i> ) (Con)        | † <b>attended the Committee</b>   |
| † Kinnock, Stephen ( <i>Aberavon</i> ) (Lab)                       |   |

**Witnesses**

Charles Parton OBE, Senior Associate Fellow, Royal United Services Institute

Sir Richard Dearlove KCMG OBE

## Public Bill Committee

*Tuesday 24 November 2020*

*(Morning)*

[DEREK TWIGG *in the Chair*]

### National Security and Investment Bill

9.25 am

**The Chair:** Before we begin, I have a few preliminary points to make. Please switch electronic devices to silent. Tea and coffee are not allowed during sittings. Members can sit in any seat marked with a “please sit here” sign. That includes the side tables and the Public Gallery, although *Hansard* colleagues have priority on the side tables. Members sitting in the Public Gallery should stand by the microphone to my right.

We will first consider the programme motion on the amendment paper. We will then consider a motion to enable the reporting of written evidence for publication, and then a motion to allow us to deliberate in private on our questions, before the oral evidence sessions. In view of the limited time available, I hope we can take these matters without too much debate. I call the Minister to move the programme motion agreed to yesterday by the Programming Sub-Committee.

**The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Nadhim Zahawi):** I beg to move,

That—

(1) the Committee shall (in addition to its first meeting at 9.25am on Tuesday 24 November) meet—

- (a) at 2.00 pm on Tuesday 24 November;
- (b) at 11.30 am and 2.00 pm on Thursday 26 November;
- (c) at 9.25 am and 2.00 pm on Tuesday 1 December;
- (d) at 11.30 am and 2.00 pm on Thursday 3 December;
- (e) at 11.30 am and 2.00 pm on Thursday 8 December;
- (f) at 11.30 am and 2.00 pm on Thursday 10 December;
- (g) at 9.25 am on Tuesday 15 December;

(2) the Committee shall hear oral evidence in accordance with the following Table:

TABLE

<i>Date</i>	<i>Time</i>	<i>Witness</i>
Tuesday 24 November	Until no later than 10.30 am	The Royal United Services Institute
Tuesday 24 November	Until no later than 11.25 am	Sir Richard Dearlove KCMG OBE
Tuesday 24 November	Until no later than 2.45 pm	The Centre for International Studies, London School of Economics
Tuesday 24 November	Until no later than 3.30 pm	Skadden, Arps, Slate, Meagher & Flom LLP
Tuesday 24 November	Until no later than 4.15 pm	The Institute of Chartered Accountants in England and Wales

<i>Date</i>	<i>Time</i>	<i>Witness</i>
Tuesday 24 November	Until no later than 5 pm	The Investment Association
Thursday 26 November	Until no later than 12.15 pm	Slaughter and May
Thursday 26 November	Until no later than 1 pm	Professor Ciaran Martin, the Blavatnik School of Government, University of Oxford
Thursday 26 November	Until no later than 2.30 pm	Herbert Smith Freehills
Thursday 26 November	Until no later than 3.15 pm	Simons Muirhead and Burton
Thursday 26 November	Until no later than 4 pm	Chatham House
Thursday 26 November	Until no later than 4.30 pm	PricewaterhouseCoopers

(3) proceedings on consideration of the Bill in Committee shall be taken in the following order: Clauses 1 to 10; Schedule 1; Clauses 11 to 58; Schedule 2; Clauses 59 to 66; new Clauses; new Schedules; remaining proceedings on the Bill;

(4) the proceedings shall (so far as not previously concluded) be brought to a conclusion at 11.25 am on Tuesday 15 December.

It is a pleasure to serve under your chairmanship, Mr Twigg, and to serve with colleagues on this important Bill Committee.

*Question put and agreed to.*

*Resolved,*

That, at this and any subsequent meeting at which oral evidence is to be heard, the Committee shall sit in private until the witnesses are admitted.—(*Nadhim Zahawi.*)

*Resolved,*

That, subject to the discretion of the Chair, any written evidence received by the Committee shall be reported to the House for publication.—(*Nadhim Zahawi.*)

**The Chair:** Copies of the written evidence that the Committee receives will be made available in the Committee Room. We will now sit in private to discuss lines of questioning.

9.27 am

*The Committee deliberated in private.*

### Examination of Witness

*Charles Parton OBE gave evidence.*

9.29 am

**The Chair:** We will now hear oral evidence from the Royal United Services Institute. Before calling the first Member to ask a question, I remind all Members that questions should be limited to matters within the scope of the Bill and that we must stick to the timings in the programme motion. The Committee has agreed that for this sitting we have until 10.30 am. Will the witness introduce themselves for the record? [*Interruption.*] I am going to suspend the sitting for a few moments to see whether we can sort out the technical problems that we are having. This is not the first time; even the Prime Minister had problems yesterday.

9.31 am

*Sitting suspended.*

9.34 am

*On resuming—*

**Q1 The Chair:** I will resume the sitting. Sir, could I again ask you to introduce yourself?

**Charles Parton:** Thank you for inviting me. I am Charles Parton. I was, for 38 years, a diplomat, mostly with the UK, but for five years with the European delegation until the end of 2017. My area of work has largely been on China and, in the last decade, on the politics of China and the Communist party. I was an adviser to the Foreign Affairs Committee of the House of Commons on two of its recent China reports. I continue, since leaving diplomacy, to study what the Communist party is doing and the relevance of that to our UK policy.

**The Chair:** Thank you very much. I call first Chi Onwurah.

**Q2 Chi Onwurah** (Newcastle upon Tyne Central) (Lab): It is a pleasure to serve under your chairship in this Committee, Mr Twigg. Thank you very much for joining us, with your extensive background, Mr Parton. As you know, we have an investment screening regime under the Enterprise Act 2002 that has led to 12 interventions on national security grounds since the Act came in. Which security threats do you feel are not covered by those existing public interest powers? While we have been waiting for the Government to act on this front, are there specific instances where you think the Government should have acted but did not exercise their powers, or did not have the relevant powers to exercise?

**Charles Parton:** I would not profess to be an expert on individual cases, but I would like to make some general response to your excellent question. The first point to make is that the Government have not really been attending to the problem with the attention that they should, given the nature of the threat, particularly from the Chinese, although others may be relevant too. I do not think that there is the structure for actually assessing the degree of the threats; I think that 12 cases since 2002 is very few indeed, when you look worldwide at the Chinese programme for technology acquisition, both under and over the table. That in itself shows that there has been insufficient attention paid to the issue.

The delay in the Bill is also regrettable, because the threat has been fairly clear for some time. I would urge the Government, first, to research the question, which is the one you asked, of to what degree in the past have the Chinese in particular bought up technology companies, the acquisition of which was greatly against our interests? That work could and should be done.

I am an associate fellow at the Royal United Services Institute, which has a team that has been looking through technology at a number of questions, but it could quite easily divert that team to look at this question, which needs China expertise and the ability to search through a lot of open data, which it has. I am not a member of the Government, but I am not aware that the Government have done that sort of research to establish the full degree of the problem.

From the point of view of the threat—if you will excuse me, as this is the first question, for putting a little bit of context to it in terms of the China thing—it is

undoubted that there is nothing wrong with investment. In fact, that is extremely good. We want as much investment and good relations with China as with everyone else, but we need to recognise that there is a values war going on. I have written an article about that, which came out in the Conservatives' China Research Group report a week or so ago.

This is not a cold war, because China is very important to us for trade, investment and many global goods, and it is a science and technology power, but we should not underestimate the degree to which Xi Jinping and the Communist party intend, as Xi said to the first politburo meeting, to get the upper hand against western democracies. He talks about us being hostile forces and about a big struggle all the time. When you add that to his policy of civil-military fusion—using civil in the military context—and the fact that he has set up a party organisation specifically to push that forward, and the change in investment policy away from things such as property, football clubs and other things, very much towards benefitting China and its technology, we have to be a lot more careful than we have been in the past.

The first step for that is to do the research. I am not aware of a really good assessment of just how much technology has been bought, the targets and so on. Maybe the Government have one—I don't know—but I do not think that they do.

**Q3 Chi Onwurah:** Thank you very much for that response. I certainly agree with you on the delay in addressing this critical issue. I appreciate your experience, particularly with China, which obviously, as you say, has made a number of technology acquisitions.

I was particularly interested in the civil-military fusion, if you like, of China's technology ambitions. Could you say a little more about how the Chinese see nascent technologies that are indirectly critical to downstream industries that supply our national security? I am trying to understand how, if you like, we differentiate between industrial strategy and technology to ensure that we have leading defence and national security capabilities. Is there a distinction that we can make there? Do we need to do further research, as you suggest? Do the Chinese make that kind of distinction? Do we need to address some elements of our industrial capability when we consider national security?

**Charles Parton:** We should widen this not only to companies, but to academia, if I could come back to your question from this angle. We have the phenomenon at the moment of Chinese companies, one might say, hiring our academics, in one way or other, to do scientific research on their behalf. Some of that is probably something that our defence establishment and security establishment would be pretty upset about if they were aware of it.

It is quite difficult to distinguish some of these and to know about them all, but a few weeks ago *The Daily Telegraph* did a story on, I think, Oxford University and Huawei's commissioning of research. I think there were 17 projects. I looked at those, and I am not a technologist by any means, but some of them rang certain alarm bells. If you are researching, on behalf of the Chinese, drone technology, cryptography, gait—Gait is very important for gait recognition. We have facial recognition and voice recognition, but in circumstances where people are wearing masks or there is bad weather, gait is an

absolute identifier. Again, are these bad technologies? Well, there are perfectly good civilian uses for them, no doubt, but there also military and surveillance uses. I think we need to be very clear on what our academics, as well as our companies, are doing.

To give you another example, if you go on the website of one of the top Oxford mathematician professors, he has now retired and set up a company with a base in Shenzhen. He is an absolutely top mathematician and does the most abstruse things in cryptography. Should one of our top mathematicians be helping the Chinese in cryptography? Well, there are perfectly good and innocent uses of cryptography, I presume, for things such as banking and e-commerce, and there are perfectly not good uses of it, in military and surveillance and other things. I have no idea whether that is something we should be concerned about. On the face of it, it strikes me that we should be.

I think we need to broaden the scope—forgive me if this is outside the Committee’s scope; you are only looking at the Bill—because the whole question of defence of technology needs to be looked at, in terms of whether we are strengthening a hostile foreign power, but also let us not forget the reputation of British companies and universities. If you look at what is going on in Xinjiang, for instance, with the concentration camps there—activities that quite definitely meet the definition of crimes against humanity under article 7 of the International Criminal Court’s Rome statute, or article 2 of the UN genocide convention—should our companies and universities be helping with technologies that can be used to strengthen that surveillance and that repressive regime? What is the difference between that and South African apartheid or some of the other things that we have seen in the past? Increasingly, the excuse of, “Well, we didn’t really know what was going on,” has gone, and companies and academia will have to be much more careful of their reputation. I have slightly moved away from the nub of your question. Perhaps you could just push the tiller a bit and put but me back to the centre of it again.

**Q4 Chi Onwurah:** I think you addressed the core of my question. I really like your phrase “defence of technology”, rather than the technology of defence, because the question was around how you distinguish in the industrial strategy between specific security concerns and the development of technologies that give us capability in those sectors. Can we identify at what point that becomes a national security concern?

**Charles Parton:** That is sort of way outside my technical expertise, but I would certainly say that one major criticism I have of the Bill is that you have to set up the right structure to be able to do that. I am not sure that the Bill’s putting everything in the hands of the Department for Business, Energy and Industrial Strategy and its Secretary of State is the right answer.

Let us take Huawei and the debate we had over the last couple of years, as well as the various flip-flops that have gone on. One might add flaps, as well as flip-flops, actually. There has been a big a division between the so-called economic and security Ministries. It is right that both have a say in the decision. Economic interests are very much at stake, but so are security interests. If you put everything into the hands of BEIS, which probably does not have the expertise on China—certainly

not in the defence, security and surveillance realms, although not unnaturally, since its job is to encourage investment—you will perhaps find that the security and repression elements are not given sufficient weight, and more to the point, the perception will be that they are not given sufficient weight. We might therefore go back to this sort of business with Huawei, where there is a fight back and another fight back and so on.

What we actually need is an organisation that is made up of people on all sides of the debate and that has some real experts who actually understand what the technology means. One specific example I came across a year or so ago was a very interesting computer game. Fine. What is wrong with that? Well, I understand that it was then bought up by the Chinese and used to train fighter pilots. You cannot defend against everything, but you at least need some unbiased experts—a sort of, if I can use the words, Scientific Advisory Group for Emergencies—who would be there to advise, and then decisions would actually be accepted by all sides, not questioned.

On occasion, I am sure that questions would be put up to the National Security Council and the Prime Minister for decision if they were really important. However, the issue is often about very small companies with some very interesting technologies that have not been established. The Chinese are extremely efficient at hoovering around, finding them and buying them up early. I am not convinced that the structure and decision making of the whole process are right.

**Q5 Nadhim Zahawi:** Good morning, Mr Parton, it is great to see you. Without going further on your last point, I want to reassure you that the Bill is designed to deliver a quasi-judicial role for the Secretary of State for Business, Energy and Industrial Strategy. The team’s infrastructure will be pulling in all parts of Government expertise. My question is this: how do you think the current challenge of covid has exposed national security threats through investment? What are you seeing? How do you see the behaviour of malign actors anywhere in the world at a time of covid?

**Charles Parton:** I think what covid has done is expose the nature of the Chinese Communist party, in answer to your question. I hope that it has brought home to people the nature of the beast. Looking at what happened, China did not do so well to start with, and its people were pretty upset with it. China then used its external propaganda machine to right its domestic problem, pushing forward the line, “Look how badly the foreigners have done, and look how well we are helping the foreigners out of the mess,” while hiding the fact that it had allowed the virus to propagate so fast in the first place. To many people in democracies, that brought home the fact that the Communist party of China is prepared to use that against us.

Where the Chinese Communist party was unhappy with how countries were acting, it started to put them under pressure and made threats about the delivery of personal protective equipment or whatever. Australia is really taking it in the neck at the moment because it had the temerity to ask—perfectly reasonably—for an investigation of the origins of the virus, which is essential for scientific and preventive purposes. Look at the political pressure on Australia. There is absolutely no doubt that where the Communist party sees an opportunity to use whatever is going on at the moment, it will do so.

The question that I have continuously asked is this: to what degree is investment threatened by a country such as the UK, Australia or Canada standing up for its own interest? We are not actually attacking China, but we are saying, “Sorry, but we have our own interests and our own security. You wouldn’t allow the equivalent in your country, possibly rightly, and we are not allowing it here because we are defending our security, in this case.” To what degree is the tool of depriving someone of investment a real threat? I have urged in a number of papers that the Government look at that in dispassionate terms. The China-Britain Business Council recently put out a paper, but I would not describe it as dispassionate. That is for the Government to do. My own feeling is that the likely conclusion is that, on the whole, the threats are pretty hollow. Chinese investment is not done for charitable reasons.

Since 2017—the high point was 2016—China has cut back on investment. Beijing was getting pretty annoyed at the way money was seeping out not in line with its policies, but investment is now more tightly controlled and aimed at the acquisition of science and technology. To what degree are we vulnerable? This is not charity. Money is very cheap at the moment; it can be got at negative interest rates. It is not as though China is the sole source of money. It invests because it wants technology. Surely we have to look at that carefully and ask where is the mutual benefit. If it is mutually beneficial, fantastic, let us go ahead. Let us not be too brow-beaten by this thing—that if you do not do x or y, or if you do not take Huawei, we will hit your investment. I think, in practice, if you look at that and then look at some of the other threats that China has made over the years, including to your exports, all those have grown for all countries, although they had been in the diplomatic doghouse historically—certainly in the past; we will see about the future—but I think it is greatly exaggerated.

**Nadhim Zahawi:** I am grateful to you, Mr Parton. I do not want to hog the floor, as I am sure many colleagues want to ask questions. Thank you very much.

**Q6 Stephen Kinnock (Aberavon) (Lab):** It is a pleasure to serve under your chairmanship, Mr Twigg. I do not know whether you can see me, Charlie, but I am here. I am sitting at the back due to social distancing, but it is good to see you.

Going back to your point about resourcing the investment security unit, can you give a bit more detail about what would be an ideal outcome from your point of view? Would it be that we need specificity in the Bill that key representatives and experts of the intelligence services, of the Ministry of Defence, of the diplomatic corps and of other agencies be formally named in the legislation, so we would have that reassurance that the body doing the screening had all the necessary breadth across the spectrum of both the economy and national security?

**Charles Parton:** That is a good question; it is not necessarily for me and I do not necessarily have the experience to lay down precisely how it works. For me, I think, first, that all those organisations you have mentioned—although others also on the economic side, such as the Treasury and BEIS—perhaps should be there to set the parameters of what needs to be referred. I think that, as a sort of preliminary filter, one would hope that there was an ability for most companies, and

most universities as well, very quickly to put forward the deals or the pieces of work that they felt might be coming up against the parameters set by such a Government body.

For a quick decision, is the topic one that is suitable, or does it need a little more investigation? Should we be working with this organisation, or in some cases this particular Chinese academic or company, which may have links to the military or to the repressive regime? The experts, as it were, which means the SAGE-type committee, surely should be very quickly—companies and academics need to move quite quickly—making a preliminary estimation of whether this needs to be referred upwards to a Government Committee that wants to look at it in more detail.

I do agree with you that the range of interests needs to be representative if the decision is to be perceived by all sides as acceptable when it is eventually made.

**Q7 Stephen Kinnock:** Thanks very much; that is very helpful. On this point about making sure that we have the most effective and streamlined system in place, one of the areas where the Bill diverges from legislation in similar jurisdictions, such as Germany and Japan, is that it does not contain a definition of national security as such.

In the Japanese and German cases, they refer to national security including concepts of public order. I refer in particular to your comments about organisations out there in the marketplace, whether they are universities or businesses, needing to have clarity to know what needs to be referred and what does not. They need to know where the amber or red light is flashing, and where it is clearly a green light and not an issue. Would that be aided and facilitated if the Bill contained a definition of national security?

**Charles Parton:** It is a bit like defining terrorism. It is really quite difficult to be all encompassing. Sometimes, I am in sympathy with the Chinese legislation that adds at the bottom “and other offences” or “and other things”. I think it is quite difficult, even if people are convinced that they can effectively define that. It is not only national security; there is a question whether you are aiding crimes against humanity or the genocide that is going on in Xinjiang. I am using loaded terms there, but I think they are justified. There must be some mechanism for ensuring that those, too, are brought to bear, but I am not expert enough in legislation to be able to say, “Yes, we need a watertight definition of ‘national security’.”

Certainly, the Bill must convey to companies and academics the need to clear a range of topics. That will not be specific, but, at best, they must be encouraged to consult almost as a default, so that they are not caught out. The other question is, what happens if they don’t? What sort of sanctions are they under if they do not consult, when it is clearly something they should consult on, for reasons either of security or of repression and crimes against humanity?

**The Chair:** Thank you very much. I now call Andrew Griffith.

**Q8 Andrew Griffith (Arundel and South Downs) (Con):** It is a pleasure to serve under your chairmanship, Mr Twigg. Mr Parton, thank you for your past service.

[Andrew Griffith]

You have clearly studied China and Asia at a fascinating time in their own economic development. I will ask you to play devil's advocate.

As a Committee considering this Bill, we will hear from a constituency that could sometimes trip over into Sinophobia, being against any form of engagement or trade with China. Looking at the economic development of that market and the opportunities that it presents, could you talk a bit about the non-risk-based categories, such as inert goods and household manufactured goods, which the Committee should draw a clear line around, and those categories that you have talked about, which are covered in the Bill and speak to a real national threat?

**Charles Parton:** Let me make the general point that I am sometimes accused of being anti-Chinese. I greatly resent that. I am anti-party, as anybody should be if they saw what it does in places like Xinjiang or Hong Kong. I am not anti-Chinese. I think the Chinese Communist party itself deliberately muddies the waters on that one and says, "You are anti-China," when, actually, you are opposing the policies of the Chinese Communist party. That said, I began the session saying that we want investment from China, trade with China and good relations with China. China is a major player. This must not be a cold war. If America or China decides to pursue that, we must try to avoid it.

I always talk about the holy trinity of national security, UK interests and UK values. We should establish those with the Chinese and say, "Sorry, those are non-negotiable. Just as you sometimes come and say, 'These are our core interests and we are not negotiating them,' we have the right to do that too." But beyond that, we want open trading relations and open investment relations. What is wrong with China buying London Taxis International? Nothing. If it wants to invest and that is mutually beneficial, great.

We want an open China as much as possible. We certainly want a much more level playing field than there is at the moment. China runs a series of negative lists and there is much on them, particularly in the area of services, which we would want opened up. We must press for that in conjunction with the Americans, the EU, Australia and all the other democracies that wish to trade with China. In many ways, that is in China's interest. It is certainly in the interests of its people. A closed market, with China just relying on its own consumption—it is a big market—is not going to be good for China any more than it is good for us. I fully go along with that. I do not think we should be anti-China in any circumstances. That is, in a sense, racist. We should be anti-Communist party, or certain against its policies, but with the Chinese people, and in trading, we should maintain a perfectly normal relationship.

**Q9 Matt Western** (Warwick and Leamington) (Lab): It is a pleasure to serve under your chairmanship, Mr Twigg. Mr Parton, I want to pick up your point about access to academics, universities and so on. There is clearly a big push from universities to invest heavily in China and build relationships. Do you think there should be more safeguards in the Bill for those relationships? Secondly, do you think the Bill provides sufficient protections for intellectual property?

**Charles Parton:** On the first question about academics, I am not sure whether this is about investment. I think that academics are in some ways a separate question, unless universities are setting up, as they do, companies, and are moving that way.

**Q10 Matt Western:** I am thinking about Cambridge and so on, which are moving into more commercial areas.

**Charles Parton:** Where academia sets up a company, and that involves itself with China, yes, that should be under the purview of the Bill. There is a separate question about when Chinese companies hire or fund—whichever you like to say—UK academics to carry out a specific piece of research for them. Universities are working on that, and that is a very urgent question. Again, I think that a much stricter regime should be put in place to stop the seeping out of technologies that could be used in the military field or the repressive one. I am not convinced that that is there at the moment; I am sure it is not. That might be a separate question. It may or may not be one that requires parliamentary legislation—people who are experts on that can make up their mind—but some form of consultation with the Government, or perhaps a sanctions regime, needs to be put in place so that that does not happen.

On the question of intellectual property rights, China has a very rigorous campaign to get hold of our IP. Some of it is stolen through cyber, and I am sure our intelligence services and others are doing their best to combat that. I am not sure about the degree to which this Bill can act as a defence against Chinese abuse. It can certainly try to encourage companies to raise their own defences, but the UK has an organisation—the Centre for the Protection of National Infrastructure—that aims to put out that advice and help. I do not know whether it is strong enough in its actions and shield; that is outside my area of expertise. It is certainly there, but perhaps it, too, needs strengthening.

**Q11 Nickie Aiken** (Cities of London and Westminster) (Con): It is a pleasure to serve under your chairmanship, Mr Twigg. Mr Parton, thank you for your time today. You said that small firms may come under pressure to be bought up, and are often targeted. What is your view on how this Bill can strengthen national security by ensuring that firms—particularly small firms—are not taken over by legitimate, friendly actors, which further down the road are bought up by China or whoever? Does the Bill protect us from that type of long-term acquisition?

**Charles Parton:** I suspect that there is a limit as to how far down the line one can go, but where activity is still going on in the UK—that is to say, where UK individuals are still running that company in the UK on behalf of a friendly foreign country, and the company is later bought up—that should be covered by this Bill. Otherwise, you are absolutely right: you may find a company in Liechtenstein buying it; then the company gets bought by the Chinese, and the technology gets siphoned out. There has to be a defence against that.

If a company is bought by a friendly country and the technology is exported, and nothing is happening in the UK, then I cannot see how extraterritoriality would be applicable.



**Q12 Simon Baynes** (Clwyd South) (Con): It is a pleasure to serve under your chairmanship, Mr Twigg.

I want to explore the extent to which the world—if I can describe it as one world—of academic consultants and private sector companies, to which you have referred, would agree with what you are saying. You refer to having a SAGE-like committee; is there a danger that, if you did have such a committee, it would actually have very divergent views?

I fully respect where you are coming from, but you made some quite hard-hitting comments earlier about crimes against humanity in the concentration camps, and questioning whether companies and academia should be involving themselves in aspects of China. You also referred to a top mathematician, who was formerly at Oxford University, helping China with cryptography.

I want to get a feel for the extent to which you think that your views are shared by academics, consultants and the private sector, and then feed that back into whether, if you did put together a SAGE-like committee—and I can see the sense in doing that—you might find it quite difficult to come to a consensus.

Finally, it must be quite difficult to judge exactly whether what is being developed—whether it be from an academic idea or from a corporate idea—will be helpful to the Chinese in a way that is detrimental to Britain, or is actually a perfectly sensible piece of research and development that could be of benefit to both countries.

**Charles Parton:** Can I take those three questions almost backwards, or certainly not in the order in which you have presented them? In terms of expertise within a SAGE-type community, those experts would not be making the political decision. They would be making the technical decision: “To what degree can these technologies be used in a military, as well as a civilian, context?” That is the advice that would be going up. It would then be for the Ministers on a committee to say, “Well, we judge that risk to be acceptable,” or “We do not.”

Of course, nothing is black and white in technology because, as the distinction between civil and military is increasingly eroded, it is quite difficult to know; there are many shades of grey here. A judgement has to be made on any particular technology—either “Sorry, we will have to rule that one out,” or “On this one, yes, there are some risks, and maybe we will come to regret it, but on balance, we will let that one through.”

On whether consultants, academics and others agree with my views on China and the nature of the regime, I think that depends, if you will excuse my saying so, on the degree to which they have studied China and looked at the issues. It is noticeable that those who read what the Chinese communist party says about itself tend very much to agree with what I say, or with the sort of views that I put out. Those who have other interests do not. Of course, there are some who I would say are captured, quite frankly, by the degrees of interference and other aspects that the Chinese United Front Work Department pushes.

There is a variety of opinion there, but I think that those who understand China and read what the party says—the party says an awful lot, actually, if you bother to read what it says; it is not a black box—are inclined very much to my views. Those views are: be careful,

because it is not coming from the same angle as us, and has some very distinct and not very nice aspects to it. At the same time, it is a major economic power, a major science and technology power, and a major influence on the goods in the world, whether for health, development, peacekeeping or whatever, and we must get on with the country to the best of our ability. I don’t know if that answers your question fully; do come back.

**Simon Baynes:** That is good. Thank you very much.

**Q13 Peter Grant** (Glenrothes) (SNP): I am pleased to take part in this Committee under your chairmanship, Mr Twigg.

Mr Parton, the Bill looks primarily at direct investment by potentially hostile operators. Does it give sufficient protection against indirect control? For example, a company may be reliant on its bankers, who may or may not be based in a hostile territory, and who may rely on technology through a company such as Huawei; or a company’s ultimate owners and controlling party could be registered in an offshore tax haven, and it could be that nobody has any idea who actually owns that company. Does the Bill give sufficient protection against those kinds of threats through indirect influence and control?

**Charles Parton:** I am not a legal expert, but the Committee stage of the Bill needs to look deeply at that question. If there is any doubt as to who the ultimate owners are, that should be taken into account by whatever organisation makes the recommendation on whether a particular investment is acceptable. If we cannot follow through relatively easily back to the ultimate beneficial owners and users, that is a factor that needs to be weighed very heavily in the decision on allowing a particular, possibly sensitive, investment to go ahead.

**Q14 Peter Grant:** In your experience, is that a technique that either the Chinese Communist party or other potential hostile players either have used or are likely to use if it is in their interests? Do you have knowledge, for example, of China using non-disclosure territories to set up companies in order to try to invest in the UK or elsewhere? Are you aware of them using the influence of the technology, for example, to try to exert influence on companies that do not, at first glance, appear to be directly owned from China?

**Charles Parton:** I have to say that that is outside my expertise, but I do think it is an extremely good and important question that could be researched relatively easily. Forgive me if I am pushing RUSI here, but I suspect that RUSI has the capability in one of its teams to do some data mining on that, and come up with an answer. It is a very important question, but I am not aware of any research, though there may be some, that goes deeply into that question. It is certainly one that should be followed up.

**Q15 Andrew Bowie** (West Aberdeenshire and Kincardine) (Con): It is a pleasure to serve under your chairmanship, Mr Twigg. Good morning, Mr Parton. The Bill obviously aims to protect national security while promoting investment in the United Kingdom and not dissuading any inward investment into the country. With your experience, and given everything that you have said this morning, do you think the Bill will succeed in its aims?

**Charles Parton:** Again, I am not a legal expert, but it seems to set out the legal framework. It all very much depends on the structures and mechanisms, and the resourcing of them, that are set up to ensure whether the judgments about a particular company or a piece of academic research and the technology from them should be blocked or allowed through. I put it back to the Committee: if its detailed research, and the measures that go into the Bill, show that whatever organisation is set up is sufficient unto the job, and that the channels are there to ensure that all these small and sometimes obscure technologies are at least passed by it, that is a really important piece of work.

**Q16 Andrew Bowie:** Secondly, I wondered how the proposal might compare to regimes that are already in place in comparable countries—for example, our Five Eyes partners.

**Charles Parton:** I have not done comparative research on that, or done a paper on it. That is something that needs to be done by the Government. Perhaps they have done that. The impression that I get from discussions of this sort of question in the various fora that I mix in suggests that the Americans and Australians have taken a much more hard-hitting approach than we have. Again, it depends on what structure is set up by the British Government, and how it functions in line with the Bill. Forgive me for not giving you a full answer, but that is the sort of research that needs to be commissioned by the Government in order to make decisions on how to deal with that question.

**Andrew Bowie:** Thank you.

**Q17 James Wild (North West Norfolk) (Con):** It is a pleasure to serve under your chairmanship, Mr Twigg. Mr Parton, I want to ask about influence. We have seen companies linked to hostile states hiring former diplomats, civil servants, parliamentarians and Ministers to provide a veneer of respectability. How can we do more to guard against that? Secondly, on the Bill, provided advice is drawn widely from the agencies and other parts of Government through the investment security unit in the way that you have described, do you think that having a quasi-judicial decision made by the Secretary of State guards against that influence and potential cronyism in the decision making?

**Charles Parton:** The question of elite capture is very important and very topical. First, I have called for this in various papers that I have written. The Cobra committee that makes decisions on employment after political or civil service careers definitely needs strengthening. I am not sure of the degree to which work on that is going on; in fact, I do not think much is. Certainly neither the provisions, nor the exercise of those provisions, have been sufficiently rigorous. It is very much a question of lengthening the amount of time between leaving a particular post and taking up a job where, in some cases, you are laundering the reputations of some of these companies. If that period is too small and the criteria are too weak, there is a great risk of people, while still in office or still in post, saying to themselves, “I’d better not be too harsh on this, because in a couple of years’ time, I might be approaching these people, or they might approach me for a job.” That is pretty crude, I know, but it is perhaps easier to see in the case of a defence company. If you were in the MOD, say, and you

had to make a decision, one hopes you would make it entirely in the national interest, rather than with a view to possible employment by whichever company might be bidding for a contract, but that is one area that needs strengthening.

The other area in all influence problems, of course, is that sunlight and transparency is the one weapon we have, but if a Minister, an ex-Minister or a top civil servant is running a consultancy company, and let us say Huawei is employing that company—I choose this example by sheer chance—that should be known. That should be declared, because if such people—who are still influential with their old colleagues, whether parliamentary, ministerial or civil service—are urging a certain line, as I have heard some urge, it may not be disinterested; in fact, it certainly is not in some cases. That needs to be made clear. Sorry, could you just repeat the second part of your question?

**Q18 James Wild:** It was picking up on your point, which I think we all share, about ensuring that the investment security unit draws advice from the agencies and across other parts of Government. Provided it does that, having a quasi-judicial decision that is challengeable under judicial review by a Secretary of State in some ways guards against that soft influence or cronyism getting involved in a SAGE-type committee. Can you see the benefits of that model?

**Charles Parton:** Yes, but I think you have to be very happy and convinced that the Minister in charge is one whose future does not incline him or her to make a decision that is somewhat biased. It is not without precedent in the world, anyway, that some ex-Ministers have been under the influence of the Chinese Communist party for one reason or another, so you have to be quite careful about that, and it is a really important decision. That is why I would be more inclined to make sure it is very clear that it is not just within the purview of BEIS, because BEIS’s job is to push investment. That is perfectly fair, but there may be occasions—not now, but in the future—where people’s backgrounds, inclinations or futures incline them to be less than even in their judgment.

**The Chair:** This will probably be the last question, from Stephen Kinnock.

**Q19 Stephen Kinnock:** Thank you very much, Chair, for giving me another bite at the cherry. Mr Parton, as a final point, I thought it might be useful to remind the Committee of the symbiotic nature of the relationship between the Chinese Communist party and the Chinese business community. Based on your extensive experience in China, could you briefly outline how the Chinese Communist party in essence runs the business community; the role that it plays in ensuring executives are appointed who are sympathetic to the party; and the whole way in which the nomenklatura works? That will help us to understand the extent to which Chinese business interests in this country are, in essence, the same as the interests of the Chinese Communist party.

**Charles Parton:** That is a very good question.

**Chi Onwurah:** Could I just add to that? That is an excellent point, but could you also say a little bit on how China responds to proposed takeovers that might implicate its national security, if those takeovers are allowed? How does it respond to that investment into its companies?

**Charles Parton:** Those are both good points. First of all, divide it into the state-owned sector and the private sector. In terms of the state-owned sector, the top executives of the big state-owned companies are appointed by the central organisation department of the party. That is the organisation that is, as Mr Kinnock has said, in charge of the nomenklatura: the top 3,000 to 4,000 party officials. Of course, a lot of state-owned companies are also owned at the provincial and lower levels, and there, too, the top executives are party members and beholden to the party. Let us not forget that most foreign investment by the Chinese is state owned, so it is not just a fair bet but a fair certainty that any state-owned enterprise investing is fully politically controlled.

When it comes to the private sector, Huawei has spent a large amount of its time insisting that it is a private company—I really do not care. And I do not really care that the national security law says that any individual or organisation must help the party or security organs when called upon. The brute fact is that, in the way the system is run in China, if the party tells you to do something, the only response from private business to an order is to say, “Certainly, Sir. How high do you want me to jump?” so this debate is entirely irrelevant. The party is now pushing committees into all private enterprises—foreign and local—and it would be a very unwise head of a private company who said, “No, Mr Xi Jinping. I don’t think so.” If nothing else has been shown by what has happened with Jack Ma, China’s second-richest person, and the Ant Group finance company in the last few weeks—there are, of course, financial risk reasons they might want to control Jack Ma’s Ant Group—it is, “Sorry, you are beholden to the Communist party.” That was a very fierce reminder of it.

In terms of this debate, I do not think we should be under any illusion that if a party says to a company about its technology or whatever, “Well okay, it’s all very well that you’ve got that, but we want it fed into our People’s Liberation Army organisations and science and technology system,” no company is going to say, “Oh no, that’s not right. We won’t do that.” For instance, when Huawei says, “If we were asked to do something against our commitments, in terms of what we do abroad, that would threaten security, we would not do that,” it is rubbish. They know that.

**The Chair:** I am afraid that brings us to the end of this part of the session. Mr Parton, I thank you on behalf of the Committee for your evidence and the clear, concise answers you gave. We must now move on to the next session. If Members want to take a comfort break for a couple of minutes, I am happy to do that.

10.33 am

*Sitting suspended.*

#### Examination of Witness

*Sir Richard Dearlove KCMG OBE gave evidence.*

10.35 am

**Q20 The Chair:** Order. We will now hear oral evidence from Sir Richard Dearlove. Please introduce yourself for the record, Sir Richard.

**Sir Richard Dearlove:** I am Sir Richard Dearlove. I was in MI6 for 38 years. I was chief of the service from 1999 to 2004. Before that I was head of operations, and

before that I was head of all the admin and personnel. In fact, I completed the building of the new headquarters and the move of the whole service into that. I retired in 2004 and became the Master of Pembroke College, Cambridge, where I was for 11 years. I am now chair of the board of trustees of the University of London and hold a number of other directorships and advisory roles. I still remain pretty heavily involved as a talking head on geopolitics and intelligence issues, and I have founded a small think tank, which is actually an educational charity in Cambridge called the Cambridge Security Initiative. That gives you in essence my colourful past.

**The Chair:** Thank you so much for being a witness.

**Q21 Chi Onwurah:** Thank you very much, Sir Richard, for bringing your expertise to the Committee. The existing powers for intervening in transactions on national security grounds came in when you were chief of MI6. How have security threats evolved since then? Specifically, which security threats do you consider are not covered by existing public interest powers? It would be helpful to hear whether you think the Government have missed specific threats, or types of threat, by relying only on historical powers, and by not bringing in new legislation until now?

**Sir Richard Dearlove:** Wow. That is a massive question. Bear in mind that a large part of my career related to the cold war. In that period, our main concern was the Soviet Union and the members of the Warsaw Pact. It was characteristic of that period that there were heavy controls, mainly exercised through NATO structures, to prevent strategic material from leaching, as it were, into the economies of the Warsaw pact. I will not go into all the mechanisms. Historically, one does not need to worry about those now, but it was very much an issue that was at the forefront of people’s minds during that period of the cold war. Bear in mind also—I think this is important in looking at the broader context of what you are interested in—that the Soviet Union had hugely sophisticated what’s called S and T operations: science and technology. A whole line of Soviet intelligence of the KGB was devoted to obtaining strategic material that would help the Soviet economy, particularly in the military industrial complex.

This is now in the public domain: in the mid-1980s, there was a major intelligence success, which, interestingly, was conducted by the French, but in which the UK had an important role. We completely dismantled, or learned, exactly what the Soviet Union and its allies were up to on a global basis. We knew before, but we did not know the detail to that extent, and what we learned was pretty shocking. That case has not been greatly publicised, but it was probably one of the most important intelligence cases of the cold war.

With the break-up of the Soviet Union and the disintegration of the Soviet empire, particularly the economic structures that bound the Warsaw pact countries together, in the West our attitudes towards those issues changed very significantly. There was a much more laissez-faire situation and, as countries broke away from the Soviet empire, an enthusiasm to trade with them without the same degree of control.

During that period, you had the emergence of China, which was still very much a regional power but with aspirations to become a global power. To short cut, we

have now transferred to China the concerns we had about the Soviet Union and its allies, but the problem with China in some respects is much more serious than the problem with the Soviet Union, although that was bad enough. Charlie Parton, who was talking to you before, is an expert on China specifically. I am not, and my view is maybe more strategic, although I had a lot to do with China when I was head of MI6.

If you look back at the emergence of China as a regional power, from the very start—when Mao was still alive and was then succeeded by Deng Xiaoping—its intelligence community focused on China’s economic growth. It was not particularly interested in what we would see as strategic or political intelligence. There is a famous passage in Kissinger’s book on China in which he is talking to Mao and Mao says to him, “We’re not interested in your politics because we have our own ideological view of the world, and I don’t really care what our intelligence service reports about what’s going on in the west.” What he did not say, but what was quite clear because it became evident subsequently, particularly under Deng Xiaoping, was that the primary purpose of the Chinese intelligence machine outside China was to contribute to the economic rebuilding of China.

We in the West have been, over a longish period of time, pretty naive and had forgotten the fundamental dangers of having a close relationship with China. I am not anti-Chinese or a cold warrior. I understand—and this is the complexity that lies at the heart of this legislation—that our economies in the West are tied to China’s. They are intertwined in a manner that did not exist during the cold war between the United Kingdom and the Soviet Union. Of course there were economic links with the Soviets but essentially the relationship was one of separation. But that is not the case any longer. We are intimately engaged with the Chinese economy. Our enthusiasm—I am using “our” in the broadest sense of the West’s enthusiasm—to trade with China and to have a close relationship and to build that relationship is thoroughly understandable, but in the process we have let down our guard and we have been extremely *laissez-faire*, as it were, in our attitude towards the commercial threat from China.

I remember very well on one of my visits to the far east, when I was coming out of China through Hong Kong, talking to a British lawyer who had been head of a legal office in Shanghai for a long time. He said, “Richard, you have got to understand one thing about the Chinese attitude to us: they don’t understand win-win. All they understand is ‘We win, you lose.’” However intimate and successful your relations with China may be economically, if you are too successful, you can absolutely guarantee that the Chinese will transfer that success to themselves in their own economic structures, having allowed you to run successfully for a period of time.

What we now know and understand is that the Chinese are highly organised and strategic in their attitude towards the West and towards us. For example, some of the thousands of Chinese students who are being educated in Western universities, particularly in the UK and the United States, are unquestionably organised and targeted in terms of subjects—I am thinking more about graduates, PhDs and post-docs—looking at areas of strategic interest to the Chinese economy, and they are organised by Chinese intelligence.

We need to conduct our relationship with China with much more wisdom and care. The Chinese understand us incredibly well. They have put their leadership through our universities for 20 or 30 years. We in comparison hardly know anything about China because we just do not have that depth of knowledge and experience. You have people such as Charlie Parton and many wonderful Chinese scholars who understand intimately, in particular, the workings of the Chinese state, but they are rare individuals who are now massively in demand in trying to educate people about the problem that we have on our hands.

I am not one who is saying that we have to hold China at arm’s length. It is impossible to do that because they are so intimately involved in our economy, but we have to understand where we restrict their access, where we control their access and where we do not allow them to build strategic positions at our expense and literally take us for a ride. If you go back a little way, we were incredibly naive about this, which accounts for the position we got into with Huawei. It was completely ridiculous that we should even have been considering Huawei to build our 5G. That is probably why you called me. I was heavily involved in lobbying MPs through these various structures. I am delighted that the Government have now taken a grip on this issue.

**The Chair:** Thank you. I have no leeway to go past 11.25 am, so please can we keep questions as succinct as possible.

**Sir Richard Dearlove:** Sorry. That was a long answer, but it is precisely the question one should be considering.

**Q22 Chi Onwurah:** Absolutely. I appreciate the response and I would like details of the Soviet case of the military-industrial complex that was dismantled, which you mentioned. That would be interesting to compare.

You have talked about the relationship between the military-industrial complex, in the case of Russia, and economic development, specifically in the case of China. We have essential industries that are critical to our economy and there has been concern that BEIS is going to be overseeing the security implications. Where we have industries and technologies that are critical for national security, they are also critical for our economic security, so our national and economic security end up being linked. You have talked about some of those links in the case of Russia and China. How can we reflect those links effectively in the Bill? Do we need structures within BEIS, or outside BEIS, to identify and reflect the overlap between economic and national security?

**Sir Richard Dearlove:** This is a really difficult question. I am expressing the problem, not the solutions. You have to bear in mind that I spent my life as a poacher, not a gamekeeper, so my view of these problems is mirror imaging. I was an offensive intelligence officer, not a defensive one. I spent my life trying to penetrate Chinese intelligence, if you see what I mean.

The problem is much bigger than just national security; that is one of the difficulties. It leaches into the whole future of our economic competition with China. I do not like to talk about it, but some people use the phrase “a new cold war”. I do not subscribe to that. We have to find some other way of talking about this. They are very serious competitors who are beginning to edge along

the path of enmity in the way they treat us on some issues—witness Hong Kong at the moment—so you have to have some sort of flexible scrutiny arrangement.

The reason this is so difficult to comprehend is that areas like climate change and energy policy, which are national security issues but not right on the frontline, are so big that, I think, China has a pretty disturbing agenda for us. They will encourage us to follow policies that they think are disadvantageous to our economy.

If you take their statements on things like climate change, which is relevant to what we are talking about, China is going to go on increasing its carbon emissions up until 2030, if we look at the figures and understand its policies. China is going to completely miss out renewables. When it has generated enough wealth and success in its economy, it is going to jump from carbon energy straight to nuclear and hydrogen. It will have the wealth and the means to do that. Renewables for the Chinese are going to be rather peripheral, because they will not generate the energy intensity that the Chinese economy requires. China has a road map in its head that is really rather different from ours and there is no question but that, competitively, our green agenda is going to put us at an even greater disadvantage to China, if you take a 30-year view of that.

There are some very worrying aspects of this. That means that if we are gaily allowing the Chinese to walk off with all sorts of bits of our economy, we are going to pay possibly a pretty high price for that over a long period. We need to take a strategic view of this. China certainly has a strategy, and at the moment we do not really have a strategy. We are beginning to realise that we have to have one, and maybe this Bill is a healthy first step in that direction.

You will need sub-committees of some sort, with flexible thinking and experts to advise on where these problems lie. The difficulty is also that we do not want to ruin our economic relationship completely with China. We still need to partner with it in areas that are advantageous to us and our economy as well.

**Q23 Nadhim Zahawi:** The Bill provides for an annual report to Parliament, Sir Richard. What is your view on balancing transparency and ensuring Government can take national security decisions sensitively? Where does that balance lie in terms of our ability to be as transparent as we can without harming sensitivities around these decisions?

**Sir Richard Dearlove:** My view would be that the annual report has as much transparency as possible, but you are probably going to require a secret annexe from time to time. It is a bit like the reports of the Intelligence and Security Committee, which I dealt with frequently as chief. They and we were keen that they should publish their reports, but there comes a point where it is not in our national interest that some of this stuff is put in the public domain. I would be pretty clear cut on that.

**The Chair:** I call Peter Grant, who will be behind you, Sir Richard, because of the social distancing rules we have in Committees.

**Q24 Peter Grant:** I think this is the first time I have had to stand further away from somebody to speak to them. Thank you for your attendance today. We have heard

a lot this morning about the threat from China and a bit about the threat from Russia. There may well be other hostile states out there that have their eyes on us. There are certainly hostile non-state enterprises that have their eyes on us. Is the Bill wide-ranging enough to allow the Government to respond to all those different kinds of threat? Does it allow enough flexibility to respond to the threats that we have not yet discovered, that we do not know about or have not yet been invented?

**Sir Richard Dearlove:** Obviously, the threat scenarios shift and change. I think I accept that. Clearly, at the moment, what is driving our considerations is mainly China, but you are right. It applies to others—Iran, North Korea—and there may be other states.

A good example in the past, not a current one, is Pakistan. The Pakistani bomb built by A. Q. Khan—the Khan Research Laboratories—was created by sending 600 Pakistani PhD students to do separate bits of research in different universities around the world. That is the origin of our thinking on counter-proliferation, and it is another very clear example of where you have to have control from the security services. Now, I believe, we register PhDs in relation to the nationalities studying in certain areas.

The Bill should be able to accommodate a changing set of scenarios, and you are right to say that non-governmental organisations can become problematic. The proliferation issue, whereby Khan was trying to sell his technology to other countries, happened around the time of my retirement and the disarmament of Libya. That was all based on Pakistani technology, but there was a commercial network run by a family of Swiss engineers called the Tinner. This is an example of how dangerous things can be. The Tinner network had several semi-clandestine factories dotted around the world that were all making different parts for nuclear centrifuges. Okay, that network was eventually dismantled by the UK and the Americans, but the problem of national security goes into some pretty odd areas, and you are right to identify those as not necessarily just being China or, in the past, Russia. There are still aspirations on the part of certain powers to break the non-proliferation treaty and become nuclear weapons states.

**Q25 Mark Garnier (Wyre Forest) (Con):** It is a pleasure to serve under your chairmanship, Mr Twigg. Sir Richard, I want to ask some questions about how the Bill and the mechanisms that make it operate cut across certain other parts of Government Departments. That is clearly looking at how we can scrutinise investments coming into the UK, but we also have a department with respect to export control. Broadly speaking, this is quite a similar type of problem. Although it is not necessarily looking at intellectual assets, it certainly looks at the ability of countries that are buying certain things to reverse-engineer, and therefore to try to steal our intellectual property in that way.

I am interested in your view on how the department that is proposed to be set up within BEIS to scrutinise this cuts across the Export Control Joint Unit, which is obviously a combination involving four Government Departments. Is that complementing it or contradicting it? Can they cut across each other? How do you see those two departments working together? They ultimately have the same aim, although they come from slightly different objectives.

**Sir Richard Dearlove:** I cannot give you a detailed answer to that question. From my experience, I would say that on some of these issues the co-ordination of Government Departments is one of the really big challenges, particularly when they ultimately have different objectives. The sophistication of our co-ordination mechanisms in the UK has not been highly developed, so we have run into problems in the past. My suggestion would be that this be given forethought rather than afterthought—that there is some arrangement to avoid those clashes of departmental interest.

**Q26 Mark Garnier:** I would not want to put words in your mouth, but it sounds like you would suggest that this Committee urge the Government to look at the possibility of developing relationships between those two departments, so that they are not contradicting each other.

**Sir Richard Dearlove:** Yes, because they could be pulling in different directions. You have to have some degree of co-ordination. It is always better if these things are anticipated and something is put in place in advance, rather than scrabbling around to sort it out afterwards. I have seen that happen a lot.

**The Chair:** We are back to facing the front now, Sir Richard. Most members of the Committee wish to speak and I want to get everyone in, but I will have to cut them off at 11.25. Keep questions as succinct as possible.

**Q27 Matt Western:** I want to pick up on a couple of points. You spoke about energy policy and, as we have seen over the past nine months, some of the risks and threats to our society and economy come from unexpected places. Do you think that the Bill does enough to recognise where those threats may come from and that they may be from a malign power?

I am thinking of the consideration of investments from China in our nuclear power stations and other infrastructure networks. Something as simple as road traffic signals or rail infrastructure might break down if someone decided they wanted that to happen. Do you think the Bill does enough to recognise the unexpected areas of investment that a malign state might want to attack?

**Sir Richard Dearlove:** Probably not is the answer. The Bill should take account of the complexity of modern technology and the difficulties that we could run into in the future if we allow foreign entities to have a strategic piece of our critical infrastructure. Relationships can change over time and you can cause huge difficulties by throwing a switch and engaging a piece of software that is deeply embedded in something somewhere and causing a huge problem.

I do not want to be too alarmist, but Chinese engagement and involvement in nuclear power is another area of terrific concern and worry. It is not something that we should take at face value. We need to think very carefully about some of these issues. I would much rather have a French company building a nuclear power station than a Chinese company.

**Q28 James Wild:** You mentioned Huawei. Were you involved in 2003 when BT was letting the contract for the network? Did you raise concerns at that point?

**Sir Richard Dearlove:** No, I was not. The first Huawei contracts were signed by BT in 2003 and, because BT was the primary provider, the relationship between BT and the intelligence community was, let us say, important; I will not go any further than that. BT was a successor to the General Post Office and, essentially, that was how the relationship came about.

At the time, people like myself were deeply concerned and shocked that we were signing deals with a Chinese company that looked to us to have strategic implications. Basically, as chief, I was not consulted. Basically, when I raised some questions, I was largely told, “It is nothing to do with you. These are issues we can control.” The relationship with Huawei took off without real consideration at the time that it would have a bearing on national security. I think that was extremely misplaced. I have written or said somewhere before that those of us who raised objections in 2003 were just disregarded.

**Q29 James Wild:** Well, the ISC report makes clear that Ministers were not informed about the contract at all at the time.

**Sir Richard Dearlove:** I knew about the contract and said I thought it was completely inappropriate.

**Q30 James Wild:** In the Bill, there are 17 sectors listed where mandatory notifications are required. They include transport and communications, as in some of the points that Mr Western was raising. Should others be added to that?

Also, do you think that although we need to look at the Bill as to what it does, we should also recognise that it does not solve all the problems and threats from hostile states—that the intelligence activity and other things we do to raise the cost of theft of IP need to be seen holistically across the piece, and that the Bill cannot solve all the problems?

**Sir Richard Dearlove:** The Bill is a step in the right direction. What is important about the Bill is that it raises parliamentary and public awareness of the issue. Everybody takes a big step forward in being sensitised to the problems in the future.

To be honest, I do not have any suggestions right now to add to the list, but I might look at that and see whether there are certain areas. For me, the Bill is almost a symbolic move—one that is long overdue and signals a change in attitude at Westminster and on the part of this and future Governments. It is a very healthy, pleasing and important development.

**Q31 Stephen Kinnock:** Thank you very much, Sir Richard, for the evidence that you have given us today. The Intelligence and Security Committee defines critical national infrastructure as

“certain ‘critical’ elements of infrastructure, the loss or compromise of which would have a major, detrimental impact on the availability or integrity of essential services, leading to severe economic or social consequences or to loss of life.”

Would the Bill benefit from having that definition of critical national infrastructure embedded in the middle? Linked to that definition, should special measures be taken to raise our guard even higher when it comes to any kind of investment in our critical national infrastructure?

**Sir Richard Dearlove:** I would certainly see that as advantageous, because it defines a clear area where you start and from which you can make judgments about

the involvement of foreign firms being given space or activity in those areas. That is not a bad idea at all, actually.

**Stephen Kinnock:** I know time is short, so thank you.

**Q32 Simon Baynes:** Thank you, Chair. Thank you, Sir Richard. When and why did we let down our guard to China and where would you restrict its access? You made that comment in your statement, and you have commented already on areas such as nuclear power. Can you add to that to give us a bit more of an idea of other strategic areas where you think we should restrict its access?

**Sir Richard Dearlove:** I think we were over-enthusiastic about becoming a favoured trading partner with China. I am not going to name names, although I think I have done in one or two instances where, let us say, certain Ministers were incredibly enthusiastic and uncritical about building a commercial relationship with China. Part of that was driven politically, in that if we are going to not be a member of the EU, we need alternative relationships. I am not sure I would see it quite like that.

There has been a big emphasis on building a privileged position with China, which has led to people such as myself shouting from the sidelines and being pretty unpopular. For example, the 48 Group Club that the Chinese set up in the UK is extraordinary. They recruited a whole group of leading British business and political figures into that group who were designated cheerleaders for a burgeoning relationship with China. Huawei was an important part of that. The composition—the British membership of the Huawei board—was a very impressive line-up of people who were there to persuade us to drop our guard.

Anyway, I am glad that that is now largely history. A lot of the people who were involved are very keen to jump ship and be disentangled from those involvements. I am sure that, in time, the economic rewards that they were offered to go on to those boards and things were pretty significant. So the Chinese knew how to play us and that is why we got ourselves into this very difficult position on 5G.

Sorry, what was the second part of your question?

**Q33 Simon Baynes:** The second part was: can you say a bit more about where you would restrict their access, because that was one of your key points? You have mentioned nuclear power.

**Sir Richard Dearlove:** On artificial intelligence, given that the UK is a leader in its own field, there are all sorts of aspects of AI and we would not want to allow the Chinese to buy those companies or take over the technology. There is no question but that the China dream that Xi Jinping has expressed is based on—let me put it like this—authoritarian technological supremacy and having a capability that dominates the global market in those areas. Huawei was definitely a step in that direction.

The critical areas are largely about the speed of technological advance and AI-related companies. We are very sophisticated in those areas, and the Chinese do not have a good record themselves of developing that sector without pinching it from the west—not to put too fine a point on it. The embargo placed on chip manufacturing by the Americans is a serious problem for China, because at the moment they cannot replicate that. I am sure that they will solve the problem themselves

in due course. Of course, we have a certain dependence on them for certain things such as rare earth elements, so the quicker we can develop alternative sources, the better.

I am Cornish—I was born and brought up in Cornwall—and I see that one area where you might, using new technology, get rare earth out of the ground is Cornwall. I am devoted to the development of the Cornish economy, and I would love to see us making a real effort to develop Cornwall, for example, as a source of those elements, which is technically possible. It would be more expensive than buying them from China, but would be of huge benefit to our domestic economy. That is a good example of a sensitive area.

**The Chair:** I call Andrew Bowie. This will probably be the last question.

**Q34 Andrew Bowie:** I will be brief. Thank you for commenting. It is a real privilege to listen to you and take on board everything you said regarding our naïveté and the intertwining of our two economies, nowhere more so than in the North sea, where CNOOC, China's national oil company, initially through Nexen, a Canadian company—this is going back to something my colleague raised earlier—is now the biggest producer of oil. Allowing what some might describe as a hostile actor to have such control over our energy security is incredible—very naïve.

I was going to ask you a question I put to Mr Parton, although it is probably more relevant to you. How does what the Bill proposes compare with what is being done in other, comparable countries, such as our Five Eyes partners? Does it go as far as the Australians and the Americans, or are we still some way short of where we should be?

**Sir Richard Dearlove:** No, I think we will catch up. A very good example for us is Australia. They are hyper-dependent economically on their relationship with China, but the current Australian Government had the resolve to take a tough line on strategic issues, and they have suffered as a consequence. But their relationship with China will come back into balance, so the idea that you cannot be hard with the Chinese on these issues because it will prejudice a good trading relationship is rubbish.

The Chinese will probably respect you more if they know you mean business, they want a clear-cut relationship, and they see you have the legal means to impose that domestically, so they cannot just buy a high-tech company and walk off with the intellectual property, thank you very much. In the past, we have been so laissez-faire, it is ridiculous.

Chinese involvement in the oil industry is an interesting example too—I mean, look what they are doing now. They are doing deals with Iran and with Saudi Arabia on carbon fuel, exactly in the way I explained earlier. They are not going to cut their fuel emissions until they are ready to go for a nuclear-hydrogen economy, which they will have the means to do. We are sitting by and watching it happen, in a manner of speaking, and not worrying about the consequences for us.

One of my friends, who is a Chinese scholar, drew my attention—you will enjoy this, I think—to the 36 stratagems from the era of the warring states, which is 481 to 221 BC. I will mention three of the stratagems, because I think they are appropriate to the thinking of this

Committee. Kill with a borrowed sword—that is, get what you can. Loot a burning house—bear that in mind in terms of taking advantage of the current pandemic. The third one is hide a knife behind a smile.

**The Chair:** We have two minutes left for anyone who wants to get a quick question in.

**Q35 Sam Tarry** (Ilford South) (Lab): It is an honour to serve under you, Mr Twigg. We have focused mainly on China. Thinking about regimes we could put in place to govern all this as we work through the Bill, do you think there could be exemptions—a bit like the US has done for potential allies? Could we have almost a graded system, so we can build relationships quicker and faster with those we want to support, or do you think that would be a bad idea?

**Sir Richard Dearlove:** You are talking about allied countries?

**Sam Tarry:** Obviously, if you are involved in global universities, for example, there will be some countries that we want to keep a much better relationship with, and whose students our intelligence services will have to monitor less.

**Sir Richard Dearlove:** There is definitely a graded difference in, let us say, our burgeoning relationship with India, but India can also raise some strategic security concerns for us. It has not always been entirely friendly, and bear in mind that it has quite a sophisticated weapons programme of its own. However, it would be wrong to treat India in the same way as you treat China; I agree that there is a gradation of treatment.

**The Chair:** That brings us to the end of the time allotted for the Committee to ask questions. On behalf of the Committee, I thank our witness very much for his time.

Before we finish, I want to read a message out to Members. I would appreciate it if Members did their best to arrive in the room a few minutes before this afternoon's sitting starts at 2 pm, to ensure we can be seated in a socially distanced manner so that everybody remains safe.

11.25 am

*The Chair adjourned the Committee without Question put (Standing Order 88).*

*Adjourned till this day at Two o'clock.*



# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT  
GENERAL COMMITTEES

## Public Bill Committee

# NATIONAL SECURITY AND INVESTMENT BILL

*Second Sitting*

*Tuesday 24 November 2020*

*(Afternoon)*

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### CONTENTS

Examination of witnesses.

Adjourned till Thursday 26 November at half-past Eleven o'clock.

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**not later than**

**Saturday 28 November 2020**

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**The Committee consisted of the following Members:**

*Chairs:* † SIR GRAHAM BRADY, DEREK TWIGG

- |  |   |
|--|---|
| † Aiken, Nickie ( <i>Cities of London and Westminster</i> )<br>(Con) | † Onwurah, Chi ( <i>Newcastle upon Tyne Central</i> ) (Lab)   |
| † Baynes, Simon ( <i>Clwyd South</i> ) (Con)                         | † Tarry, Sam ( <i>Ilford South</i> ) (Lab)  |
| Bowie, Andrew ( <i>West Aberdeenshire and Kincardine</i> )<br>(Con)  | † Tomlinson, Michael ( <i>Lord Commissioner of Her Majesty's Treasury</i> )                                     |
| Fletcher, Katherine ( <i>South Ribble</i> ) (Con)                    | † Western, Matt ( <i>Warwick and Leamington</i> ) (Lab)   |
| † Flynn, Stephen ( <i>Aberdeen South</i> ) (SNP)                     | Whitehead, Dr Alan ( <i>Southampton, Test</i> ) (Lab)   |
| † Garnier, Mark ( <i>Wyre Forest</i> ) (Con)                         | † Wild, James ( <i>North West Norfolk</i> ) (Con)   |
| † Gideon, Jo ( <i>Stoke-on-Trent Central</i> ) (Con)                 | † Zahawi, Nadhim ( <i>Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy</i> ) |
| † Grant, Peter ( <i>Glenrothes</i> ) (SNP)                           | Rob Page, Yohanna Sallberg, <i>Committee Clerks</i>   |
| † Griffith, Andrew ( <i>Arundel and South Downs</i> ) (Con)          | † <b>attended the Committee</b>   |
| † Kinnock, Stephen ( <i>Aberavon</i> ) (Lab)                         |   |

**Witnesses**

Dr Ashley Lenihan, Fellow, Centre for International Studies, London School of Economics

Michael Leiter, Partner, National Security; CFIUS and Foreign Investment Reviews; Cybersecurity and Privacy; Congressional Investigations and Government Policy; Skadden, Arps, Slate, Meagher and Flom LLP and Affiliates

David Petrie, Head of Corporate Finance, Institute of Chartered Accountants in England and Wales

Chris Cummings, Chief Executive, Investment Association

## Public Bill Committee

Tuesday 24 November 2020

(Afternoon)

[SIR GRAHAM BRADY *in the Chair*]

### National Security and Investment Bill

2 pm

*The Committee deliberated in private.*

#### Examination of Witness

*Dr Ashley Lenihan gave evidence.*

2.3 pm

**Q36 The Chair:** Members can sit in any seat where there is not a “Do not sit here” sign. Any Member sitting in the Public Gallery should stand by the microphone when they wish to speak.

We will now hear oral evidence from Dr Ashley Lenihan from the Centre for International Studies at the London School of Economics. Thank you for joining us today. Can you hear me now?

**Dr Lenihan:** I can hear you now.

**Q37 The Chair:** We have until 2.45 pm for this session. Will you please introduce yourself for the record? I will then call Committee members to ask questions.

**Dr Lenihan:** First, let me thank the Committee for including me in today’s evidence-gathering session. My name is Dr Ashley Lenihan and I am a fellow at the Centre for International Studies at the London School of Economics, as well as an associate at LSE IDEAS. My research for almost 20 years now has focused on foreign direct investment and national security.

**The Chair:** Thank you very much.

**Q38 Chi Onwurah** (Newcastle upon Tyne Central) (Lab): Thank you very much, Dr Lenihan, for putting your expertise at the disposal of the Committee. I am particularly interested in your expertise in the international aspects of the debate. As you are aware—the Bill responds to this—a number of the UK’s allies have national security and investment screening regimes, and almost all of them have updated their regimes in the light of the changing geopolitical and technological contexts. From your comparative work, what governance and decision-making structures have you found others adopting to ensure that all relevant Government expertise shapes national security and investment decisions? Are they appropriately reflected or considered in the Bill?

**Dr Lenihan:** That is an excellent question. To answer it, I will first step back for a second and say that the Bill is a very important step in the UK’s alignment with its closest allies on this issue, and especially the Five Eyes, because there is clear evidence that states are trying to use the market and companies over which they have control and influence to gain economic, technological and even military power in foreign investment. During times of economic downturn and crisis when asset prices are low, the opportunities for that type of behaviour increase. Hence, we have seen these modifications to regimes not only in the West, but outside the West as well.

I think one of the most important elements of regimes as they have evolved—especially among the Five Eyes, but among our NATO allies and even in Russia and China—is the move to ensure that review mechanisms have the institutional capacity and resources that they really need behind them. Part of this institutional capacity usually involves a multi-agency review body of some type.

There is always a lead organisation, and in the West—especially in the US, Germany and France—these tend to be in Treasury or in business or trade Ministries, and that lead body, like the Department for Business, Energy and Industrial Strategy in the Bill, receives the information and handles the day-to-day activity. However, in the US with the Committee on Foreign Investment in the United States, the idea behind having a multi-agency review body with multiple agencies and Departments across vast areas of Government is that you have the ability for regularised monitoring and feed-in from these agencies across the spectrum of possible threats, and you have dedicated staff within those agencies who have the necessary security clearances, training and specialised knowledge over time to keep an eye on potentially risky transactions and bring them to the awareness of the lead agency.

One of the key elements of CFIUS that has been very positive is that, as it has evolved, it has brought in more agencies, not less, so you have multiple opinions on the same potential transaction being brought to light and discussed before any decision needs to be taken by a Secretary or Head of State, depending on the question. In CFIUS, that responsibility ultimately lies with the President, but the idea is that you have had a multiplicity of views and, under the Foreign Investment Risk Review Modernisation Act—the most recent update of US legislation—you have an ensured national security risk assessment made by the head of intelligence on detailed investigations of certain transactions.

The idea behind this is that—hopefully—any decision made will be viewed by the public as one that is truly based on national security concerns because of the debate that had to take place behind the scenes. That lowers the risk of politicisation and intervention, and again heightens the possibility of actually catching risky transactions in a way that otherwise can be difficult.

One of the great examples of transactions in the US caught not originally in the regularised monitoring process, but by a CFIUS employee in one of the agencies, was the unwinding in 2011 of Huawei’s purchase of 3Leaf, which was a US-based cloud computing technology company that had gone bankrupt. The assets, employees and patents had been purchased by Huawei—bankruptcy assets were not consistently monitored by the regime at that time. The purchase was caught by a Government staffer who happened to notice on his LinkedIn account that somebody whom he knew, who had partially run 3Leaf, was now listed as a consultant for Huawei. That transaction had to be reviewed and retroactively unwound. At that point, of course, one must assume that the bulk of the damage had been done, but it goes to show the importance of having not just one agency looking at these cases and being responsible; a multiplicity is needed across the piece. If I have any concerns with the Bill, my primary concern would be that the institutional capacity and resources behind the review regime are not made clear.

**Q39 Chi Onwurah:** Thank you, Dr Lenihan. That is absolutely fascinating. The need for different agencies to be involved needs to be recognised.

In terms of your work on investments, and the investment regime, is there not a risk that it ends up capturing a host of investment transactions? I am particularly thinking of the burden and impact on our innovative tech start-ups. The likely definitions of the sectors to be involved include artificial intelligence and data infrastructure. Based on your experience of other countries' introduction of new investment screening rules, have you found patterns in how similar changes have affected foreign direct investment, and potential trade deals, which is a topical subject? Do you have any thoughts on ways to mitigate the burden and impact, particularly on start-ups?

**Dr Lenihan:** The Bill is arguably broader in scope on call-in powers than some other foreign direct investment regimes—I would argue that these perhaps even include the US regime—because it does leave wide latitude for call-in powers. The Bill also covers trigger events that are initiated by all investors, both domestic and foreign, and that is truly rare among Western FDI review regimes that are focused on national security. Usually, the concern is to focus the regime on investments from foreign-owned, controlled or influenced entities. Domestic entities and acquirers that have, for example, ultimate foreign ownership or influence in some ways should be able to be caught by any well-institutionalised and resourced regime. I am not sure why it is that we do not actually see the word “foreign” in the Bill, even though it is supposed to be based on foreign direct investment. Perhaps that is a concern about potential domestic threats down the road, but either way, it will lead to a much larger volume of mandatory notifications than most other national security FDI regimes—the US, Germany, Australia and other countries. Almost 17 have made changes in the past couple of years, and these have increased and been modified since the covid pandemic.

I understand that the legislation may be written as it is to include domestic investors, perhaps to avoid appearing to discriminate against foreign investors. I would suggest that that is probably too broad a formulation for focusing on and identifying real risk. The EU framework for FDI screening encourages its EU members to adopt mechanisms that do not discriminate between third-party countries, but that does not mean that it takes the word “foreign” out of its legislation to target foreign investments as opposed to domestic ones. Part of that is about the volume of transactions.

One thing I would highlight is that FIRMA expanded the scope of covered transactions to include non-controlling investments of potential concern, as well as any other transaction or arrangement intended to circumvent CFIUS's jurisdiction. But because it has had more cases to review on a detailed level in the past two or three years than in its history, since 1975, a major element of that Act is, again, around staffing and resources. There is a specific provision in FIRMA, which is very clear that each of its agencies needs to hire under-secretaries in each agency just to be dedicated to this task.

There are two elements. An inter-agency review team is needed. You need enough staff to actually handle and catch all the risks. You need the proper resources to do so—the right access to the databases, the right security clearances, the right training. On top of that,

the volume of mandatory notifications will be increased by the fact that this is not just focused on foreign investment. I do not think there is much you can do about the foreign cases that you will get. There will be a high volume of those, and you need to be ready for them, but it is an important national security risk that needs to be dealt with.

**Q40 The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Nadhim Zahawi):** It is a pleasure to serve under your chairmanship, Sir Graham. Dr Ashley, considering your experience of other countries—we talked about the US at length in the first couple of questions—such as Japan and Germany, what are your views on the retrospective powers under our Bill?

**Dr Lenihan:** Personally, I think they are fine. I know that might not be a popular answer with some. Germany, France and even parts of the EU framework set up this five-year retroactive for cases. I think that that is at minimum important. Other countries, such as China, Russia and the US, do not place any limit on retroactivity. I would have to check up on Australia and Canada, but there have been cases that have gone beyond a year there. Under the original Government White Paper, the idea of having only a six-month period, whether or not you have been notified, is quite dangerous, because there have been cases that were well known where they have been caught after that point.

Some of my examples are from the US. The reason for that is that it is one of the longest-standing and most institutionalised regimes. It is also one of the most transparent, from which we know most about the cases that have gone through it. I have looked at over 200 cases of this type of investment over a seven-year period in the US, UK, Europe, China and Russia. One case that stands out in the US is the 3Leaf acquisition by Huawei, which was caught almost at the year mark. Another good example that went over the one-year mark would be the review in 2005 retroactively of Smartmatic, which was a Venezuelan software company, and its purchase of Sequoia Voting Systems, which was a US voting machines firm. Smartmatic was believed to have ties to Chavez. However, that acquisition completed without knowledge of CFIUS and it was not actually able to be unwound until 2007. At that point, you worry about what has happened, but at least you do not have the ongoing concern.

You do need flexibility. With the volume of notifications and the learning curve that the investment security unit will have to undergo, or whatever the final regime truly looks like, it will take time to get the team in place and get the knowledge and systems down, to accurately catch even the most obvious investments that are of concern. Dealing with the kind of evolving and emerging threats we see in terms of novel investments from countries such as China, Russia and Venezuela needs the flexibility to look at retroactively and potentially unwind transactions that the Secretary of State and the investment security unit were not even aware of.

One thing is that for mergers and acquisitions transactions, which are historically what have been covered under these regimes, across Europe, Australia, Canada, Russia, China and the US, all the systems that have been used—the M and A databases: Thomson ONE, Zephyr, Orbis—take training, but they only cover certain

types of transaction. They do not cover asset transactions; they do not cover real estate transactions, which are of increasing concern, especially for espionage purposes.

It is going to take time, and I believe that flexibility really needs to be there. It can always be reviewed in the future, but I do not think that so far foreign investment has been deterred in any way in countries that have that retroactive capability. To limit the UK's capacity to protect itself for some kind of strange feeling that we need to be perceived as being even more open than everybody else when under threat is not really wise at this time.

**Q41 Matt Western** (Warwick and Leamington) (Lab): It is a pleasure to serve under your chairmanship, Sir Graham. Dr Lenihan, I am keen to know more about whether, other than in the US, you have seen good exemplar approaches to screening investments into these sectors; we spoke about Japan and Germany a moment ago. Can you give examples which we might learn from?

**Dr Lenihan:** I do think the US system is the most institutionalised that we have, and the best at the moment. That being said, Germany's system is very good; it has caught quite a bit. The German system has also been very good about regularly updating, changing and adapting its regulations as it sees new emerging threats to itself. They seem to have good feed-in across Government and they are exceptionally good at co-ordinating with other states in terms of information of concern.

In terms of national security review, Canadian and Australian systems are quite good. The problem with those systems is that they tend to do national interest reviews at the same time or in tandem with their national security reviews. Over the long term, including national interest in the regime has had an impact on how they are perceived in terms of their openness to foreign direct investment abroad. In the OECD's FDI restrictedness index, Canada and Australia rank far lower than the US, the UK, Germany and France, and I think this is because of their inclusion of national interest concerns. Similarly, on the World Economic Forum's global competitiveness index, they rank far lower. That does not provide investors with the type of clarity that they need. In general, we see that investors tend not to be dissuaded from investing just because there is a new foreign direct investment regime, as long as that regime is seen to have clear regulatory guidance, is transparent, and is applied consistently over time.

France sometimes gets quite a bad reputation for economic nationalism, but its review mechanism is also quite good at catching potential threats to national security. Japan is an interesting case. It has been so restrictive for so long that it is a little harder to compare with the other western countries. Its system has been tied in again to an overarching inward investment regime that has been restrictive towards foreign investment for other means beyond national security, so I find that country to be less of a comparator for these purposes. I hope that answers the question.

**Q42 Simon Baynes** (Clwyd South) (Con): It is a pleasure to serve under your chairmanship, Sir Graham.

I have found your comments particularly interesting, Dr Lenihan. My own background is in the financial world, where I was involved in cross-border M and A and quoted equity transactions. I fully accept the premise of the Bill, which I think is important and has to be put

into effect, and I draw encouragement from what you are saying about other regimes, but I am still left wondering a little bit whether, in practice, it will be really quite difficult for us to put into effect. Your point about the necessity of expertise among staff is crucial. Having sat at the centre of the process, I recognise that the point you make about a huge amount of information flowing across, especially in respect of unquoted companies, is very important; often, there is not much established information in the public domain. That first point is very important. The second point is that there is a very complex mechanism of market sensitivity as well. I do not quite know how this system intervenes with that. Also, within the UK itself there is a culture of openness, which has been touched on before, and in some respects we are a very different country from the others, particularly given the strength of the City of London. We therefore have the ability to transact in a way that some other countries do not, and a different culture.

The other point I wanted to raise and to hear your comments on is that there is a danger of political interference. I know that that is not the intention, but it must be a hazard in this process. What happens if the Government get it wrong about a company? Could not that be interpreted as political interference rather than seeking to establish a security risk?

**Dr Lenihan:** I started my career in mergers and acquisitions in aerospace and defence M and A, in London. I think you make an important point: the UK has historically been the most open country to foreign direct investment on most indices and indicators. That perception is strong, and I do not think that that culture of open investment will or should change with the introduction of the regime. To the contrary, it actually gives you one of the best starting points that any country has to do this.

As I said, on the whole, in the Bill as written, and in the statement of policy intent behind it, it is very clear that the powers for review and intervention should be used only for an identified risk of national security, and not on the grounds of national interest. Regimes that are based only on national security, like that in the US but also Germany and France—even with a very different culture in many ways—have not seen a lowering of levels of foreign direct investment over time, because they have introduced, modified or kept these regimes up to date. It is because, on the one hand, the stable environment that they provide and that the UK will definitely provide for foreign investors, is far more attractive than any uptick in cost from having to get up to speed on a new regime; also, they are able to retain these global perceptions of openness to foreign investment and ease of doing business because of the way in which the rules are applied. As long as the rules are applied consistently, and with clear reasons behind their use, and applied consistently and transparently over time, it should be okay.

The Bill provides for a lot of regulatory guidance, which needs to come forward in a clear and very easily comprehensible and understandable manner. As long as that happens, it should be okay. Global Britain should still be the proponent of liberal economic values that it always will be, while also being able to demonstrate to itself and to its allies that it is able to protect itself from this type of investment.

Going forward, Britain's relationship with many of its Five Eyes allies is going to depend on having a comprehensive regime of this nature that is used well. Under FIRMA, under US law, for example, the UK is an exempt foreign investor in certain categories—one of three with Canada and Australia. It has been stated that for that to continue—it is going to be reviewed—it needs to have a regime to protect itself. We can talk about this later, but part of that is about the potential concern about not just the ability to share intelligence on these issues, but about acquisition laundering, export controls and all these issues that tumble on behind that can affect investment, trade and intelligence-sharing relationships over time. That is important.

The research evidence shows that foreign investment is not deterred unless there is a problem in how this is applied. There has been politicisation of cases; demonstrated proportionality of response is also extremely important. There are many cases in which a threat to national security can be mitigated by agreements and undertakings without needing to block a deal. When you look at the modern history of foreign direct investment intervention across Europe and the US—even if you look at Russia and China and how they behave—the preference is, where possible, to mitigate national security concerns through comprehensive agreements, and that can be done in a host of ways. It can be that you have a board of directors that is only UK nationals, or that you require divestment of a certain black box technology company to another UK company or a friendly allied country. Whatever it may be, historically, there has been a preference for that type of action to be taken. Vetoes of cases are actually quite rare since world war one, when we first really saw this type of issue pop up.

The concern is if we see the UK blocking deals where it could mitigate because a deal has become a political hockey puck. In today's world, where this is something that is constantly discussed in the *Financial Times* and *The New York Times*, whereas it was not 15 years ago, any case has the potential to be discussed widely in the political debate. The question is how it is treated by Government and how other countries perceive that treatment. I know that I have used US examples quite a bit, but if you look at US-China investment, China still invests a lot in the US, even though it complains every time a deal is blocked or mitigated. The reason behind that is because this is a sovereign right under customary international law, and China does the same thing when it has the same concerns. It is only if a case becomes truly politicised that there is an issue.

To give you an example, in 2005 in the US, the case of Dubai Ports World and P&O, which was a takeover of a UK company, became overly politicised in the US system. It is one of the only real examples where it has happened, and that was because there were a few US lawmakers who had a completely different view of the risk and relationship of the US vis-à-vis the United Arab Emirates than the Department of State or the Department of Defence. That is quite rare but what ended up happening was US lawmakers seeking to block a deal when most reasoned professionals in the industry and in various Government Departments thought that any risk could be mitigated simply in a host of other ways.

In the case of overuse, overbalancing, misuse, politicisation, whatever you want to call this tool of economic statecraft, there was a momentary blip in

relations between the US and the UAE. There was a momentary stalling of trade talks, change in the currency basket and some uncomfortable months, but the relationship was strong enough to survive and it usually is. This is not really an aspect of going to war. I think the key is proportionality in response, how it is applied, and it is about consistency and transparency. The Bill is well written in many ways, but how it is used can go any number of ways, so it is about how the UK uses it going forward.

**The Chair:** Thank you, Dr Lenihan. There are lots of Members wanting to speak and we have limited time, so I will try to get through some quickly. I will call Stephen Flynn, Mark Garnier, then Stephen Kinnock.

**Stephen Flynn** (Aberdeen South) (SNP): Thank you for your comprehensive and helpful answers, Dr Lenihan. I would like to divert back to some of the comments that were made about the Bill on Second Reading, particularly relating to definitions, or a lack thereof, in relation to national security. I would welcome your thoughts as to whether the Bill should or should not have a definition.

My second question relates to the scope of the Bill, which you mentioned earlier. In terms of the consultation going on, 17 sectors have been identified. The glaring omission seems to be social media, but I would appreciate your view on whether artificial intelligence would cover off social media to a level that you would be comfortable with.

**Dr Lenihan:** Those are both really good questions that I hoped would be asked. If national security is that which seeks to maintain the survival of the state and preserve its autonomy of action within the international system, unfortunately that means that you cannot necessarily define national security in law without binding yourself in an inflexible way. What we have seen is that most foreign direct investment regimes of this nature all refer to national security. I do not know of a single one that actually defines it or limits itself to a particular definition. I could be recalling incorrectly but I have looked at over 18 of them and I have never seen a particular definition.

What you do see in regulations is guidance as to how national security risk might be assessed or examples of what could be considered a threat to national security. US guidance is helpful on this, in terms of how they put their regulations together. Some have argued that it is too comprehensive—it is a lot to read and provides the lawyers with a lot to do—but it is useful and has meant that the process of knowing when you might be triggering concerns is easy to navigate. I really do not think that the UK wants to define it in the Bill.

There was a US Government Accountability Office report in 2008 examining the foreign direct investment restrictions in 11 countries at that time. Each was determined to have its own concept of national security but none of them actually defined it. In 2016 the OECD did a similar report after a new resurgence of changes in laws, and it looked at 17 countries including Lithuania, Korea, Mexico and Japan, and they came to the same conclusion. The OECD has quite good guidance in general on this and they have not recommended that their countries define national security risk, but they have recommended regulations to help increase transparency around what could be considered a risk.

Regarding the sectors for mandatory notification, I think that is a very good question and one that it is difficult to grapple with in many ways, because the threat is emerging and changing at the very same time that technology is emerging, changing and interacting with our society in various ways. Various countries have been trying to deal with this. In the US, a final rule was just put out in relation to non-controlling investments and situations where you have certain mandatory notifications. A pilot programme was initiated in 2018 to try to define—as your consultation will, in many ways—the proper sectors using North American industry classification system codes, instead of standard industrial classification codes as the UK regulation does.

Whatever codes you use, though, the US found that they had an incredibly high volume of mandatory notifications and were not necessarily getting to the issue that they wanted to. They have changed that under the final rule, and now mandatory notifications in that classification are going to be defined [*Inaudible.*] and would come under certain US export control regimes. The idea behind that is that the US is doing a review of export control regimes, which will try to get to what foundational technologies might be of concern. I think that applies to your question about social media.

Social media is of concern because of the data, and data retention, involved in most social media. As I understand it, the sectors in the Bill will be kept under constant review and can be changed and updated as needed. That is important, and it might be worth doing a pilot programme.

**The Chair:** Dr Lenihan, I was trying to squeeze two more questions in, but I think it will probably be just one.

**Q43 Mark Garnier (Wyre Forest) (Con):** Thank you, Sir Graham. Dr Lenihan, my questions refer back to points you made in response to the first batch of questions. You spoke of the review regime not being quite up to full standard. It is an interesting dichotomy that the Bill sets up a new review regime in BEIS, but there is an export control unit in the Department for International Trade that already looks at arms control, as well as intellectually sensitive exports. I would be interested to hear your comments about how those two play together.

Secondly, it is worth bearing in mind that the Minister, Lord Grimstone, sits in both the DIT and BEIS. He is responsible for investment promotion. We are talking about more acquisitive types of investment, but do you see a potential conflict of interest between the ambitions of the Government to secure more investment into the UK and potentially having the wrong kind of investment?

**The Chair:** Sorry, Mark, but we have about 90 seconds for that to be answered. Please have a go, Dr Lenihan.

**Dr Lenihan:** I would suggest that the investment security unit and the unit that will handle the processing of this regime remain in BEIS. That is fine; however, it would be useful to set up in the Bill some sort of multi-departmental review body that contributes regularly, and that has staff in those Departments who monitor the risks in relation to this concern. As you say, the Department for International Trade will be able to monitor, find and catch risk that others—such as the Foreign, Commonwealth and Development Office, GCHQ and its new cyber unit—cannot.

It would seem very strange to not have a feed-in from intelligence agencies and the Ministry of Defence on a regular basis. If you set that up in an institution that is clear, at least to the outside world, about its composition and makeup, as opposed to having ad hoc feed-in over time, it would help with the perception of openness from the outside. It would also help to counter any claims of an individual or place being politicised or used for some other purpose by a particular Minister, because then they could give a balanced opinion for the Secretary of State in charge to make a final decision.

**The Chair:** Thank you very much, Dr Lenihan. That brings us to the end of the time allotted to the Committee for asking you questions. We are grateful to you for your time. Where members of the Committee wanted to ask questions and were not able to, I will try to give them a bit of priority on the next panel—or in another, if that is helpful.

### Examination of Witness

*Michael Leiter gave evidence.*

2.45 pm

**The Chair:** We come to our fourth panel of witnesses. We will hear oral evidence from Skadden, Arps, Slate, Meagher and Flom LLP and Affiliates. For this panel we have until 3.30 pm. Mr Leiter, I welcome you, and ask you to introduce yourself for the record.

**Michael Leiter:** Good afternoon. My name is Michael Leiter, and I head the national security and Committee on Foreign Investment in the United States practice at Skadden Arps. It is a pleasure to be with you this afternoon.

**Q44 Chi Onwurah:** Thank you, Mr Leiter, for joining us and sharing your extensive expertise with the Committee. I wanted to look at strategic and critical industry. There are a series of cases where nascent or strategically important industries might become critical to national security in the future, but they are important to industrial and economic strategy now. For example, it was not clear that there was a direct national security threat from Deep Mind's artificial intelligence algorithms in 2014, but it is clear that the company was important for the UK then, and it is clear that artificial intelligence is important for national security now. That is reflected in the Bill. Based on other countries, how do you think the Bill can capture these forward-looking public interest or industrial strategy concerns within national security grounds for acting?

**Michael Leiter:** Thank you for the question; it is quite a good one. It is one that the United States has struggled with, as have other countries and their regimes. We suggest a couple of approaches. First, one piece that I think the Bill does quite well—although there is a countervailing concern that has to be addressed—is not having a de minimis threshold, in terms of dollars. The Bill is quite strong in that regard, because as you note in your question, just because someone acquires a start-up company for a relatively modest amount—a few million pounds—it does not mean that that company and that technology does not have, or will not have, very significant national security implications.



The flipside of that is, of course, that without the de minimis threshold, it becomes a far more difficult regime to manage. The volume can be much higher. It can potentially poison venture capital innovation. This is best balanced by not having a threshold for dollars, as you do with the no de minimis threshold, but then making sure that regulators have the ability to review these matters extremely quickly. The pace of investment in emerging technologies requires a very short timeframe. It is not like a large public company transaction, which has extended timelines. As long as one implements a very rapid review process and has the officials in Government to keep up with that potential backlog, I think those two interests can be effectively balanced.

**Q45 Chi Onwurah:** To follow up on your point about notifications, the Government impact assessment for the Bill suggests that up to 1,830 notifications might come in each year under this new regime. I am concerned that they look at the impact on the acquirer, and they do not capture the fact that almost every start-up seeks capital investment at some point. What impact do you foresee on the overall UK investment climate, and what might FIRRMA and CFIUS changes lead us to expect in our case?

**Michael Leiter:** This is very important. I was rather taken aback by two things about the Bill. The first is the projection of over 1,000 matters, going from the very, very few that the UK has traditionally had; this is an explosive increase in matters. I am concerned that no Government are ready for that rate of change. Even in CFIUS under FIRRMA, although there is not an increase in the overall number of long-form notices, in the short-form declaration process, there was an increase. That was relatively modest, an increase of about one third, so the US now reviews approximately 240 full cases, and about another 100 short-form.

When you talk about going from a few dozen to 1,000, you have to be very sure that you have both the resources and the expertise to process that. I would be concerned by that. Another case where your Bill goes much farther than anything I have seen, and certainly much farther than anything in the United States, is in encompassing not just acquisition and investment in businesses but acquisition and investment in supplies, goods, trade secrets, databases, source code and algorithms, so it is tangible and intangible objects, rather than businesses. That scale is very difficult to predict, and if one is more in the mood for incremental change, so as to see how a Government can handle change, including those elements poses some real risk for management.

**Q46 Nadhim Zahawi:** Thank you, Mr Leiter. That is really good feedback. Building on the point made by my colleague the shadow Minister, the CFIUS regime in the US obviously operates successfully, in the sense that the US remains an incredibly attractive place for inward investment. How have the US regulators balanced those two things? Does the Bill as drafted provide us with a similar opportunity to strike that balance?

**Michael Leiter:** I am honoured to have worked with the UK Government for 20-plus years on security issues, and over the past 10 years on economic issues. I certainly think you have the potential to strike that balance. In the US, traditionally, the CFIUS structure was a balance between the security agencies, which tended to want to

restrict investment, and the economic and commerce agencies, which tended to want to encourage that investment. Certainly, in the case of China, we have seen massive decline in direct investment because of both Chinese controls and US controls: a tenfold decrease from 2016 to 2018. But as you said, the scale and strength of the US economy mean that global investors look to the United States no matter what.

I do not mean to make less of the UK in any way but, from a UK perspective, one has to be a bit more careful, because you simply do not have the scale that inevitably will attract investment. The US could be a rather poor place to invest, with lots of regulation, but people would still come because of the scale of the market. You don't have quite that luxury. That is not to say that the UK has not for generations been an incredibly attractive magnet for investment, but whereas the US can err on the side of security, from my perspective, admittedly an American one, the UK might want to be a bit more careful about restrictive measures, because the size of the market is not in and of itself so inherently attractive that companies and investors must be in it. We have a bit of an advantage over you on this one.

**Q47 Peter Grant (Glenrothes) (SNP):** Good afternoon. I do not know whether you saw much of the previous witness's evidence, but she commented on how countries such as the United States have a limited number of excluded or exempt countries—including the United Kingdom—that are not covered by their equivalent legislation. What are your thoughts on how the Bill does not have any provision to exempt entire countries from its scope?

**Michael Leiter:** I was able to see part of Dr Lenihan's excellent testimony, which was quite informative and good. First, to clarify, although the US does make distinctions for exempted countries—obviously those are the UK, Australia and Canada right now—that exemption is extremely narrow. It limits those countries only on mandatory filings, and only if investors from those countries fulfil a fairly rigorous set of requirements. So, although Canadian, UK and Australian investors were quite excited before CFIUS reform, when the regulations about exempted investors were promulgated, that has had a minimal effect on those countries. It is not a significant advantage. Those countries are still subject to CFIUS review in the vast majority of investments they make. Now, that gives only half the story, because clearly investments from those nations go through a much less rigorous review, and come out with much better results than those from countries where the US has a more strained security relationship.

On what I see in the Bill, I would say a couple of pieces about the excepted possibility. First, as I read the Bill right now, it covers investments from other UK investors—not even simply those outside the UK. If my reading is correct on that front, I have to say that is probably not wise. We have already talked about the significant increase you could have, based to some extent on mandatory transactions as well as some other factors, and I think trying to take a slightly smaller bite of the apple and not including current UK businesses in the scheme would be well advised.

To the extent one has open trade and security relationships with certain countries, lowering the bar for review to exempt them, or including things such as

dollar limits and getting rid of the de minimis exemption, might well make sense. That is another way of making sure that the Secretary of State can focus on those areas you think are the most sensitive from a security perspective. Whether we like to do so or not, that can be aligned to some extent with the country of origin of the investor. It is not always perfect—one must often look below that, especially when dealing with limited partners and private equity—but it is a relatively easy way to reduce the load you may experience if all these measures were implemented.

**Q48 Nickie Aiken** (Cities of London and Westminster) (Con): There are 17 sectors included in the Bill, but are any sectors missing? Is there scope for future-proofing?

**Michael Leiter:** Right now, it is a very robust list. In fact, I would probably err on the side of going in the other direction. I think this is a good list of 17, but what is critical is that these sectors gain further definition about what this actually means. Let me give you a quick example: artificial intelligence. I invite you to go online and try to find more than 10 companies in the world right now who are doing well and do not advertise their use of artificial intelligence in one way or another. It is one of the most commonly used marketing terms there is: artificial intelligence and machine learning, all to serve you in your area of work. If one interprets artificial intelligence as encompassing all those businesses, there will be a flood of reviews. Now, if one focuses on those companies not using artificial intelligence but actually developing artificial intelligence, I think the definition of the mandatory sector will make much more sense. That is an area where I think the US is still finding its way. As Dr Lenihan noted, the US began with a set of listed sectors where transactions were more likely to be mandatory. They eliminated that and now focus purely on export controls, but again, it is not that a company uses export control technology; it is that it produces export control technology.

That may be too narrow for your liking, but if one mapped out your 17 sectors as currently described to their widest description, I think there would be very little left in the UK economy, except for some very basic manufacturing and some other services that would not be encompassed. This is a very broad list and, again, I think it will take some time to tune those definitions so they are not overly encompassing. Again, if you look at data infrastructure, communications, transportation—at their extreme, that is quite a broad set of industry descriptions.

**Q49 Sam Tarry** (Ilford South) (Lab): Just thinking and reflecting on a few of your comments, Mr Leiter, if we are given the timescale that you have had at CFIUS—it has a long history, it has been here a long time and you have brought in a new and updated regime to meet the threats that the US Government see are coming towards us—how could we translate that to our context as we put together this regime here? Are there any particular lessons that we could use? Are there new threats that have been captured by the new regime that you now have in place?

**Michael Leiter:** Thank you for your question. I will do my best to provide some advice. I do so with some hesitation, because I readily accept from my experience working with the US and the UK that although we are

related, we have two very different systems. The scale of our Governments and the scale of our private sectors are different, so one should always be very careful of trying to learn lessons from any other single country.

First, I would try to take this incrementally. This is a very big step and in trying to predict second-order and third-order effects of this—both the security effects, which may be positive, and the economic effects, which may not be as positive—I would tread carefully. I would start narrowly, then open up the aperture as necessary, rather than opening up quite wide and then narrowing it down.

Secondly, I think it will take some time, and not only to develop the administrative capabilities to handle this volume within the Government. I think you would have a significant amount of learning to do within your private Bar as to how this works, but also how to manage those voluntary filings. You are talking about including voluntary notifications across the economy, which I think is quite a sensible approach, but that requires a degree of collaboration between the UK security sector and the Secretary of State and the UK private legal Bar and commercial sector to understand where those national security threats and risks may lie. This is something that has developed in the United States over the past 20 years, but does not, in my view, yet exist fully in the UK.

Next, I would say that it is very important to consider how this should be applied for limited partners in private equity. Private equity plays a massive role both in UK and US investment and having clear rules about limited partners and the rights that may or may not implicate non-British ownership in those private equity funds is a very important step to take and one that should be clarified up front. It should not be approached without further clarification.

Lastly, I think it is important to build into the scheme the ability to evolve as technology evolves. I heard some of the questions about social media during the previous panel and it would have been very difficult to understand the sensitivities that are implicated by social media 10 years ago, or perhaps even five years ago. The ability for the review and notification to evolve with changing technology, access to data and new national security threats is critically important. The regime should be a living one that will evolve with those changed political or technological circumstances, not one that keeps still.

**Q50 Sam Tarry:** Following on from that, given the scale and breadth of the challenge you have outlined, covering so many areas, including private equity, how do you think we would best resource and staff this arrangement? Clearly this will be a potentially large undertaking for the Department as it stands at the moment.

**Michael Leiter:** Having worked with some of them, I think you have some outstanding individuals in some of the relevant Departments who can look at this matter. I believe that they will have to increase their interaction with the security elements of Her Majesty's Government in a way that does not perhaps yet fully exist. The departments and agencies that I worked with while I was in the US Government were generally fairly separate from these sorts of investment review, and it will be necessary for training among those agencies to ensure that there is an understanding of the nature of acquisitions and investments in the private sectors in a

way that security agencies do not yet fully understand it. Teaching the economic agencies about those security concerns will also be necessary. I think that the Government will need an initiative to make sure that there is a degree of integration across Her Majesty's Government based on an understanding of those cross-fertilisations, which will take some period to take hold.

**Q51 Andrew Griffith** (Arundel and South Downs) (Con): It is a pleasure to serve under your chairmanship, Sir Graham.

Thank you for joining us, Mr Leiter. It is invaluable to have a practitioner's perspective as we make legislation; that is something I would like us to do more often. I wanted to ask about your practitioner experience with respect to two things: first, the inclusion in the Bill of personal criminal sanctions and, secondly, its behavioural impact, from the point of view of attorneys and lawyers advising clients, on the likelihood of notification.

**Michael Leiter:** Let me answer that with two points. First, there is clearly an educational process when such a new regime comes into place for bankers, attorneys and business people. This regime will take some time for them to understand as well, but I think that the UK, like the US—I have already drawn some distinctions about the risk of reducing investment in both countries—remains overall one of the most attractive places to invest in the world. One of the reasons it is so attractive is that it has a strong rule of law and courts system, and clear legislation. In that regard, those who would come and invest in the UK very much understand the need to comply with these regulations, and criminal and civil penalties.

What we have seen in the United States is an appreciation, even if there was some initial shock at the scope of the review and what might be considered a national security concern, and a very robust understanding that we at the Bar and our clients have developed about the importance of these reviews and compliance with the legal regime that applies. I do not see any likelihood of, or reason for, the same not taking hold in the UK. I find that my clients are quite appreciative of the counsel we give them, whether it is related to the US or a UK foreign investment. Overall, I think that the concern tends to be less about personal criminal liability, although such concern undoubtedly inspires some, and more about the ability to continue to have good, strong, open relations with regulators in the country in which business is being done. That is critical.

The second piece I would commend you on, which is much better than the US system, is that the Bill provides for a very full and complete review by your courts. That is quite positive, especially with the change that will have to be implemented by the Government. The fact that there is an ability to turn to the courts for review is central and important. As you may know, that is not nearly equivalent in the United States. The ability to pursue remedies in the courts in the context of CFIUS is actually quite narrow. On behalf of my clients, and for improvement of the system, I am quite jealous of your approach on this front.

**Q52 Stephen Flynn:** Thank you for your comprehensive answers, Mr Leiter. I am afraid that I have crossed out many of the questions that I had because your answers have been so comprehensive. To go back a couple of

steps, you have referenced the structure and understanding of the regulations, and the challenges posed by that, as well as the understandable challenges posed by the creation of a new body to oversee the call-in process. That, understandably, will take time to implement. Do you think that lag and uncertainty might put off investors? On a similar line, in terms of the timeframe for call-in, there is the five-year retrospective, the six months for the Secretary of State to act, and the potential for up to 75 days or more to act. Is any of that likely to put off investors?

**Michael Leiter:** I will take those in reverse order. You are absolutely right: the timing is often central to much of what goes on in the world of mergers and acquisitions. With respect to the effective five-year look-back with six months of notification, that is not dissimilar to what we have in the United States. It serves a very useful purpose in that it certainly incentivises parties to file voluntarily.

To the extent that one includes a voluntary notification regime, I think that it is very important to have some period of look-back. I do not have a strong view whether that should be four or five years, but I do think that look-back is important in a voluntary regime. Of course, in CFIUS, there is no statute of limitations at all, but in reality, we rarely see CFIUS going back more than one year, at most two or three. Again, I think that if everything were mandatory, this would not be required, because to the extent that one has a voluntary regime, it is perfectly reasonable to give the Government an opportunity to look back. Doing so also provides an important incentive for parties, because they will often calculate the likelihood of the Government coming and knocking on their door one or two years down the line. I think that a general approach makes sense.

With respect to the specific timeline for the reviews, your Bill mirrors not perfectly, but closely, the CFIUS approach. In most cases, that timeline works relatively well, but there are a few exceptions. First, in public company mergers and acquisitions, this is no problem. The period between signing and closing tends to be quite long, so the idea of 75 days is not problematic. Similarly, whenever you have a matter where there is a competition review, which of course encompasses many things—on our side, Antitrust and Hart-Scott-Rodino, and in the UK and EU there are separate regimes—that 75 day-period seems to fit relatively well, provides sufficient time for the Government do their review, and will not be problematic.

The place where I think this is more problematic—I apologise that I cannot recall the Member who asked the question—is in smaller-scale, early-stage venture investments. That is where deals can go signed to close within hours or days, and having that longer period could be quite disruptive. In that sense, to the extent that one is concerned with early-stage technology investment, these timelines can be problematic, and finding a window to get through that quickly is quite important.

Finally, with respect to the timing of implementation and the time that it will take to get up to speed, I think it is important to have this effectively phased. I know I have said this several times, but I think this is a rather seismic shift in the UK's approach to review of investment. I am not saying it is a bad shift. I think it is a shift that is consistent with the United States and other allies in Europe, and Australia. I think it is going in the right

direction, but it is very significant, so having some opportunity to make sure that both the private sector and the public sector are ready for that and understand the rules—that the sectors are defined in a clear way and that parties understand, especially in the realm of having criminal penalties—I think it is particularly important to do that.

I think there are probably ways, to the extent you are worried about a risk during that interim period that things are not being reviewed, of addressing that as well, with the look-back provision, or initially implementing things in a narrower or separate sense, but I would be a bit careful about not having some transition period, which allows, again, both the public and private sectors to adjust to this very significant change.

**Q53 Stephen Flynn:** Obviously, the consultation in relation to the 17 sectors, which was mentioned earlier by a colleague, is going to run beyond the end of the Bill—perhaps, I imagine, of its being implemented. The Government may well just get it through the House, but were that to happen the consultation would still be ongoing, so, again, I am sorry to try to pin you down on this, but do you think that would create a level of uncertainty that investors simply would not be comfortable with, and that they might well look elsewhere unless the Government were clear about having a system in place that makes things more flexible for business?

I am sorry to flip back again, but on smaller-scale early-stage ventures, we said this could be an issue, and again, I am sorry to pin you down: could it, or will it, be an issue? Where would you lean in that regard? Will we find that investors seek to go elsewhere with this a little bit more, where the timing is a little easier?

**Michael Leiter:** I think it will be an issue unless you are confident that small-scale, early-stage investors can have their transactions quickly reviewed within roughly 30 to 45 days. If it is longer than that, that will make the investment climate, I think, worse than other competing markets. I think that could have an impact.

On your first point, let's face it, business always likes predictability, so you always want certainty, but deal makers have to understand risk and understand some uncertainty. That is inherent. I will say, it is not that the US has done this remotely perfectly. The US announced almost two years ago now that it was going to further define foundational and emerging technology that would then be subject to different levels of review under CFIUS. Here we are, almost two years later, and we still do not have that. The fact is that there has been uncertainty, and there will be uncertainty on your side as well. Having those definitions clarified as quickly as possible is good.

Do I think that a lack of clarity for three, four or five months about these sectors will suddenly stop investment in the UK? No. I don't want to exaggerate it to that degree. You can try to pin me down, but the fact is this is all a matter of balancing, and there is no clear answer about when people will stop or start investing. More clarity is better. The faster there is clarity, the better, and to some extent, a lack of clarity will push people to look at other markets.

**Q54 Stephen Kinnock (Aberavon) (Lab):** It is a pleasure to serve under your chairmanship, Sir Graham, and thank you very much, Mr Leiter, for your insightful evidence. I was wondering about the acquirer definitions, which are an important part of the equation, and the

extent to which the legal structure and ownership base of the acquirer should play a role and, perhaps, be more clearly defined in the Bill, in terms, also, of what the triggers are for the screening process. If the acquirer is a state-owned enterprise or a state-backed investment vehicle, should that trigger a, for want of a better word, tougher or more robust screening process? If so, what might that look like in practice, and do other regimes contain that differentiation between a private sector acquirer and a state-backed acquirer?

**Michael Leiter:** Thank you for the question. The answer is that many regimes do draw such a distinction, which is generally a good thing, but there is an exception to that as well. This is important on two points, one of which I have already raised so I will not belabour. Understanding the ownership structure of private equity to understand how the Bill will or will not handle limited partners who are managed by a general partner at a fund is very important. That is a significant amount of investment, and clarity on that point is critical.

In the United States, for example, foreign limited partners in US private equity are fundamentally, overall, not considered for CFIUS. For foreign private equity investing in the United States, foreign limited partners are considered. Again, that is broad brush, but that is fundamentally how it works. With respect to sovereign wealth funds or state-controlled investments, there is a perfectly good argument that yes, the standard of review might be a bit more rigorous. In the United States, the way that works is that if a foreign Government-controlled entity invests in what is known as a TID business—one that deals with critical technology, critical infrastructure or sensitive data—in the United States, and if they own more than 25% equity, that is a mandatory filing. So, it is increasing the likelihood of a mandatory filing if you are controlled by a partner.

Using such a standard makes sense. Right now, I do not believe the Bill provides many opportunities for that. You are already saying that, in the 17 sectors, all will be mandatory and there is no de minimis threshold. From that perspective, whether you are a sovereign wealth fund or not, it will be mandatory in a large scale of matters. You could of course say, with a dollar threshold such as you have now, that in the voluntary sector, if it was a state-sponsored entity, that would also be mandatory. I think there is some sense to that, but I would move slowly on that because, as I have noted several times, you are going to have a relatively high number of mandatory filings in the first place.

There is a second important piece to this, though, about whether you actually want to change it for Government-controlled entities. That is, especially in the case of China, but other countries as well, the distinction between state controlled and not state controlled is becoming less and less. Again, in some western democracies, it is quite clear whether it is a state-controlled entity, but to the extent a foreign Government can influence a private sector actor, that distinction starts to fade away, at least partially. Under your regime, it is not clear to me, other than expanding some voluntary into mandatory, how that will apply, and I think, to some extent, the distinction is losing some of its fineness.

**Q55 Stephen Kinnock:** I have a small follow-up question. The points that you have been making about private equity are very interesting. Large swathes of our social

care system in this country, particularly residential care homes, are owned by private equity companies. Do you think it would have a material impact on the assessment of a private equity company if it was looking to invest in the social care sector, which one could argue is critical national infrastructure?

**Michael Leiter:** That raises two excellent points. First, yes, I think private equity is quite methodical about thinking of those restrictions. Whenever I deal with private equity in the United States, whether it is US private equity, foreign private equity or sovereign wealth funds, there is always a consideration of the way in which the business in which they are investing may be subject to a national security review and whether or not they will, even if approved, lose access to critical information, technology or other management control of the business in a way that would make it a less attractive option. From a US Government perspective, I think that is entirely appropriate; it is the entire purpose of the national security reviews.

It could affect the choices of private equity in the UK, but one still has to identify what the national security risk would be—and not just what the national security risk might be, but the extent to which, if the investment was allowed, the Government could still put in place restrictions that would eliminate or mitigate that national security risk. That leads me to make two very quick points.

First, there has been much commentary about defining what national security means. I would not welcome to go down that path; frankly, I think it is a bit of a fool's errand. The Government will define national security as they may. Certainly, they should not overreach in extreme ways, but this is not one that I think legislative language is well tuned to trying to capture. That is not to say that it should not be limited in practice, but trying to capture it in legislative language is, I think, exceedingly hard. Again, it changes over time, depending on technology, access to data and other factors. One can imagine certain things that, before covid, we never would have considered to be issues of national security, but that are today. Capturing language for that is quite challenging.

The second piece is making sure that you have a good regime. We have been talking so much about screening, punishment and what falls into the bucket of review. There has been much less discussion here, and there is much less discussion in the law, about what mitigation and rules and enforcement there will be. If you permit a foreign investor to invest in one of these sectors and you put in place certain protections to protect British national security, how will you actually make sure that that occurs? It is wonderful to have these rules, but unless you actually have the regime and follow these things and ensure that there is enforcement and monitoring of them, you will have spent an enormous amount of time and money but actually not protected national security, so I think we should not give short shrift—*[Inaudible]*—deal is closed and approved but still being monitored by the Government for the very national security risk we are trying to protect against.

**The Chair:** We have to end this session at half-past 3, so I think that this will be the last question and it will come from Simon Baynes.

**Simon Baynes:** Actually, Mr Kinnock has asked my question, Sir Graham.

**The Chair:** In that case, the last question will come from Matt Western.

**Q56 Matt Western:** Thank you, Sir Graham. Mr Leiter, I would like clarification on the point about disguised takeovers, and perhaps you can use CFIUS as an example. What happens if a benign country or an organisation in a benign country, such as Canada or wherever, takes over a business and then that gets sold on to a state actor or a non-obviously state actor? How does CFIUS respond to that, and do you think that this Bill covers it?

**Michael Leiter:** I think your Bill does cover it. CFIUS would cover it in two ways. First, to the extent that a non-benign actor was behind the first transaction, CFIUS looks at the ultimate parent and whether it has been structured to evade review, so I think there is robust authority there. Secondly, the follow-on transaction itself would of course also be subject to CFIUS review, so I think you could catch it in the first instance or the second instance.

I think your Bill covers that. I will say also that I think the Bill is quite expansive and potentially problematically so. The US regime looks to see if there is a US business that is being acquired or invested in. That is a broad definition, but it still requires, generally, some physical presence, some people or the like. Your Bill does not seem to contemplate that, and specifically it says, "If the business simply provides supplies and goods to the UK or from the UK". That is a very broad definition. It fundamentally means that if someone in London is buying something from a US business and it sends that to London—well, I read that as being covered by the Bill. That would actually be more expansive than CFIUS. It might, in that sense, give you greater national security protection, but I think it also may implicate a far more significant scale of transactions.

**The Chair:** Thank you very much, Mr Leiter. We are grateful to you for giving of your time so generously to assist the Committee.

### Examination of Witness

*David Petrie gave evidence.*

3.29 pm

**The Chair:** We now move to the next session. David Petrie is from the Institute of Chartered Accountants in England and Wales. Mr Petrie, would you be so kind as to enough introduce yourself for the record?

**David Petrie:** Good afternoon, Sir Graham, and thank you very much indeed for inviting me to give evidence to the Committee. My name is David Petrie, and I am head of corporate finance at the Institute of Chartered Accountants in England and Wales. My background is in corporate finance and mergers and acquisitions, for 10 years or so now in my current role at the ICAEW and prior to that with PwC. My experience includes advising on transactions, principally in the mid-markets, including private equity buy-outs, company sales and some infrastructure transactions. Prior to that I had a career in industry as well, so I have seen all sides of the fence on this, I suppose.

**The Chair:** Thank you very much. Before I move on to taking questions, I remind everybody that this session has to close by a quarter past four.

**Q57 Chi Onwurah:** Welcome, Mr Petrie, and thank you very much for placing your expertise at the disposal of the Committee. You have experience of mergers and acquisitions, and I am sure you will be aware that we have seen several transactions in this country—I will name GKN and Melrose, SoftBank and Arm, and indeed I will include the failed Pfizer-AstraZeneca case—where it appeared that the Government had no legal powers to secure jobs, pensions, research and development and key UK industries, relying instead on behind-the-scenes soft power. That created uncertainty and lack of clarity for investors. Do you think that is a problem for both Government and investors, and how do you think we could effectively tackle that gap?

**David Petrie:** The Government have been very clear that the purpose of this legislation is to focus on protection of national security. The guidance notes they have issued, which accompany the Bill and are intended for market participants, are very clear on that aspect. I would suggest that probably all the factors you listed in your question extend beyond a simple matter of national security—if national security can be a simple matter; no doubt that this Committee has heard this afternoon about the difficulties associated with defining national security. Many of the factors that you set out there, important elements though they are to all stakeholders in a company, are not necessarily matters of national security.

I would also say that that for some of the companies that you mentioned there, while certain of their activities might well be included within the scope of this new Bill, it would be very difficult in certain instances to suggest that they had a direct impact on our national security. Of course, that would be up to the new investment security unit to determine, based on a full representation of the facts. If that unit was at all concerned, a procedure is set out in the Bill whereby it would be able to call for as much evidence as it felt was necessary in order to be able to reach a balanced determination on whether investment by an overseas entity did indeed constitute a real threat to our national security. I think that is the point here.

**Q58 Chi Onwurah:** Thank you for your response. If we look at GKN-Melrose and, indeed, even SoftBank-Arm, we could consider that they had national security implications. I suppose the point is that there are essential industries that are directly critical for our economy, but that at first may not seem directly critical for national security because they are evolving technologies, as in the case of Arm and the ongoing takeover by Nvidia, or because they are indirectly critical as suppliers to downstream industries that support national security. Indeed, in the response to the Government's consultation for this Bill, an example is given of the undermining of the functioning of an airport by a software manufacturer, which would be within the transport sector but would not necessarily immediately appear to be directly concerned with national security. Economic security and national security end up being linked. Do you think that should be reflected in the Bill, and how do you think it can be reflected?

**David Petrie:** I have read the impact assessment, which included that example. It is a difficult situation, as described in the example. In accordance with the way that this new legislation is drafted and the number and extent of the sectors that are regarded as mandatory—the

sectors in scope such that their operating activities would require a notification of the unit—the example set out in the impact statement would indeed require screening by the investment security unit. The Government would likely have the opportunity to review a potential acquisition in that software company.

I was struck by that example, in that it suggested that service had failed, or a malign actor had decided not to provide the necessary services to the airport. I think a broader question here is what might happen in reality. Those services would be procured through a commercial contract, which in turn would, presumably, be backed by insurance. If it were an absolutely critical service, I would expect that the airport would have a back-up system, whether power supplies or a parallel running system, as they do for air traffic control. There are commercial protections for the actual operating activities of critical infrastructure, which should work. It is difficult to protect against the actions of malign actors, but critical infrastructure already has systems and processes, and invests heavily in capital equipment, to ensure that there is not an interruption of supply. The question would be the extent to which ownership of that asset physically gave the owners of the shares the ability to get in and interrupt supply. That almost implies mechanical breakdown or some deliberate and malign disconnection. Again, companies have cyber-security systems in place to ensure that critical infrastructure does not fail.

The point you made was about whether suppliers of that sort of service to our critical infrastructure and their ownership should be subject to review. As the Bill is set out and as the sectors in scope are drafted—of course, the Government will consult over the next month or so on those definitions and whether they should be adjusted or whether they are as wide-reaching as they should be—a business like that would be captured. The investment security unit and, presumably, the security services would have an opportunity to review whether or not to allow that to go ahead.

**Q59 Nadhim Zahawi:** Mr Petrie, you will understand better than most that businesses will want to ensure information is being treated sensitively in any transaction. I want to capture your view of the closed material procedure for judicial review under the Bill and what you think of it in terms of that sensitivity of information.

**David Petrie:** I think a quasi-judicial review is really important and a part of the process, and then, if necessary, there is judicial review. I think the question cuts back to how many times that is likely to happen. We have to step back a little bit and recognise that that would be a situation where the parties to the transaction are challenging the Secretary of State's decision as to whether or not this is in the interests of national security.

I would assume that if the sellers are British companies, they will probably have received what they feel are adequate assurances that it is okay to sell to an overseas acquirer, but the Secretary of State takes a different view, presumably based on evidence provided by our national security services. Ultimately, if there is a compelling body of evidence to suggest that a transaction should be modified or adjusted or, in extremis, blocked, it would be quite an unreasonable group of shareholders to disagree with that if the Secretary of State was applying the test as set out in the Bill, and indeed in the guidance note, that intervention is to be limited only to matters where the national security of this country is at threat.

That is quite different from the national interest. It is tempting—or possible, rather—in this debate to get sucked into questions about what we should and should not be doing in this country. That is not what this is about. The Government have been very clear to the investment community, and to British business more generally, about the purpose of this legislation. That is why, although markets and investors recognise that it will take a certain amount of time and effort to comply with a mandatory regime—the Government have been very clear about their purpose in introducing that—the market is generally favourably disposed towards it. We can see that it is unfortunately necessary in these modern times.

**Q60 Stephen Flynn:** Thank you, Mr Petrie, for your answers so far. I just have a couple of straightforward points for you to address. We discussed the timeframe in earlier sessions, in relation to the five years of retrospectivity, the six-month call-in and the potential 75 days. Do you have any concerns about the impact that that might have on potential investors into the UK? On a similar note, in terms of the fact that there will potentially be in excess of 1,800 notifications annually, an entirely new body will have to be set up, possibly working across Departments and involving the security agencies. A lot of detail will need to be put behind that, and again, that will take time. Do you think any of that will cause any uncertainty among investors and perhaps lead them to look elsewhere?

**David Petrie:** Perhaps I could deal with the second part of your question first, if I may, on the potential number of notifications that the new legislation is going to necessitate. The first point I make about that is that this new investment security unit will need to be very well resourced. A thousand notifications a year is four a day; I am just testing it for reasonableness, as accountants are inclined to do. That is quite a lot of inquiries. I note from the paperwork that the budget allocated to the new unit is between £3.7 million and £10.4 million. I do not know and cannot comment yet as to whether that is likely to be adequate. What I can say is that the impact statement also suggests that of those 1,000 or so transactions which are going to be subject to mandatory notification, only 70 to 95—the numbers set out in the impact statement—are likely to be called in for further review by the Secretary of State, where a very detailed analysis of those businesses and the potential target is going to be necessary.

As, I hope, has been echoed by other witnesses, it is going to be extremely important that this new unit can engage in meaningful pre-consultation with market participants—with British companies, finance directors, and investors and their advisers—so that they can get a pretty clear steer at an early stage as to whether or not this is likely to be subject to further review. If the unit operates in a way where it can give unequivocal guidance to market participants at an early stage and is open to dialogue—I understand from discussions with the Minister that this is the way the unit is being asked to operate—that would be extremely helpful.

I would say that that is about process, certainly, but I think it is also about culture. It has to be a balance, which is well achieved by the Takeover Panel, for example, in this country. You do not tend to approach the Takeover Panel unless you are well-informed and have done your homework—“Don’t bother us with stuff you ought to

know” is the unwritten rule. But at the right time and place, I think it is important that there is an opportunity for market participants to be able to engage in a dialogue. The guideline where we put this “Don’t bother us with stuff you ought to know” question is going to shift. At the moment, we really do not know a lot about the way the Government are going to look at certain transactions. We do know which sectors and operating activities are in scope, but, again, we are not quite sure at what stage it will be right to consult and try and get clear guidance. This process will evolve.

I note that the Bill includes provision for the new unit to issue an annual report as to the number of transactions called in and the sectors they are in. That will be extremely helpful for market participants. An issue here, I think, is potentially asymmetry of information. In order to resolve potential asymmetry of information amongst the investment and advisory community, it would be very helpful that the unit is well resourced and able to engage in meaningful pre-consultation, but, by way of a third recommendation, it would also be extremely useful if it was able to issue meaningful market guidance notes, similar to the notes that accompany the takeover code. That would again be extremely helpful so that we can understand. It would help the market to be better informed. If, for example, the unit is receiving a lot of notifications that are not correctly filled in or with important details as to ownership missing, then it would be helpful to have guidance notes as to what we can do to make sure this process works with more certainty, speed, clarity and transparency—these are the things financial markets need to see—to help us with that, beyond what has already been issued, which is very helpful, I have to say. As the market evolves, that would be extremely helpful.

**Q61 Mark Garnier:** May I follow on from that question about the resources? There is talk about 1,800 companies coming forward and voluntarily disclosing that this transaction is going on, but I am just as interested in what happens with those companies that do not disclose this? I am not for a moment suggesting that there are a huge number of dishonest actors involved in the corporate finance market, but given the fact that the threshold was reduced to £1 million a year under the recent review, there are an awful lot of small businesses with turnover of about £1 million a year that are not very well resourced for their corporate governance functions and that could easily miss the requirement to disclose, should a transaction come through that is enticing for the shareholders, who are presumably offered the same as the directors. Are you confident that the Government have in place sufficient resources to be able to police the whole sector, to make sure that we are not missing out on a number of transactions that are going through? Even if we do, are we getting in there quick enough to make sure that the intellectual damage is not done by the time we have found out what is going on?

**David Petrie:** That is a very difficult question. We will find out—that is the answer to that. I think businesses working in sectors where there is a real threat to national security know that. They know that they are involved in weapons design or designing software that could have a dual use. In advising companies over the years, I have found that no one knows better than the company directors about the value of their assets and their business, both from a market perspective and to competitors or others seeking to gain access to their technology.

The Bill has been in discussion for some years now, and the advisory community is well aware of its existence and of the Government's desire to put this legislation on the statute book, so I do not think there will be many corporate finance advisers for whom the Bill emerging last week was a surprise. I am very sympathetic to the points made about small companies falling under the provisions of the Bill, but I hope that it will be possible for them to complete what, in the first instance, is a five-page questionnaire—when completed, it could run to 20 pages or more—at a relatively low cost.

To my earlier point, I hope they are able to engage in formal and meaningful dialogue with the unit at the earliest possible opportunity by saying, “This is what we do, and this is what we are worried about.” They have to say, “We're concerned about this. These are the people from whom we are hoping to attract investment to take the business to the next stage. How do you feel about our business, and how do you feel about the people we are talking to? How does the Government feel about xyz corporation?” I think that kind of steer would help remove a great deal of uncertainty from the circumstances that you have set out.

**Q62 Simon Baynes:** Thank you, Mr Petrie, for a very interesting presentation. I want to look at two areas. One was touched on by the previous witness: the inclusion of not only businesses, but tangible and intangible assets. That is one issue. The second is the acquisition of material influence over qualifying entities' policy being another trigger point. I would have thought that these are more subjective—perhaps I am wrong—in terms of how you define them, whereas the other trigger points are obviously very clear cut. There are different levels of voting shares in the qualifying entity. I think the previous witness was somewhat surprised to see the tangible and intangible assets element of it and said that this goes further than other similar regimes in other countries. Can you comment first on whether you are surprised or whether you think it makes perfect sense? Secondly, is it easy to define the material influence and the assets, either intangible or tangible?

**David Petrie:** On the question of tangible assets, it really depends on what we are talking about. Again, it was trailed in the White Paper and the Green Paper that assets would also be within scope, so it is not going to be a surprise. It depends very much on the nature of those assets. In a relatively small country, the ability to acquire land or other buildings—strategic assets—immediately next to a sensitive military installation is, presumably, now included within scope because people who know about these things think it ought to be. I think the investment community will have a degree of sympathy there.

With intangible assets, that is a much more difficult question. It depends on the extent to which ownership of those assets is necessary in order for a malign actor to have the control or the information that they might need. It is possible to gain access to intellectual property through means other than ownership, so the question here is, how might those intangible assets be applied in ways that might prejudice our national security in some way? Again, that is something that the unit is going to have to assess on a case-by-case basis.

It makes sense to include assets that could be sold separately, without the sale of shares in a business. Companies often do that. They may well sell a parcel of

patents, or parcel up a division and sell it on because it is no longer core to their operating activities. That is understandable. The investment community will understand that. In short, it is not a surprise, and we are going to have to find our way through this on a case-by-case basis.

**Q63 Simon Baynes:** Could you expand on one or two examples of such intangible assets? You have stated patents. Could you illustrate what you understand to be such assets?

**David Petrie:** That would be the most obvious example. There are things like industrial designs, blueprints or chemical processes that may not be subject to patents. It is typically those aspects of production and design that it is necessary to ensure would be in the scope of this kind of legislation.

Much of the discussion that has led to the publication of the Bill has been around the ownership of shares or of the business—as to whether that is actually the bit that malign actors might want to get hold of. That may not be what really interests them with the business. It may well be intellectual property or these other assets, which it is necessary to separately define. If they are able to get hold of those without buying the company, then it seems to follow that it makes sense to include that within the scope of this Bill.

**Q64 Simon Baynes:** But they would be quite difficult to police, would they not? How would you know—

**David Petrie:** Yes. I don't think anyone is suggesting that the job of this new investment security unit is going to be straightforward. In fact, we are absolutely not suggesting that. It is going to be absolutely essential for Government Departments to work together and, going back to my original point, for this unit to be extremely well resourced, to be able to respond quickly and appropriately to what is put before it.

**Q65 Peter Grant:** Good afternoon, Mr Petrie. There will be some entities that try to take over British businesses where the warning flags are flown immediately, because it is well known that either it is a foreign state, or a company controlled by a foreign state. Often, it is difficult or even impossible to know who the ultimate controlling party of a business is if they have arranged to have their ultimate ownership registered somewhere offshore, where that information is not made public. Does the Bill, as presently worded, provide enough protection against a hostile power trying to infiltrate the system by going through a secretive intermediary state? If it does not, what more should be done in the Bill to protect us against that scenario?

**David Petrie:** This is an issue that is well recognised by the investment and advisory community. I think that, as you say so rightly in your question, the warning flags, flares or whatever they might be will already be going off if this is a particularly sensitive military asset that is being considered for acquisition. I think that the unit will be able to look first at the nature of the asset, and it will be apparent very quickly as to whether this is a very sensitive issue. If the acquirer is not a British public limited company, a British private company or one invested in by private equity, if the ultimate ownership is structured in a way that is not conventional—many companies are held through offshore companies for entirely conventional, obvious and transparent reasons for the investment community—and if there is something



strange about that ownership structure that makes it extremely difficult to trace the ultimate ownership, it feels to me as though that would be one of the 70 to 90 cases that the Secretary of State would want to review in a lot more detail. Then, due and diligent inquiries would be made to try and understand the ultimate ownership of those holding companies. There would be lots of complicated diagrams drawn, no doubt, showing who owns which bit of what and who are the key individuals and shareholders. The answer would be that, I am afraid, this unit is going to have to keep digging until they get to the bottom of who are the ultimate shareholders.

The Bill is drafted in such a way that you do not need to own much in the way of shares—or there are provisions included within it such that if an entity or individuals, or individuals reporting elsewhere, have control or influence over those holding companies, that in itself would be something we would be concerned about. The Bill includes provision for that because we know, and I believe the security services are well aware, that the equivalent of layering is used for acquisition of these sorts of businesses, or people have certainly tried to do that. So, it is going to be a matter of hard work and digging to get to the bottom of who really owns and controls those entities.

**Q66 Peter Grant:** When you talk about a lot of hard work and digging to get to the bottom of it, does that include potentially gaining information that is not in the public domain and from a jurisdiction where that information is not allowed to be disclosed? Does that potentially mean having to rely on information that is gained covertly by British intelligence, which then cannot be shared in open court if the case is challenged?

**David Petrie:** I suspect that would be the corollary of that, yes. We are probably dealing with a relatively unusual set of circumstances here. It rather assumes that the shareholders of the British company are absolutely determined to sell or take investment from an entity where its ultimate ownership is quite difficult to identify. We are dealing with quite an unusual situation—not unprecedented, certainly, but relatively unusual. I do not know what resources the new unit will have at its disposal, but given that this is relatively rare and is a question of national security, I would expect that the Secretary of State would ask it to use whatever resources are necessary to gain the information it needs.

I hope—again, we will see—that the closed doors process for the judicial review, should it come to that, would enable national security to be protected, so that if there were some other breaches as a result of the investigation, or if explaining how we found out what we know caused a breach in national security elsewhere, that problem could be resolved. I am comfortable—I think that would be the right expression—that those difficulties can be dealt with in circumstances in which the absolute preferred option for the company is to take investment, but I have to say that I think those circumstances would be relatively rare.

**Q67 Sam Tarry:** How have you found your engagement with Government so far, and what processes are you looking for, in terms of how the Government engage with you and the industry—whether it is with your organisation or more widely? Do you have any comments on that?

**David Petrie:** Yes, I have. The Government have been very clear about the need to bring this legislation on to the statute book, and they have done so through the Green and White Papers. When consulting on the White Paper, they sought opinion from a very broad spectrum, including business groups, businesses, the investment community and so on. They have set that out in the response to the consultation.

The next consultation is the one on the sectors within the scope of the mandatory regime, and the next month or so is going to be a very important stage in this process. Defining those sectors in a way that market participants understand and that does not trigger manifestly unnecessary notifications is going to be very important, and we look forward to engaging in that process, as does the legal and investment profession and British business.

**Q68 Sam Tarry:** How do you think the mandatory notification framework could impact small and medium-sized enterprises in particular, which are obviously having a difficult time, given the consequences of the pandemic?

**David Petrie:** Yes, that is an important consideration. I hope that if small businesses have limited resources, that is recognised by the new unit, and that smaller businesses are able to have an open dialogue with it, and can say, “This is what we do, and this is what we need the money for. We are going to need it quite quickly because we are running out of money.” If the unit is able to give unequivocal guidance very quickly, that would be very helpful.

I would also say that the new unit should not treat the 30-day turnaround for a mandatory notification as the target. The target should be to respond as quickly and efficiently as it can, and in such a way that does not cause difficulty or distress for small and medium-sized companies. A five-page form for a small or medium-sized company seeking investment for a UK or a relatively straightforward overseas entity is not a terribly burdensome obligation. I hope that it will be possible for them to find their way through that at relatively low cost.

**The Chair:** I do not think there are any more questions, so once again I thank you, Mr Petrie, for generously giving your time to assist the Committee.

**David Petrie:** Thank you.

#### Examination of Witness

*Chris Cummings gave evidence.*

4.10 pm

**The Chair:** We welcome Chris Cummings, the chief executive of the Investment Association. Mr Cummings, would you be so kind as to introduce yourself for the record?

**Chris Cummings:** Thank you for the opportunity to appear in front of you. My name is Chris Cummings, and I am the chief executive of the Investment Association. We represent UK-based fund managers, an industry of some £8.5 trillion used by three quarters of UK households today. We own roughly a third of the FTSE.

**Q69 Chi Onwurah:** Thank you, Mr Cummings, for sharing your expertise with us. We all recognise the importance of inward investment, and indeed of the Investment Association, to our economy. The impact assessment for the Bill estimates that up to 1,830 notifications might come in each year under the new national security

[*Chi Onwurah*]

and investment regime, but those numbers do not capture the fact that almost every start-up seeks capital investment at some point. The requirements to notify are put on the acquirer, but I would like your thoughts on the impact that may have on start-up companies. As part of that, I imagine it will be especially hard to hold merger and acquisition auctions while checking on the outcome of these processes. What do you foresee will be the overall impact on the UK investment climate, and in particular on the ability of our most innovative start-ups to raise capital? I am often told that access to finance is the key barrier to start-ups growing, and staying in the UK as they grow.

**Chris Cummings:** Thank you; that is such a pertinent question. Before I address the substance of it, I want to try to describe the work of many of my members, which is broadly portfolio investments. They seek not to acquire a company but to invest, taking a very small stake—a fraction of a percent—of those companies. That provides an opportunity for those companies to receive the investment they are looking for, and enables us as investors to invest in a company, an industry or a whole sector in order to generate a return for the investors whose money we are managing. They tend to be pension funds and insurance companies—institutional investors.

Of that £8.5 trillion I mentioned that we manage, about 80% to 85% comes from institutional investors; the other 15% or so comes from retail: people on the high street saving in individual savings accounts and so on. Our view on the Bill is about how we can continue to do our work to help finance companies in the UK and internationally with the investment collateral that we can bring to bear. We do that in the two major parts of the market: listed companies and unlisted companies.

Perhaps I can address the point you made about small and medium-sized enterprises. We make investments in unlisted companies—of course, small and medium-sized enterprises are not listed organisations—by developing an understanding of sectors and industries. We look for individual institutions that we regard as high-performing—that is, high-performing over a long period of time, because we are patient investors, tending to take a long-term view, unlike colleagues in other parts of the industry, who are more high-frequency, or looking at a two to three-year earn-out period. To help us do that, we need two things. The first is legal certainty around the investment climate here in the UK, so that we understand the rules of the game, so to speak. This particular Bill is helpful in establishing greater clarity about the rules of the game; we do have one or two caveats, but it is helpful. The other is publicly available information, such as analysts' reports—the type of thing that we as investors would look to receive and interrogate, and on the back of which we would then make an investment decision.

We are really looking for whether the Bill helps make the UK more attractive; whether it helps us funnel savings into productive investment that can help companies grow, create jobs and so on; and whether it is adding to the legal certainty of our investments. You are right to ask about SMEs; our members who invest in higher-growth companies are really keen to make sure that the process is as friction-free as possible, and that there are no

surprises. Being very clear about a pre-notification regime is especially important to us, as is something like the five-year review period that could come after a deal has ended. Certainty about those 17 sectors is particularly important as well. That is why we have wanted to maintain a really close dialogue with the officials—the team that has sponsored this Bill—to make sure that no inadvertent barriers have been erected to us deploying that investment in the right way.

One of the suggestions we would like to commend to this Committee is something we have seen work particularly well in Japan, which considered a similar raft of legislation: a blanket exclusion for investment—not for takeovers, obviously, but for portfolio investment, where the investment industry wants to support unlisted or listed companies, and it is clear that there is not a desire to take them over, involve ourselves in the management of those firms, seek a position on the board or secure the intellectual property, but where we are just performing the role of long-term investor. That has been judged as being outside the scope of the legislation, but we commend that to the Committee as a practical step that takes forward the principles of the Bill and secures the “investability” of the UK's investment landscape.

**Q70 Chi Onwurah:** Thank you very much. I note your suggestion regarding the blanket exception for investment funds. I had two quick follow-up points: first, could you say how they would be defined in such a way that would exclude, for example, foreign sovereign investment funds and so on, which might give cause for concern? Also, you said you had a couple of caveats. I take it that is one; what is your other caveat?

**Chris Cummings:** Forgive me: I noticed that I missed the point about mergers and acquisitions. We regard the pre-approval facility that officials have mentioned—I believe the last witness mentioned it, as well—which is a way in which the team responsible could be approached ahead of a deal being put together, as a very sensible, practical step forward, as long as confidentiality was absolutely rigorously maintained.

In terms of definitions, we find the Japanese definition quite attractive, and again we commend it to the Committee. It clearly differentiates out investors such as the ones we represent, who are looking to provide capital for a company and share in its success for the benefit of the investors whose money we manage, but are not seeking to take an active role in the management of those companies. We are not looking to put somebody on the board; we are not looking to intervene directly in day-to-day management decisions. Our relationship is with the board chairman and so on, in order to engage in a constructive and strategic discussion, but we stop short of securing assets or taking an active role in management. That is a system that works well.

Turning to our caveats, I mentioned the five-year review period. We undoubtedly recognise the spirit in which this legislation is drafted, but Governments change, as does public opinion. The strength of this Bill is that it is focused around national security. Perhaps a definition of national security may go a little further in helping investors as well, because we could not really strike upon a catchy, well-turned phrase that defined national security, and have a reluctance to move away from national security; we would hate to see the Bill being widened into more public interest ability.

A final point to note would be the interplay between this legislation and the Takeover Panel, which has a different and distinct role to play. The notification percentages are slightly different: it is 25% in the Bill, and 30% in the Takeover Panel, so ensuring that there was no accidental misalignment would be most useful.

**Q71 Nadhim Zahawi:** Welcome, Mr Cummings. You mentioned the feedback from your members about keeping the Bill focused very much on national security. The message that we want to get out there is that Britain remains very much open for business, and that we want to maintain our place in the premier league of foreign direct investment. How has that statement of policy intent, which we published alongside the Bill, landed with your membership?

**Chris Cummings:** When it comes to a clarification point around national security, this is similar policy-intent-driven legislation to what we have seen in other emerged markets, such as the US, Germany, France and so on. We do not find that it is out of step with other developed markets. In other jurisdictions—I will take the US as an example—the legislation has started small and then grown as people have become familiar with it. The UK, perhaps because we feel we are playing catch-up—that is not for me to say—has started on a larger scale first. That is why there are queries around scope and around the durations. We look forward to engaging with the definition of the 17 sectors to ensure it is as specific as possible, and to ensure that we understand the operation. We would like to hear from officials and colleagues in ministerial positions on how they see it working in practice, so that the investment community is really clear that the rules of the game have not changed, and that the UK really is as attractive as we want it to be for incoming investment.

As I mentioned, we represent UK-based investment managers, but of course, those organisations are headquartered not only across Europe, but in other parts of the world, particularly the US. We are managing pension scheme money not only for UK savers and pensioners, but from other parts of Europe and places as far-flung as Brazil. If we as investors were looking to make an investment in UK plc, we would need to be clear about where head office was, and where the money was coming from. All those things could be either pre-approved or ruled in court as quickly as possible to ensure that there is not a missed beat in attracting the investment that we all want to see.

**The Chair:** Nickie Aiken.

**Q72 Nickie Aiken:** I forgot to say earlier that it is a pleasure to serve under your chairmanship, Sir Graham. Mr Cummings, thank you for your time today. Are there any particular areas in the Bill that concern you—that you think may put off the investment community from investing? Also, what would you say are the particular strengths of this Bill?

**Chris Cummings:** As for particular strengths, we feel that the aspects that deal evidently with national security are strengthening a regime that needed some modernisation.

On the protection of intellectual property, one of the key areas—it is absolutely essential for us as investors—is knowing that if we are investing in a particular company,

we are doing so because, depending on the market and sector it is in, we feel that the intellectual property is clear, maintained and protected by clear legal contracts, and that if something goes awry, we, as investors, have recourse to legal sanctions.

There is much in the Bill to be commended. In terms of areas of weakness—forgive me; I feel I have touched on these—it is about ensuring that, as investors, our position is clear and understood. In investing in a company, when doing that not to try to take it over or seize the reins, it is to provide more of a long-term investment to support the company's development. We do not feel that quite comes through in the way the Bill has been written at the moment. It has been written, rightly, for takeovers. We do not want to be hit by ricochet—by accident—in wanting to continue to support UK plc and find that new barriers have been erected that prevent us doing that, simply because this part of the investment landscape had not been completely thought through. That is a caveat, rather than a point for deep consideration.

**Q73 Nickie Aiken:** On the 17 sectors that were included in the Bill, do you think there are too many or do you think any sectors are missing?

**Chris Cummings:** That is something we are looking forward to engaging with. When you first hear it, 17 sectors sounds like quite a lot, but having worked through the 17 sectors and looked at some of the draft definitions, I think that each one is justifiable.

We would be keen to point out a few things to the Government. First, the greater the specificity around the definitions, the better. Secondly, we should not rush to change the sectors by adding to them too quickly. Investment needs a degree of stability, and legislative stability most of all.

Thirdly, in consulting with industry and thinking about the operations and practice, I would ask to have industry expertise around the table. We found time and again working with officials—they are hugely valuable, talented individuals, but do not come from a commercial background, almost by definition, although some do—that having the commercial insight, we can play a role in nudging in the right area, to ensure that nothing is hard-coded that would prevent a deal because the nuance has not been appreciated. Having that industry insight would be a big step forward, if it could be accommodated.

**Q74 Peter Grant:** Good afternoon. The Government's impact assessment expresses the view that a national security regime such as this does not have much of an impact on overseas investors and their investment decisions, as long as they are comfortable that any interventions are appropriate and the regime is predictable. Do you share that view?

**Chris Cummings:** With any new piece of legislation, and certainly one of this character and this far-reaching, investors will always want to understand the motivations that led to it being introduced, how it will work in practice and whether we can give case studies as quickly as possible to prove that it does work in this way.

The important thing—I cannot stress this enough—is how it gets spoken about by Ministers. That enduring political support for investment carries such weight with investors. More than the words on the page, what matters

is how it is presented—how Ministers then talk about the desire to continue to attract investment and how they make themselves available to investors.

All major economies, because of the covid-19 crisis, are seeking new levels of investment, whether for individual corporates or infrastructure investment, let alone Government debt. We feel very strongly that the UK has a tremendous story to tell. Introducing new legislation such as this at a time when, bluntly, we are looking for more investment to come into the UK, will require a degree more explanation. The way it has been phrased so far, as national security and almost as a catch-up activity with other developed jurisdictions, is fine. However, if Ministers make themselves very much available to investors to explain how this will work, and make a bonus of the pre-authorisation facility, so that if investors are troubled that an investment they are considering could attract attention, there is an ability within 30 days—that is a really important point: within 30 days—to have it pre-approved and then stood by, that will go a long way in the investment community.

As you can tell, we will have to paddle a little bit harder, but that has the potential to be a short-term explanation for a long-term gain. Potentially, that is fine, but I say again that we hope Ministers will seize the opportunity to explain this to investors, the course will be set and we will not see further iterations or scope creep from national security to other sectors, which then becomes a little more worrisome.

**Q75 Peter Grant:** Thank you. Decisions under this legislation will initially be taken by the Secretary of State. In the United Kingdom, the way that Ministers exercise the authority given to them by legislation, and indeed the way that Governments or Prime Ministers exercise the authority that comes down through the concept of the royal prerogative, is governed as much by tradition, convention and understanding as it is by hard legislation. Recently, we have seen an increasing number of occasions when Governments have chosen to do things that are allowed but are completely unprecedented and not according to the usual traditions and conventions. There are some notable examples here, and clearly a number of examples from the outgoing President of the United States. Does that give you a concern that legislation might be passed giving a Minister power under certain understandings, but that the understandings themselves might have no legal force, so a future Minister might exercise that power in a way that is very different from what had been expected or intended when the legislation was passed?

**Chris Cummings:** Forgive me, but it is obviously not my role to advise future Ministers on attitudes they may take. I can simply say, from an investor's point of view, that we prize stability, predictability and accountability beyond all things. Making sure that the rule of law applies and that there is no handbrake turn in policy direction matters hugely. Investment is being sought by every economy around the world, and it would be a very rash Minister indeed who decided to unpick something that is a great strength of the UK and one of our global competitive advantages: a system based on the rule of law and an approach to policy making that is entirely transparent and accountable to Parliament, which gives the investment community great confidence that the UK retains its position as being one of the safest places in the world to invest in.

From our perspective, that accounts for one of the reasons why our investment management industry here in the UK is globally pre-eminent. The UK is not only the largest investment centre in Europe; we are bigger than the next two or three added together. Only the US is a bigger market, and that is because of its substantial domestic scale. When it comes to international investment, the UK is streets ahead of its competitors. We would very strongly urge any parliamentarian, and certainly any Minister, to think twice before taking actions that would have a lasting consequence for our international reputation.

**Q76 Simon Baynes:** Thank you, Mr Cummings, for a very good presentation. I just want to go back to your point about the blanket exclusion for investment managers. First, you say that is the situation in Japan, but maybe you could say where else it exists. Secondly, why is it needed? I totally accept that, on the whole, the investments being made by your members will not fall within the trigger points, because they will not be taking over 25% of Shell or even some small companies, but they might do in certain circumstances.

Thirdly, to what extent do hedge funds represent members within your organisation? Obviously, they have greater capacity, or greater natural affinity, for investing in smaller companies—not always, but in certain cases. They might actually fall within the remit of the triggers, so I do not quite see how we could implement the blanket exclusion, if from time to time there are exceptions to the exclusion.

**Chris Cummings:** Thank you for asking me to clarify; I apologise that I was not as clear as I should have been. The hedge fund community has a representative organisation. It is a splendid one that can do a tremendous job in speaking for them, and I would not put myself in that position; I would not try to speak for them. We have members that invest substantially through private markets into smaller and unlisted companies. Again, it comes down to intention. The intention is not to invest in such a way as to take over the company and to seize the reins; the intention is to make an investment that is in the strategic direction of the company, to support its growth.

I am trying not to use the term “passive investment”, because we are anything other than passive when it comes to investing, but it is an approach that is designed to support the company, rather than to change dramatically the company's ownership or direction, or to land one of our members on its board—in effect, they would then be part of the management and governance of that company. I hope it is more than a subtle definition; it is a distinction with a real difference. That is part of why we think it is an important distinction to make.

Other jurisdictions have been through similar experiences. The Japanese example is so relevant, because it is only a year or so ago that the Japanese Government were considering very similar legislation. As a result of consultation, they came up with the approach that we are suggesting: to exclude the activities of investors, insurance companies and so on, because it is around the intentionality—not wanting to take an active role in the management or to change the company's direction, but to support through investment rather than to seek control.

The US has a similar *modus operandi*. It is not quite as framed in the legislation as it is in Japan—again, just through history. The approaches that we have seen in Germany and France also nudge in the direction that I am describing, so there are parallels. The Japanese experience is the closest match that I can offer the Committee, but we will continue to do further investigations and to feed in ideas through the Bill's stages and through the consultation on individual sectors.

**Q77 Simon Baynes:** There is a fairly fine line in smaller companies in which an investment manager takes a major stake. There is a fairly fine line between having an active role in its management and having very close scrutiny of its management. From my own experience in the business, the investment manager keeps a very close eye on it in those cases. If they do not, quite a lot of risk is involved. That is quite a crucial grey area, and it therefore makes me think that a blanket exclusion would create problems. It might be viewed by private equity companies or whatever as being an unfair advantage to investment managers.

**Chris Cummings:** Certainly, we are keen to see those smaller and medium-sized companies get access to as much growth capital and investment as they need. Part of our enthusiasm for this piece of legislation, and indeed others, is that it is an opportunity to re-excite the UK public about the opportunities for equity—for shareholder participation in fast-growing companies. That is partly why we are so keen to work with your Committee and others to communicate the message.

Perhaps a clearer distinction could be found for the difference between listed and unlisted companies. That is perhaps where we could focus our attention more, on explaining—I am not sure that “blanket exception” is quite the right language for me to use because that seems to be a one-and-done exercise and perhaps there would be more to it than that—but focusing the attention on the listed sector, where it is much more obvious that we as investment managers are investing for the long term rather than seeking control over the company. I hope that would allay some of the concerns that you rightly mention.

**Q78 Matt Western:** Thank you, Mr Cummings, for being a witness today. I want to come back to the point about capacity in terms of the mandatory notifications. As described, do you think it is going to be able to cope with that, and just how opaque are some business organisations and ownership? With that opacity, will they realistically get to that within 30 days? That is my first question. Secondly, in terms of many transactions, the Government have no legal powers over retaining jobs or research and development in the UK—thinking about SoftBank, Arm and many others. Do you think there is a need to plug those sorts of gaps or deficiencies?

**Chris Cummings:** You rightly raise the question of scale and resources. It is one of the things we have been consulting our members on, and having discussions with others, to try and get a better view of what the notification process would be, who would notify, who would then respond, the scale of the team in the Department that would be exercising due diligence in the applications and whether the system could cope. Bluntly, what would concern us deeply is having a 30-day notice or turnaround period that the Department regularly missed, because

that would then create a shadow over this particular piece of legislation. It would gum up the works and, frankly, none of us would wish to see that.

Looking at how the regime works at the moment, with very few notifications, there seems to be a scale difference between where we are today and what the legislation proposes. We would like to hear more from Ministers on how they are going to address that and what the processes would be. There have been discussions about a portal, a very brief form of five pages or so that would be easy to complete, but I think a degree more of reassurance on that point would not go amiss—as would the confidentiality. There is so much around any investment process and the acquisition process that has to remain entirely confidential, that investors would require and would be looking for reassurance that these conversations could be held in the strictest of confidence and that nothing would appear until the right time. In terms of scale and resources, it is a point that we share your interest in.

I was making a note of the point you raised on transactions, but could you repeat that part of the question? Apologies.

**Q79 Matt Western:** No problem. It was just about various deals, with the example of, say, SoftBank and Arm, and the protection of jobs, research and development and pensions in the UK, and whether the Government need to plug that gap to give assurance and protection here in the UK to those elements.

**Chris Cummings:** Thank you, and apologies again for omitting that. This is something that we, as the investor community, have been observing for the last few years at least, looking at the different requirements that Governments have tried to put on acquiring companies—Kraft Cadbury and so on, through to SoftBank—and seeing what has happened there, and the role that the takeover panel has been asked to play to police or report on those activities.

The intent behind the Bill at the moment seems to be for national security to preserve intellectual property in that R&D capacity here in the UK. If that is going to be seen through, transparent and accountable mechanisms need to be clarified in the Bill, on how that will work in practice, what resources will be in place to measure, monitor and report it, to whom it would report, and any sanctions that would be applicable afterwards. Those are definitely areas that we feel deserve further scrutiny.

From our point of view, as investors, the last thing we want is to invest in companies where we feel the IP is protected and the R&D facility is well known to us, but where within one, two or three years there has been either a change of management or further changes that mean that IP has been moved or duplicated elsewhere. That is a very legitimate concern.

**The Chair:** If there are no further questions, I thank you very much on behalf of the Committee for giving your time and assistance, Mr Cummings.

*Ordered,* That further consideration be now adjourned.—(Michael Tomlinson.)

4.46 pm

*Adjourned till Thursday 26 November at half-past Eleven o'clock.*



# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT  
GENERAL COMMITTEES

Public Bill Committee

## NATIONAL SECURITY AND INVESTMENT BILL

*Third Sitting*

*Thursday 26 November 2020*

*(Morning)*

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### CONTENTS

Examination of witnesses.  
Adjourned till this day at Two o'clock.

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No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor’s Room, House of Commons,

**not later than**

**Monday 30 November 2020**

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**The Committee consisted of the following Members:**

*Chairs:* † SIR GRAHAM BRADY, DEREK TWIGG

† Aiken, Nickie ( <i>Cities of London and Westminster</i> ) (Con)	† Onwurah, Chi ( <i>Newcastle upon Tyne Central</i> ) (Lab)
† Baynes, Simon ( <i>Clwyd South</i> ) (Con)	† Tarry, Sam ( <i>Iford South</i> ) (Lab)
† Bowie, Andrew ( <i>West Aberdeenshire and Kincardine</i> ) (Con)	† Tomlinson, Michael ( <i>Lord Commissioner of Her Majesty's Treasury</i> )
Fletcher, Katherine ( <i>South Ribble</i> ) (Con)	† Western, Matt ( <i>Warwick and Leamington</i> ) (Lab)
Flynn, Stephen ( <i>Aberdeen South</i> ) (SNP)	Whitehead, Dr Alan ( <i>Southampton, Test</i> ) (Lab)
† Garnier, Mark ( <i>Wyre Forest</i> ) (Con)	† Wild, James ( <i>North West Norfolk</i> ) (Con)
† Gideon, Jo ( <i>Stoke-on-Trent Central</i> ) (Con)	† Zahawi, Nadhim ( <i>Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy</i> )
† Grant, Peter ( <i>Glenrothes</i> ) (SNP)	Rob Page, Yohanna Sallberg, <i>Committee Clerks</i>
Griffith, Andrew ( <i>Arundel and South Downs</i> ) (Con)	
† Kinnock, Stephen ( <i>Aberavon</i> ) (Lab)	† <b>attended the Committee</b>

**Witnesses**

Lisa Wright, partner, Slaughter and May

Christian Boney, partner, Slaughter and May

Professor Ciaran Martin, Professor of Practice in the Management of Public Organisations, Blavatnik School of Government, University of Oxford

## Public Bill Committee

Thursday 26 November 2020

(Morning)

[SIR GRAHAM BRADY *in the Chair*]

### National Security and Investment Bill

11.30 am

*The Committee deliberated in private.*

#### Examination of Witnesses

*Lisa Wright and Christian Boney gave evidence*

**Q80 The Chair:** Before calling the first Member to ask a question, I should like to remind all Members that questions should be limited to matters within the scope of the Bill and that we must stick to the timings in the programme motion that the Committee has agreed. For this session, we have until 12.15 pm.

I welcome the two witnesses from Slaughter and May. Can I ask you to introduce yourselves for the record, please?

**Lisa Wright:** Hi, my name is Lisa Wright and I am a partner in the competition group at Slaughter and May.

**Christian Boney:** Good morning. I am Christian Boney and I am a partner in the corporate mergers and acquisitions group at Slaughter and May.

**Q81 Chi Onwurah** (Newcastle upon Tyne Central) (Lab): Thank you very much, Ms Wright and Mr Boney, for sharing your expertise and time with the Committee. It is indeed extensive experience of mergers and acquisitions.

I am sure you are aware that many countries—the US and Canada are just two—give some sense of the factors that might be considered under a national security assessment. Do you think it would be helpful for market participants to have greater clarity about the types of factors that would be considered? How could we give that clarity while retaining the sensitivity and discretion that are needed on those matters?

Joined to that, there are cases such as Arm and DeepMind where economic security became national security over time. When considering what national security is, what links do you see between national security and economic security or sovereign capability? Can they better be reflected in the Bill?

**Christian Boney:** Lisa, shall I have a go at that first?

**Lisa Wright:** Yes, go for it.

**Christian Boney:** Starting with the need for factors to help inform market participants' decisions about whether, for example, their potential transaction presents risks, yes—in short, the more guidance that can be given about the kinds of factors that the Government will consider in determining whether a transaction presents a national security concern, the better. The statement of policy intent is very helpful in framing that, but clearly the more detail that can be included, the better.

The other thing that will be important in giving people a sense of whether their transaction should be notified or whether it falls within a mandatory notification sector is the interaction that will take place through informal engagement through the investment security unit. It is very important that the process for getting informal guidance from that unit is as streamlined, interactive and responsive as it can be. That will go some way to giving practitioners realtime guidance on potential concerns.

**Lisa Wright:** Can I just add a point to the idea of the desire for more certainty around what national security means? I think it is worth recognising that that is particularly important if you look at where we have come from. With the existing regime under the Enterprise Act 2002, there have only ever been a dozen or so interventions on national security grounds. There is not a widespread understanding of what it means and the circumstances in which the Government would intervene. That is the historical position, but we all know that this is constantly evolving.

When you take that and add to it the fact that the prediction now is that there will be, as it says in the papers, between 70 and 90 call-ins a year, that is obviously a huge increase against the 12 since the Enterprise Act. Any greater clarity that can be given around the circumstances in which the Government would be looking to, for instance, exercise the call-in powers would be beneficial, particularly at the beginning of the regime when everybody is trying to learn the ropes.

**Q82 Chi Onwurah:** You mentioned, and I think it is absolutely right, the issue about going from a standing start to such an increase in the number of callings but also in the number of notifications—the impact assessment estimates 1,830 notifications. That is on the acquirer and does not take into account the fact that almost every start-up seeks capital investment at some point and I imagine would, therefore, as a consequence have to think about this regime. What impact do you foresee on the UK's investment climate and especially on capital sources for small and medium-sized enterprises? How could that impact be mitigated or encouraged to be as positive as possible?

**Christian Boney:** I think this question really divides into two. In terms of larger corporates, investment by, and in, larger corporates is very likely to be unimpacted in any meaningful way by this legislation, because large corporates and their advisers are very used to going through regulatory clearance processes. This will just be another thing that needs to be added to the list.

I think you make a very valid point in the context of start-up and early-stage companies. The concern I would have principally is with those companies that are in that phase of their corporate life and fall within the mandatory notification sectors. Given the kinds of companies that this country is trying to encourage to flourish—those that are active in areas like artificial intelligence, advanced robotics and quantum technologies—a reasonable number of start-ups, I would expect, would fall within those mandatory notification sectors. For them, this regime is going to make the process of getting investment more time-consuming and more complex.

Anything that can be done in the process of consulting on the mandatory sectors, and anything that can be done to pair back the regime to make it more workable

for companies in that stage of life, the better. An example might be some form of de minimis threshold, which is included, such that really early-stage companies do not fall within the mandatory notification regime, but the Government can nevertheless rely on their call-in power down the track, should that early-stage company becomes successful and more strategically important within the UK. Those are my principal thoughts. Lisa, do you have anything to add?

**Lisa Wright:** Not on that point, no

**Q83 The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Nadhim Zahawi):**

May I return to the national security issue—as opposed to the wider public interest test, which is an important question—and get your view as to the Bill’s scope, which is very much focused on national security, versus the wider public interest, to which I think my colleague’s first question alluded?

**Chi Onwurah:** To clarify, my question was this: how would you distinguish between national and economic security?

**Nadhim Zahawi:** My question is more about your reflections on the Bill being narrow in its purpose to deal with national security versus the wider public interest.

**Lisa Wright:** It is already a very broad regime; it catches a lot of transactions, as we have just discussed. I therefore think it is important and right that it is limited, in terms of the substantive concerns that it is catching, to national security. That is already a necessarily, I think, uncertain or undefined concept. Corporates and investors can make it work as long as other aspects of the regime work efficiently. That may be subject to some of the points that Christian just made about the impact on start-ups.

I think that once you broaden the regime out from national security into other considerations, you do risk introducing quite a degree of unpredictability, which possibly would impact on people’s assessment of the investment climate in the UK. My understanding is that the existing intervention regime under the Enterprise Act is planned to remain in force, so the national security considerations will come out of that and will be dealt with under this new regime. But there will still be the ability for—[*Inaudible.*]

**The Chair:** Mr Boney, do you have any observations while we are waiting for the tech to work?

**Christian Boney:** I agree entirely with what Lisa has been saying. I think the scope of the Bill is already broad, so to my mind, broadening it further to take account of other areas is likely to introduce the uncertainty that Lisa was referring to and, as a consequence, have a potentially negative impact on the investment climate in the UK.

**The Chair:** Lisa, it looks like we have got you back now. Would you like to add anything?

**Lisa Wright:** I am not sure at what point you lost me, but I think I was saying—

**Nadhim Zahawi:** We lost you while you were talking about a “degree of unpredictability”, Lisa.

**Lisa Wright:** Okay. In my view, if you were to broaden the regime out from national security to take into account other considerations, that would introduce quite a degree of unpredictability and would, I think, potentially impact negatively on people’s assessment of the investment climate in the UK—I am sorry if I am repeating myself. However, my understanding is that the existing intervention regime will remain, so national security will come out of it, but the Government will still be able to intervene in transactions on other public interest grounds under the Enterprise Act. That regime has some limitations, but those powers will still be there.

**Q84 Stephen Kinnock (Aberavon) (Lab):** Thank you very much for the really excellent evidence you have already given us. I want to go back to what Mr Boney said about de minimis thresholds and whether you might look at introducing de minimis thresholds for particular areas, sectors or industries that I guess you would say are considered to be low risk from a security point of view and highly beneficial to the UK economy, which should therefore affect our thinking about how you might filter this whole process. But are there not other considerations on filtering as well? In essence, this is a risk management process and you have to identify the highest risks. Surely issues of critical national infrastructure would place a type of acquisition into the high-risk quadrant. If the acquirer is close to a state or Government—particularly a hostile Government—that would place it in the high-risk quadrant. Therefore, on having a more filtered process, is the de minimis threshold the right way to go, or would it not be better to have a strategic approach based on a hierarchy of risks?

**Christian Boney:** I think the de minimis concept is potentially relevant and helpful in the context of thinking about what needs to be subject to mandatory notification. If you are not within the mandatory notification regime, that does not mean that the Government cannot exercise the call-in power so long as the relevant tests in the legislation are satisfied; it just means that the relevant company does not have to make a notification. There are elements of the mandatory sectors where some form of de minimis has already been included. Energy is a good example of that, and that makes sense in the context of energy.

I think it is worth exploring whether, within any of the other sectors, where we are more likely to see start-up, early-stage companies operating, there is benefit in introducing some form of de minimis regime solely in respect of the mandatory notification requirement. As I say, if a small-scale company operating in critical artificial intelligence is receiving investment from somebody who we view as a hostile actor, that transaction might escape mandatory notification, but that does not mean it escapes voluntary call-in by the Government at the point they become aware of it. That is something that might be worth exploring.

**Stephen Kinnock:** Thanks very much. Does Ms Wright want to add anything?

**Lisa Wright:** No.

**Q85 Stephen Kinnock:** I want to explore a bit further the issue of critical national infrastructure, which is defined by the Intelligence and Security Committee as

[Stephen Kinnock]

the Government's 13 sectors ranging from energy to transport infrastructure and anything that relates to public health. With covid, we have seen the massive importance of how we have been overexposed in certain supply chains, and that might have an effect on our thinking about critical national infrastructure. To what extent does that influence your work on mergers and acquisitions and your thinking about whether such mergers and acquisitions in areas of our critical national infrastructure are in the national interest?

**Christian Boney:** If I am following the question correctly, I think it is the correct balance to strike to say that people pursuing significant M and A activity involving the UK's critical national infrastructure should expect to go through a notification process and should expect their transaction to be at potential risk of examination and call-in. From my experience, corporates undertaking transactions in the spheres of national infrastructure and so on expect that. It is what they see in other countries and jurisdictions, so it is something they come to accept as part of doing deals in top-tier democratic nations.

**Lisa Wright:** I agree with all that. I guess I would also add that people are well aware that these considerations change over time. This year has shown that more than ever. People have an eye on what might not have been an issue yesterday; today, it might be different. We saw the amendments coming through to the Enterprise Act earlier in the autumn to bring in the power to allow the Government to intervene on public health grounds. People are very conscious of the fact that this changes, and they keep an eye on it from that perspective.

**Q86 Simon Baynes (Clwyd South) (Con):** Thank you both for your submissions this morning. I want to go further into the issue of how you, the Government or the agency it sets up to do this makes a judgment about whether a small or start-up company really falls within being a threat to national security. I imagine that that might be quite a difficult judgment to make. I am putting to one side the issue of mandatory notification, which Mr Kinnock has looked at in more detail. I am saying that once it has been notified, how do you make the judgment about whether it is a threat to national security?

I would have thought that there are two aspects to that. One is the nature of the acquirer, which is partly what you have already alluded to. The second part is that I would have thought that it is quite difficult to ascertain whether something at the cutting edge of technology is or is not a threat. I would have thought that that is a really difficult judgment to make in practice. Do you have any thoughts on that, and what experience do you have of other regimes trying to make that kind of judgment?

**Lisa Wright:** I think there are probably a number of ways to tackle that question. I guess that an answer is that it is ultimately a question for the Government. They are the ones who understand the threats and the intelligence. As advisers, we can look at the guidance and cases that have happened in the past, and we can speak to the unit, which, as we understand it, will be open for engagement and will welcome that. We can guide clients through the process, using the touch points

and information that is available to us, but ultimately it is the Government that are in possession of the full set of facts and considerations that go into the decisions about whether that particular transaction is a problem or not. I guess what that speaks to is having the right people in the unit and getting them plugged into the right people elsewhere in Government to arm them with the ability to make these assessments.

**Christian Boney:** To pick up on that, I agree entirely with what Lisa said. It is not necessarily an easy thing for the advisory community or clients themselves to make a judgment about whether they are presenting risk to national security. That is why this concept of real-time, interactive engagement with the unit that is set up to police this regime is going to be so important.

In the world I operate in, one of the regulators we deal with is the Takeover Panel, which is fantastic at being responsive, with real-time engagement. It results in a dialogue and an interaction that helps advisers navigate their clients through a regime that is not straightforward at times. That is the kind of practice that could usefully be learned from in the context of the investment security unit, because that kind of real-time feedback and informal advice will be very helpful in helping companies make the judgment about which side of the line they fall.

**Q87 Peter Grant (Glenrothes) (SNP):** Good morning, Ms Wright and Mr Boney. I want to look in more detail at the kind of information that might be included in the Secretary of State's clause 3 statement, which will set out the kind of factors that they will take into account in deciding whether they needed to intervene.

There is a fair amount of information in the Bill and the documents published alongside it about the kinds of businesses being acquired or taken over that might give rise to concern. There are quite clear definitions of what constitutes a trigger event, whether it is a purchase of shares or whatever, but there is very little detail about how the Secretary of State will decide which potential acquirers pose a threat. There are clearly good reasons why that information cannot be made public in too much detail, but is the fact that there is so little on the face of the Bill about how that decision is arrived at a problem? Does it make it less certain and therefore more likely to result in legal challenge?

**Christian Boney:** Acquirer risk is one of the points picked up in the statement of policy intent that is going to be looked at when determining the level of risk that a transaction presents. When looking at and explaining acquirer risk, I think that helpful additional guidance could be added to it to, for example, make clearer how the Government will consider acquirer risk in the context of things such as private equity funds and other funds that may be looking to invest in the UK. By that, I mean in particular whether the Government will be willing to disregard the identity of limited partners and other investors in funds that sit above the particular acquisition vehicle that is doing the relevant transaction. That is the kind of thing that I think there would be real benefit in trying to make clearer in the statement of policy intent.

**Q88 Peter Grant:** Thank you. I will focus a bit more on the definition of a trigger event, and in particular the catch-all provisions that define when somebody becomes a person with significant influence or control over a company.

The Companies Act 2006 has similar requirements for a company to notify Companies House if certain things happen that put someone in a position of significant influence. From a lay person's point of view, such as my own, some of those provisions are almost word for word the same in the Companies Act and the Bill. Some appear to have the same effect but the wording is different, and therefore there will potentially be occasions when the definition is different. Would there be benefits in completely aligning both pieces of legislation so that a particular event either has to be notified or does not have to be notified? Otherwise, there is the possibility that some events will have to be notified under the Bill, and other events will have to be notified under the Companies Act but not the Bill.

**Christian Boney:** In short, I think there would be benefit in having as much alignment as there can be. Clearly, the two pieces of legislation are not necessarily designed with the same intent and focus in mind. Yes, I think there is merit in having as much alignment between the two as there can be.

If I may, there is just one point about the trigger events that is worth considering. One of the points in the statement of policy intent in the context of trigger events is the Government considering the risk of espionage. That seems to me to be something that is worth thinking about in the context of this regime. At the moment, the trigger events are focused, as you were saying, on the ability to influence a particular company, but there are certainly circumstances where, without acquiring a level of shareholding that enables a person to influence the company, the person can nevertheless gain very significant access to information—for example, through a board seat, which might come at a shareholding of lower than, for example, 15%. That would give that person considerable access to information within the company. If they were a hostile actor and they wanted to act in a nefarious manner, it would enable them to feed that information back to another hostile party. We have spoken about narrowing the scope of the regime, and I appreciate that that would be an amplification of it, but I think that is a point that is worth considering.

**Q89 Mark Garnier (Wyre Forest) (Con):** I will carry on with the line you took just now about an investor's potential influence over or access to a company. A little earlier, you were talking about start-ups who sought to get staged financing in order to try to build their businesses. Of course, there are more ways of getting investment than just getting equity. We know that if a business has a relatively small amount of equity but a huge amount of debt, the provider of the debt has much more influence over the company than perhaps the shareholders do. We saw that on the banking commission when we looked at the role of bondholders in influencing banks, compared with equity holders. Clearly the bondholders, in effect, had much more influence.

The other thing is that a start-up company can raise money in other ways. The Bill tries to make sure that we are not losing intellectual property, but a business can raise finance by licensing the intellectual property that we are trying to protect—I am not sure that that would come within the scope of this Bill—or even sell the intellectual property and license it back again. There are various other ways in which a company can raise finance, over and above equity, where there is a huge

amount of influence or it falls outside the Bill. Clearly, crucial national infrastructure is a very different thing, but intellectual property is something that is very difficult to grab hold of; it is like trying to grasp a handful of sand. Given the objectives, I wonder how the Bill tackles those other areas, which seem to allow malign investors a way through.

**Christian Boney:** I think an important aspect of the Bill—this is one of the reasons why Lisa and I have described it as a broad regime—is that it does allow policing of the acquisition and control of assets, including intellectual property. In my experience, at least, that is quite different from what you see in other international regimes. Clearly, the acquisition of control of assets does not fall within the mandatory notification regime; nevertheless, it is helpful that the Government have the power potentially to exercise a voluntary call-in in respect of, for example, an acquisition or a licence of intellectual property.

**Q90 Mark Garnier:** And the debt issue—the fact that debt holders can be more influential over businesses than equity holders?

**Christian Boney:** That is certainly fair. I think the level of influence and control that a debt provider will typically get in what I will call the ordinary courts means that it is less likely—I am certainly not saying it is impossible—to be at the level of getting such granular, sensitive, let us call it operational information, which is the kind of thing we would really be concerned about. It would more be focused on getting access to financial projections, financial performance and that kind of information, which, although it can still be sensitive, is probably less sensitive than operational data. A balance needs to be struck, it seems to me, in the context of this legislation. Not having debt providers obviously within scope does limit the legislation, but does it strike an acceptable balance? My personal view is that, on balance, it probably does.

**Q91 Nickie Aiken (Cities of London and Westminster) (Con):** From your professional point of view and experience to date, what could be the long-term impact of the Bill on UK business and investors? Will the Bill help or hinder the global position on investing into the United Kingdom?

**Lisa Wright:** In many ways, the regime just brings the UK into line with major international peers. From that perspective, for people doing deals around the world who have already experienced those other regimes, it ought not to have any real negative impact at all, provided that BEIS can deliver on the aspiration set out of a slick and efficient regime, turning around notifications within sensible deal timeframes and providing the kind of informal advice and early engagement promised. That will be critical, particularly in the early stages of the regime. From that perspective, I do not think this should have a long-term negative impact on people wanting to do deals in the UK. As Christian was mentioning earlier, it may be a slightly different picture for the start-ups and the smaller companies where they are caught up in the mandatory sectors, but overall I think it is right that this can be viewed as the UK bringing itself into line with what else is going on around the world.

**Christian Boney:** I agree with that. That is the right assessment.

**Q92 Sam Tarry** (Ilford South) (Lab): Picking up the idea of bringing us into line with global peers and equivalent countries, there are many different regimes and you both have incredible global experience legally. If you have experience of dealing with companies and transactions, mergers and so on, particularly in the US, you will know that it has the Committee on Foreign Investment in the United States, with its white list of almost green-lighted countries, which they can deal with slightly differently. Should we consider something like the US does with its more established regime and having not necessarily an approved list but different layers for our regime, from the most hostile countries through to those who are our closest allies?

**Lisa Wright:** It is certainly worth considering. I would imagine that those sorts of considerations will be going through the mind of the officials and the Secretary of State tasked with making these assessments and issuing the decisions. I can see there may be some sensitivities and a desire perhaps not to make that all transparent in terms of public documents. Perhaps they think they will deal with it over time through this engagement and, with advisers and parties coming to talk to them, you will get a sense of who is okay and who is not that. But I can see that perhaps they will not want to put that down in very great detail on a public piece of paper, not least because one might imagine it could change over time. I guess there needs to be a degree of flexibility to recognise that.

**Christian Boney:** I agree. I am certainly not a CFIUS expert, but my understanding of the exempt list of countries is that actually the practical impact is quite tightly drawn. I do agree with Lisa. I think we are likely to get the best sense of those countries that are viewed as more risky than others through the engagement process and as people's experience of the regime develops.

**The Chair:** We are almost at the end of the time available for this session, so there will be no further questions for these witnesses, but thank you, Ms Wright and Mr Boney, for being so generous with your time and assisting the Committee so much. We will now move on to the next witness—either we will suspend the sitting briefly until everything is sorted out or we will move seamlessly on—but thank you both very much.

### Examination of Witness

*Professor Ciaran Martin gave evidence.*

12.10 pm

**Q93 The Chair:** Would you mind, Professor Martin, just introducing yourself for the record and for the benefit of the Committee?

**Professor Martin:** Thank you. My name is Ciaran Martin. I am currently a professor of practice at the Blavatnik School of Government at the University of Oxford, but until August of this year I was the founding chief executive of the National Cyber Security Centre and a member of the executive board of GCHQ, within the Government. I should also declare for these purposes,

although I am not sure it is relevant, that I serve on the advisory board of a US venture capital company called Paladin.

**Q94 Chi Onwurah:** Welcome, Ciaran; it is great to see you here. Thank you so much for sharing your expertise: as the founder of the National Cyber Security Centre, you have a great deal of expertise. I want to ask you to talk about a question that I have raised a number of times and that your expertise should be able to give us a real view on, which is about understanding the distinction, if there is a distinction, between national security and economic security concerns. You will be familiar with a number of cases, such as Arm and DeepMind, to name just two, that involved an economic security issue, you could argue—in terms of sovereign capability in artificial intelligence in the case of DeepMind, and of mobile silicon in the case of Arm—but that pretty swiftly turned into national security concerns. This Bill identifies a number of different sectors or areas—up to 17, I think—where a notification will be mandatory. How can we look at understanding or reflecting a distinction between evolving economic security and, ultimately, our national security?

**Professor Martin:** Thank you for your comments, Ms Onwurah; it is nice to see you again. I speak as someone who thinks that the Government have broadly got this issue correct, in terms of their proposals in this Bill. That is not to underestimate the sheer complexity of dealing with the core, fundamental question that you rightly identify of balancing economic security and national security and of where one stops and the other begins. That is a very complicated and difficult thing to do. I think one starts with an attempt to define a core principle, which is essentially around the freedom to act. I think that if you look at something such as Arm—I would say this probably more in the case of Arm than DeepMind—and its potential ultimate sale to Nvidia, you see that the UK has less freedom of choice in a key strategic technology, which undermines its own ability.

I think there is an analogy with the little known but quite long-standing—for more than a century—work on sovereign cryptography. That is one of the areas that has long been covered by national sovereignty requirements. There are things in information security, as we used to call it, cyber-security, as we do call it, that have always needed to be fully sovereign, entirely British-made—they are not very many areas. The problem has been that as technology and communications have changed, it has been quite hard to keep up, and there are always pressures to expand that in a way that is economically harmful to competition and so on. So it needs a clever buyer within Government to identify what will be the strategic areas and what will not be.

In the area of sovereign cryptography, we end up trying to keep, depending on the era, around half a dozen or a dozen companies viable, because it is not a lucrative market. You can see the problem, but the key issue is whether there is enough, first, sovereign, but if not sovereign, friendly capability that allows us the freedom of choice to adopt key technologies. That means identifying the key technologies in the first place, evolving them over time and then having a very difficult to achieve but necessary intelligent function within Government that can evaluate the notifications that it

gets. Of course, at the moment we do not have the power to do that, and that is what this Bill correctly seeks to remedy.

**Q95 Chi Onwurah:** Thank you. I am very taken by your definition of sovereign and friendly capability. Indeed, that is exactly what we do not have in our 5G networks, hence the mess with Huawei.

Moving on slightly, a comment made numerous times on Second Reading was about the role of the intelligence services. Indeed, my right hon. Friend the Member for North Durham (Mr Jones) asked for more intelligence in the process. How can the Bill better ensure that the intelligence services, including the National Cyber Security Centre, have input and scrutiny and, indeed, provide their expertise as part of the process so that the appropriate decisions are taken?

**Professor Martin:** I think the essential, principal requirement is not the intelligence services' involvement—although that is important and I will come to that in a minute—but the understanding of technology and technological developments within Government. These are fundamentally economic issues as well. Apart from anything else, if you look at some of the reasons why the Bill has come about, you will see that, in strategically important technologies, the Government have invested heavily in university-sponsored research and in private sector research, only to see the fruits of that research sold off. Even if that did not impact on national security, which in most cases it does, it is not a good return for the taxpayer in terms of long-term UK involvement if the intellectual property ends up being monetised elsewhere.

I have enormous respect for Mr Jones and I think he is on to something in terms of involving the national security and intelligence services, but I do not think this should be intelligence-led. In my experience—obviously, I cannot go into detail on this particular aspect of it—secret intelligence adds relatively little to your knowledge of intent. If we take Russia and China, the two big strategic threats to the UK, Russia does not have a strategy in this space. We have to worry about Russia and cyber-security because it attacks us, but it attacks us on the internet that the west has built.

China is very different. China has a technological, strategic dominance aim, but it is not a secret. It is published and has been translated into English in the Made in China 2025 strategy, as you know. Our knowledge about the precise, intricate details of how that is implemented gains relatively little from secret intelligence.

What secret intelligence does have, particularly in GCHQ and the NCSC within it, is a knowledge of how technology works in terms of the national security threat space. I think the UK has a head start on other countries, because the National Security Council innovations of the 2010s gave the intelligence services a much bigger voice at the table, and that is reflected in the structures that we have now. The UK should be well placed to be able to listen to the intelligence services, but I would encourage—not least to make sure that in this very delicate balance of trying to show that we still have an open economy and are not shutting the doors to investment—as much transparency as possible on the decision taking. It will not always be possible because GCHQ technologists will know about things—exploitations of particular bits of technology—that they cannot reveal.

They will be able to tell that to secret forums within Government for consideration—I am quite confident about that: there will be a seat at the table for them.

My recommendation would be that, as far as can safely be done, the Government should be relatively open about why they make the judgements they make about strategic areas of technology and the interventions they will make once this Bill is passed—assuming that both Houses wish to pass it.

**Q96 Nadhim Zahawi:** Professor, that was excellent and I am very grateful for it. I will follow on from that thought and ask about the proposed powers within the regime for the Secretary of State to gather that information, which, as you quite rightly remind us, is not necessarily secret but about understanding the technology, or a particular piece of the technology, within the sector. What are your thoughts on the regime for the Secretary of State to be able to gather that information to inform a decision or to call in witnesses, so that they are able to really understand that particular issue and therefore make a decision on it?

**Professor Martin:** I suppose the mantra, if I had one, would be, “Broad powers, sparingly used, with accountability mechanisms”. It is incredibly hard to be specific about this, for two reasons: one is that new areas of technology crop up, as they invariably do, and the other is that sweeping categorisations are needed on the face of legislation.

I am not a deep technical expert—although others are available from my former organisation—but if you take sweeping, umbrella titles like “quantum” or “artificial intelligence”, there are huge swathes of that where, actually, not a lot of these powers in the Bill will be used. There will be companies that will be doing very interesting things—10 interesting things—of which only one would be caught by this Bill.

If you take areas like specialist quantum computing and so forth, I think the community of interest and expertise is actually relatively small and has relatively good relations with Government—not least because, again, while it is not perfect, the whole system of research council funding and Government investment in funding technological research is pretty good, by international standards—so you end up knowing these people. One of the reasons that this sort of policy evolution came about, which has led to the publication of the Bill before you—I remember this from discussions within Government—is that people were volunteering to come to us. World-leading experts, people who had been funded by the Government—I will not go into individual cases because it is commercially sensitive and possibly security sensitive—would come to Government and say, “Look, we’ve had this inquiry from a Chinese behemoth,” or even, “We’ve had this inquiry from a US company,” and so forth: “What do you guys think about this?” and, invariably, we would have to have an informal influencing discussion.

I do not think that some of the businesses to which this will apply will be screaming that this is horrible Government regulation and intervention in areas where that should not be made. There was already a dialogue; there was just no legislative framework. Of course, that meant that companies that felt a loyalty to the UK and so forth but that also had to look after their commercial interests were sometimes in a real bind.

To try to answer your question, I think that the powers should be fairly broad. I think there should be accountability and transparency mechanisms, so that there is assurance that they are being fairly and sparingly applied.

**Q97 Stephen Kinnock:** This is very interesting evidence. I want to ask you a little bit more about China. As you rightly pointed out, much of this is in the public domain, and the Made in China 2025 strategy is very clear about the objective, which is to achieve global technological dominance. Given your experience at the National Cyber Security Centre, can you share with us a little bit more about how that would manifest itself in practice? What do you see as China's next moves, in terms of rewriting the rules on technology and on creating that dominant position that you have talked about? How do you see that manifesting itself?

**Professor Martin:** I think there are broadly two or three areas in which China is very interested in doing that. I can make some comments on motivations, because I think they are very important, and then I will finish with how that manifests itself in UK casework.

Clearly, China has set out a stall, which it published in Made in China 2025, in which it said it wants to be the world's pre-eminent leader in a number of key areas of technology. It mentioned artificial intelligence and quantum, and it is throwing vast sums of state money and long-term strategies at them, unencumbered by the need to seek re-election and popular consent, so it is a very powerful movement. That is the first thing: it is trying to build up its capability.

China is also trying to change, at least for itself—we will come to that in a minute—the way the internet works. It was reported earlier this year that Huawei and other major companies in these international standards bodies are looking at something called new IP protocols, among many other things. To give you a sense of what the motivations behind that are, at the minute when traffic flows around the internet, despite some popular impressions to the contrary, it is actually pretty hard to work out what is going through it. Therefore, it is relatively difficult to censor, although China has managed it in some ways. The new IP protocol will make it much easier to work out what sort of traffic is going through and being rerouted, so it makes it much easier to control. China is trying to dominate and essentially get a lead in the strategic technology, and also to change the character and culture of the technological age from one that started off fairly anarchic to one that is much easier to control. That is what it is trying to do.

Why is China trying to do that? A lot of this is about the assertion of its own power for itself—the regime, power, Chinese nationalism and so forth. I think it does intend to extend its sphere of influence, but I have never seen that as the primary motivation. One of the interesting things, post the pushback from the Trump Administration and the US sanctions on Huawei, is the extent to which China will now accelerate its desire for self-sufficiency, and the extent to which that leads to a separate pole of technological influence that may become less interested in countries such as the UK, European Union countries and North America.

To date, how has that manifested itself in cases in the UK? Ms Onwurah has already mentioned the Huawei controversy. If you take Huawei as a company, I think it

shows the different ways in which this can manifest. The Huawei 5G controversy is going to be dealt with by a Bill that I believe is coming to the House next week, not this one. The 5G controversy was not about investment; it was about selling to British companies to build stuff. Obviously, that case has been very heavily analysed.

I think that the more interesting case in the last 10 years involving Huawei was its acquisition in 2012 of the Centre for Integrated Photonics—a world-leading British firm in a really key area of technology. That, in my view, was pretty strategically damaging. If we had our time over again, that is the sort of thing that the Bill might well notify. I know you have taken evidence from the likes of Charles Parton and people with huge China expertise. The fact that the acquisition of the Centre for Integrated Photonics did down Britain's technological development was probably a by-product. The point is that Huawei could buy world-leading research, which China could then take and appropriate for itself very cheaply. That is what it will continue to do to build up its own capabilities.

**Q98 Stephen Kinnock:** Given what you just said about the nature of the threat, how should that inform the composition of the investment security unit, which is going to be placed in BEIS and will be the primary locus for the screening of acquisitions? Would you say that it needs to have absolutely leading expertise in technology in the issues that you mentioned—quantum and so on? Should it also have China experts and people who speak Mandarin?

**Professor Martin:** One of the reasons that this is so difficult, as I said in my first answer to Ms Onwurah, is that I can think of at least three areas of expertise that the unit is going to need to draw on. Technological, yes, because of what technologies will matter. Geopolitical, yes, and I do not have a strong view on whether it needs Mandarin speakers because the UK has a strong and intelligent foreign service mission in country in China and all over the place that can provide input. But the third thing is actually quite a lot of commercial nous—patent laws and so forth.

This is where there is a distinction. This is not all about China. It is layered, and there will be things that we would not want to see going even to quite friendly countries. Arm is a case in point, with the concentration of power in a couple of US companies—particularly when one of them is derived from UK technology. That is not comparable as a strategic threat to Chinese dominance—I hope the Committee does not think I am saying that—but there are times when it would be a damaging foreclosure, if you like, of UK freedom of action and freedom of choice. We know that the US has a strong and sometimes aggressively used extraterritorial legal system in which it can use the power of US companies and block trading with US companies and so on, so we need people who understand those areas where we think, “We are not sure we would want that to leave the country at all” as well as people who understand Chinese. That involves a lot of expertise in things like patents, international law, US commercial law, sanctions and so on.

**Q99 Andrew Bowie (West Aberdeenshire and Kincardine) (Con):** Professor Martin, I have been listening with interest—it has been fascinating—especially when you were talking about the need to balance national security,



the national interest and economic security. I have been reading the very good briefing by the Law Society of England and Wales, which suggests that the Bill could be improved by the insertion of a definition of national security. Do you agree?

**Professor Martin:** I do not vehemently disagree with that suggestion, but I am not persuaded by it. It is not a new issue. I remember cases—they have nothing to do with this—going back to the aftermath of the so-called global war on terror, with demands during inquiries for definitions of national security. I am not sure what that would achieve other than it would be heavily litigated. In terms of both definitions of national security and the categories of technology, a better answer is a drumbeat of reviewable activity, which is by definition transparent, about how the Government interpret the scope of the Bill, if it becomes an Act, and the sort of cases it applies to so that, over time, you build up a broadly accepted framework—of course, not everyone will accept it—that is seen to be fair and rational.

**Q100 Peter Grant:** I understand the reluctance to have an explicit legal definition of national security, but would there be a benefit in having an “except for” clause that makes it clear that certain activities do not come under the category of a threat to national security? Would that help to allay fears about infringements of rights of democratic participation—the right to protest and so on?

**Professor Martin:** I certainly would not be against things like that, if it could be done in a way that did not compromise the wider use of the Bill, because I do not think there is intent to interfere in the democratic process. I think the intelligence services take that pretty seriously. I remember in other contexts, when asked to co-operate on cyber-security with other countries, given that some cyber-security capabilities—by no means all—can be intrusive, that a lot of due diligence is always done on whether they could be turned by more authoritarian regimes against their own people. I would not object to that in principle. I do not know whether you have a case in mind when you say that might be necessary, but I have an open mind on that.

**Q101 Peter Grant:** There has been some discussion of whether the investment security unit is best placed within BEIS, the business Department. Do you have a view on that? Does it matter where in government it is based? If it does, would BEIS be your preferred location, or do you think it should be based elsewhere?

**Professor Martin:** In general terms—this is a personal view, for what it is worth—I do not think the location of most government functions matters a great deal. Perhaps I am just a bit of a contrarian on that point, and always have been. The Government is the Government. Institutions do have cultures. I do not know whether the Government or the intelligence services have offered a formal view, but personally I would be reluctant to put it within the national security estate, first, because it has to be economically literate, and secondly, because it has to justify its existence and use. A strong national security input is important, but I would not leave it in the national security community.

I am sorry to sound like a broken record on this point, but I think the more important force in function is some form of reviewable transparency requirement.

If you set it up and let it go away, first, you take away pressure to perform well, and secondly, you take away pressure to justify the decisions that are made.

This is a really hard problem. When I was still in government and there were discussions around it, this was not the sort of Bill that most Ministers and politicians came into Government to want to pass. It is a necessity of a bunch of case work that we have become concerned about that has required us to do this. It is sort of the least bad option. The country wants to be open to investment—we are all mindful of the impression it may give that it is trying to deter investment—so it is probably the least bad option, as I say.

I do not think there is any arrogance in government or belief that a bunch of civil servants assembled in BEIS or another Department will make infallible judgments on individual cases, but what is the alternative way to stop the sort of things we have seen happening—world-class taxpayer-funded research in key strategic technologies that are going to be vital for national security being sold for a song to potentially hostile regimes?

**Peter Grant:** I will leave it there, Sir Graham. I may want to come back later, but I will let someone else in now.

**Q102 Simon Baynes:** Thank you for your excellent evidence, Professor Martin. You said, if I understood you correctly, that the process needs to be relatively open about why it is making decisions, but I foresee problems, particularly where there are issues of confidentiality and national security. Would you explore that a little? I note that within the terms of the Bill, decisions will be subject to judicial review or appeal, and the Government will be able to apply for a closed material procedure to protect sensitive matters in such proceedings. It seems to me that there is a potential problem there in relation to commercial and national security information sensitivity, so the “openness” of the system might be fairly limited and it might not be as respected as it could be.

**Professor Martin:** I get that completely. I do not think 100% transparency will be possible in this case. Obviously, it will be judicially reviewable, but I am entirely unsurprised that there is an explicit provision for closed material procedures. It will be a minority, but there will be cases in which the reason why a particular aspect of a particular piece of technology is really sensitive—it will probably be highly specialised, and there might be a dozen people, of whom four serve in government, who actually understand why—cannot be published. Then, of course, there will be commercial sensitivities.

Having said all that, if you take, for example—these are real examples—the current debate around the potential use of offensive cyber, or the sort of allegations Edward Snowden made against Five Eyes countries in 2013, or some of the defences that the Government had to use in the 2000s about their role in the aftermath of 9/11 and Iraq and co-operating with US forces, in my view there is a clear distinction between being able to describe the operating environment and the sorts of thematic issues that you are dealing with, versus individual cases, which often contain extremely sensitive detail. National security organisations can say much more about the former than historically they have been willing to do.

In something like this, where we are talking about business confidence and how the country looks to potentially very friendly and helpful outside investors who like the UK, want to come here, want to put money here and like the high-quality research and the brilliant innovators and individuals, it should be possible to give them something that says, “In the course of the last year, we have looked at quantum resistant cryptography and here are the types of aspects of this that we are reserving and here are the bits that are more open” or that sort of thing, without disclosing anything sensitive. That is all you need to be able to say—these are the judgments. Let us say that the Bill becomes law in the middle of 2021, for sake of argument. By 2025 and the beginning of the next Parliament, the tech landscape will look very different. You will not want investors to be looking back at the debates you are having in the House now as a guide to the latest way in which the Government are applying this, or looking at drip feeds of information. You will want something official. It should be possible to do that.

**Q103 Mark Garnier:** I want to refer back to some earlier questions about the skills within the investigatory unit that would be within BEIS. With your knowledge of Government, do you see any sort of experiences that can be carried over from the export control joint unit within the Department for International Trade? They do not have all the skills there, but they draw on skills from other Departments, particularly when it comes to arms export control and the eight consolidated criteria. Do you think there is potentially an opportunity in the day-to-day structure of the investigations unit for some lessons to be learned and carried across from the ECJU? Or do you think that is irrelevant?

**Professor Martin:** I do not know the ECJU that well, but it is relevant. I remember, although it was some time ago, being asked for specific inputs into that sort of point. The important thing is that the unit achieves a prominence and reach across the Government, because bits of Government will have to be involved occasionally and there will be bits that will be embedded. It needs a home—in our system of government, every organisation needs a home with a responsible Minister and an accounting officer and all that. However, I do think this needs to be broadly based and multidisciplinary. Export controls are one of the few areas where we have had to do that consistently for a number of years, so I agree that it is well worth a look.

**Q104 Mark Garnier:** Do you think it should be formalised or do you think an informal relationship with other Government Departments will be adequate?

**Professor Martin:** I think it should be formal. The Government are not new to this. There should be some sort of review board to make sure that it has the right resources, the right performance, the right skillset and so forth. I would encourage ministerial interest. It may be something that the National Security Council wants to periodically review. In my time in national security, there were standing issues that the Government would come back to twice a year, whether there was anything interesting happening on them or not, just to take stock. That might be an issue. In answer to the previous question about transparency, there may be a case for a formal presentation, secret detail and all, to the National

Security Council every year, which would include all the potentially covert and sensitive stuff. It really needs to work with the grain of ministerial thinking as well. That will need to be done collectively, at some point, so there may be a role for the NSC.

**Q105 Peter Grant:** Good afternoon, Professor Martin. As part of the provisions for transparency and parliamentary oversight of the way the powers in the Bill would be used, the Bill would require the Secretary of State to have a statement approved by Parliament and then reviewed at least once every five years. Does that time period seem reasonable to you? Is there an argument for a shorter review period, especially in the early days when everybody will be feeling their way as to how the Bill works?

**Professor Martin:** There is a reasonable case for a more frequently reviewable point. There is also a cultural point about the way in which the political processes work. There are aspects of government about which questions are not routinely asked in Parliament, because they seem to be too secret. Again, it is a point about casework versus framework.

To my mind, there is no reason why the Secretary of State for BEIS could not be asked from time to time to update on this or why questions in the House should not be asked. I do not think technology changes fast enough that the whole framework of categories of regulated activity and so forth have to be updated more than every five years, but there will be a possibility of more frequent updates on working, approving listings and that sort of thing.

**Peter Grant:** To be fair, there is nothing to stop MPs from asking questions about international security, but the chances of us ever getting an answer may be somewhat less.

**Q106 Chi Onwurah:** You have placed a lot of emphasis on the right technological skills and said that they should be forward looking, for a number of reasons, including identifying new technologies, but also giving clarity and certainty to businesses. Where do you see those tech skills being located? How can the Bill ensure adequate appropriate access to them?

**Professor Martin:** I am not sure if the Bill will get in the way or help, one way or the other. I think Government technological nous across the civil service needs to be invested in properly. There is a deep, fairly sizeable reservoir in GCHQ. Again, without going into too much detail, more and more people are being transferred and seconded from there into other areas. That is a good thing, and we should welcome that rather than cast aspersions on this being all secret state stuff. It should be permeating normal Government activity.

There will be issues about how to pay for some of the specialists that are needed. I do not think we will ever compete with the big tech companies, but there may be scope for paying some specialists a bit more and bringing them in here. There is something about creating a career path for technologists in Government. There are big issues for the heads of the civil service and the permanent secretaries. If I were heading it, I would want an immediate infusion of seconded talent and private sector buy-ins relatively quickly. Government can do that quite well sometimes, and sometimes not so well. There also needs to be a long-term strategy for technologists in Government.

**The Chair:** I will now thank you very much, Professor Martin, for giving your time so generously and being of such assistance to the Committee. Given that the next witness is not due to give evidence until 2 pm, I invite the Government Whip to propose the adjournment.

*Ordered,* That further consideration be now adjourned.  
—(*Michael Tomlinson.*)

12.49 pm

*Adjourned till this day at Two o'clock.*

