

## Should Foreign Direct Investment be restricted on national security grounds?<sup>1</sup>

13<sup>th</sup> March 2019, BIICL

### Summary<sup>2</sup>

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The Bingham Centre for the Rule of Law convened a panel discussion between leading experts to share their views on the restriction of FDI on national security grounds and to provide an overview of restriction mechanisms in place in various jurisdictions. This note provides a highlight of the key messages:

#### Presentations:

##### Japan:

Until recently, the history of inward FDI screening in Japan has been one of gradual investment liberalisation. However, in 2007 and 2017 there was a policy shift towards tightening of FDI screening.

A 2007 legislative amendment introduced relatively minor changes, tightening restrictions only in relation to technologies with potential military application. The 2017 amendment was much more substantial, as the types of foreign investors, foreign investments, and businesses subject to advanced screening were expanded. The effect of advanced screening is that the relevant government minister can recommend, and if necessary, expressly order the modification or discontinuance of a proposed investment. The government's reason for the amendment was a concern over the protection of sensitive technologies.

In order to avoid conflict between these domestic laws and Japan's international commitments to investment liberalisation, Japan relies on self-judging security exception clauses in the General Agreement on Trade in Services (GATS) and in its international investment treaties. The extent to which such clauses should be subject to judicial review is open to debate and is a question of how much deference should be paid to the State's freedom of action to restrict FDI on national security grounds. A particular concern is that the State might abuse the concept of national security to pursue protectionist policies.

##### EU:

An EU-wide instrument on FDI—[Regulation of the European Parliament and of the Council establishing a framework for the screening of foreign direct investments into the Union](#)—will enter into force in April 2019, with full application in October 2020. The instrument is deemed necessary due to concerns about new investors with close connections to foreign States investing in the EU as well as an increased awareness that security does not stop at national borders: once an investor is established in one EU State, they can invest in other EU States very easily as there is free establishment under internal market rules.

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<sup>1</sup> <https://www.biicl.org/event/1379/should-fdi-be-restricted-on-national-security-grounds>

<sup>2</sup> By Anthony Ellington Wenton, March 2019. Note this event was held under Chatham House rules.

Also, there is a lot of common infrastructure in the EU. For example, FDI into a pipeline in one State may pose a national security risk to a neighbouring State that is also served by the pipeline.

The EU framework on FDI screening sets out minimum standards that States must adhere to if they introduce FDI screening mechanisms or maintain one. It also has a mandatory co-operation mechanism whereby a Member State that is screening an investment must notify other Member States and the Commission that screening is ongoing and provide information about the investment. The other States and/or the Commission can then ask questions and signal any concerns they have. The Commission can also give an opinion if the security of more than one Member State is affected. However, this opinion is not binding and the decision on what to do with the transaction ultimately rests with the State.

#### UK:

In July 2018, the government published a [security and investment white paper](#) setting out specific proposals for a standalone FDI screening system, and received feedback from business. The government is currently in the process of fine-tuning its proposals.

Parties will be encouraged to notify the government ahead of any transaction which may pose a national security risk. The government will publish guidance setting out where and how national security concerns are likely to arise. However, the Government will retain the right to call in transactions for a national security assessment.

If the government deems there is a threat to national security, it can impose conditions to prevent or mitigate the risk, such as restrictions on the acquisition of intellectual property rights or on access to confidential data. Only as a last resort will a transaction be blocked.

In compliance with rule of law principles, enshrined in domestic law and in international instruments and agreements (such as the 2009 OECD [Guidelines for Recipient Country Investment Policies Relating to National Security](#)), regulatory proportionality is at the core of the regime, which is why a voluntary notification system has been the government's preferred option. Restrictions will narrowly focus on national security and will be specifically tailored to the risk posed by the investment. In order to ensure transparency and predictability, the guidance published by the government will set out where and how national security concerns are likely to arise and the criteria that the government will use to assess whether a transaction raises a national security issue. There will also be prescribed time limits for completing FDI review procedures. The fairness of the process is a key concern and it is intended that government powers will be subject to review, based on judicial review principles, whereby appeals could be made against the lawfulness of a decision.

#### Industry:

FDI is critical to UK business: in 2016, the UK was the 2<sup>nd</sup> largest recipient of FDI in the world; in 2017, FDI stocks in the UK increased by around £150 billion to above £1,300 billion. The 2017 figures comprise nearly 1,000 new investment projects, more than £25 billion added value to the economy, and around 60,000 new jobs.

Investors choose to put money in the UK because of its business-friendly environment and stable institutional systems. It is critical that regimes seeking to regulate FDI do not dissuade foreign investors or dissuade UK businesses from seeking FDI. This would be negative for the economy and negative for protecting key national assets which need investment to survive, innovate and grow.

An effective regime must not be burdensome and must be exclusively limited to the protection of national security and not be used as a vehicle for other policy objectives such as protectionism.

Furthermore, when making decisions on restrictions, security risks have to be balanced against the risk of a business not being able to survive and of new technology not being developed. If the government blocks FDI then it must take action to protect the key industrial asset concerned.

### Questions and Answers:

There was a lively round of questions and answers. In particular, questions were asked about whether, under the UK proposed regime, appeals will be subject to Closed Material Proceedings (CMPs) and what their impact would be on the transparency and predictability of the regime. A Member of the panel clarified that CMPs, which generally apply in procedures where national security interests are involved, will only apply to the extent necessary to protect such sensitive material, and that not all documents will be automatically covered by these procedures. An additional concern is that judicial review does not mitigate the risk of reputational damage to investors if the public is made aware that the government is scrutinising a transaction and/or imposing restrictions.

A number of concerns were raised about the potential for screening regimes to be used in a discriminatory manner against particular foreign investors. Members of the panel were keen to stress that FDI is critically important to States and that the new regimes are to be applied in a neutral fashion, with restrictions only imposed where specified criteria are met. In the same vein, a Member of the panel also underlined that it appeared that in the majority of cases where a security risk was identified, States tried to find appropriate mitigating measures to address the risk, in order to allow the investment to be made.