Policy Submission: Corporate Governance and Bradwell B

8th July 2020
Sir Bernard Jenkin MP
House of Commons

Issue

It is currently proposed that Bradwell B Nuclear Power Station should be built and operated by a subsidiary of the Chinese state, CGN, which owns 66.5 pct of Bradwell B. There is justifiable concern that this exposes a major asset in the UK's Critical National Infrastructure (CNI) to Chinese state control. China's new "wolf warrior" diplomacy is backed by well documented examples of direct attacks on UK's national security, theft of intellectual property and technology, of source codes and techniques, of the misuse of information shared with the Chinese state for military purposes, and of exploiting vulnerabilities in western countries' CNI.

Particular issues have been raised about CGN in other countries. For example, it was indicted in 2016 by the US Department of Justice in connection with nuclear espionage and the US has applied export sanctions.

Recommendation

The government should adopt the following policy:

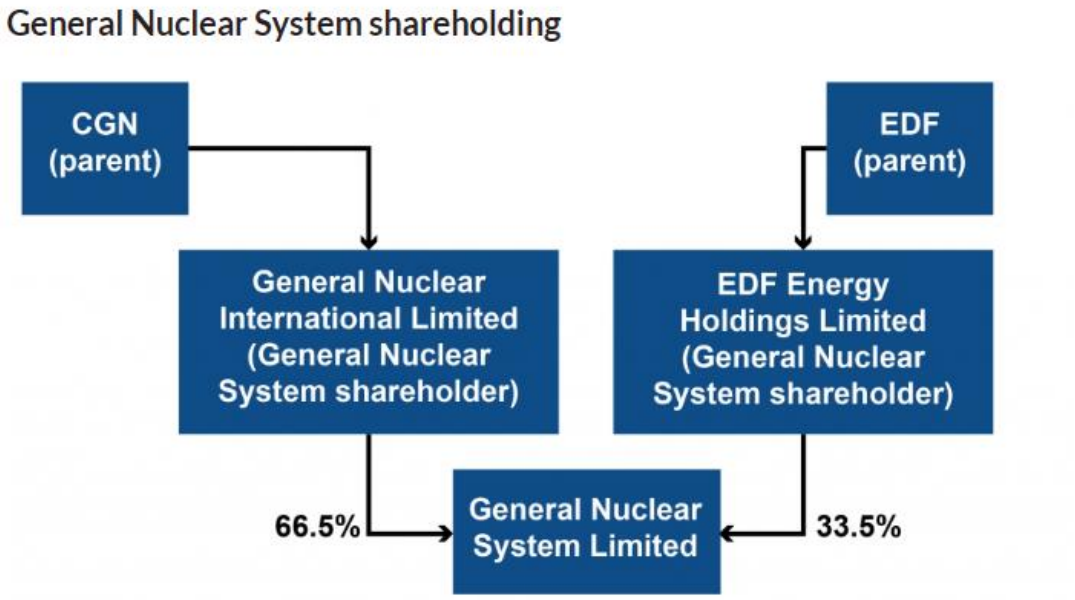
- Bradwell B Power station shall be operated and owned by the British owned, domiciled and controlled corporate entity, Bradwell Nuclear Company plc (BNC).
- HMG should acquire a 'Special Share' (sometimes known as a 'golden share') in BNC, granting it the power to:
    - Prevent the sale or transfer of shares in BNC if such sales are not in the defence or security interests of the United Kingdom;
    - Prevent the appointment of board members;
    - Require the board of directors to take any action if such action is in the defence or security interests of the United Kingdom.
    - Ensure that [at least one of/ or both] the Chairman or Chief Executive is a British citizen;
- The Articles of Association should place all board members of BNC under obligation to give written notice to the Special Shareholder if they become aware of any facts that might lead the Board to take the view that:
    - A foreign power is attempting its influence with BNC in a manner which threatens to undermine UK CNI or UK national security in any way;
    - Intellectual property owned by BNC is being prepared for transfer, theft, export or sale to a third party, or at risk of being used for military purposes by a government other than that of the United Kingdom;
    - BNC employees or contractors are preparing for or are involved in the recruitment of nuclear expertise for international projects, or for any activity hostile to the UK.

Implementation

This would be implemented via the Articles of Association of the Bradwell Nuclear Company, which would create the 'Special Share', its associated rights and powers, and stipulate that it may only be owned by a Minister of the Crown.

Background

The Bradwell B Nuclear Power Station is owned by General Nuclear System Limited (GNS), which is itself 66.5% owned by the China General Nuclear Power Group (CGN), a wholly owned subsidiary of the Chinese state. The remaining 33.5% of GNS is owned, through a subsidiary, by EDF.



The ownership of nuclear power stations is an internationally recognised source of concern. In addition to the consequences of direct ownership of critical nuclear infrastructure by foreign states, there are also risks represented by the involvement of State-Owned Enterprises (SOEs) in the development and management of such power stations, such as CGN.

In particular, the US government has concerns that the Chinese nuclear industry is engaged in IP theft, and necessarily advances the interests of the People's Liberation Army. In a speech in July 2019, US Assistant Secretary of State Dr Christopher Ashley-Ford said: *"the Chinese nuclear industry is not a purely civilian industry, instead operating in close partnership with the People's Liberation Army (PLA)… To cooperate with the Chinese nuclear business, in other words, is thus to some extent inescapably to cooperate with the PLA."*

He went on to add: *"All three of China's nuclear SOEs have engaged in illicit activities against their international competitors – and even their international partners – including theft, unauthorized reverse engineering, and aggressive recruitment of international subject matter experts."* [1]

[1] https://www.state.gov/competitive-strategy-vis-a-vis-china-the-case-study-of-civil-nuclear-cooperation/

The US government has singled out CGN specifically for sanction, following the indictment in 2016 of US citizen Szuhsiung Ho and CGN itself on charges of Nuclear Power Conspiracy against the United States. [2] Following this indictment, the US Department of Energy imposed export restrictions on CGN, presumptively denying any new licence applications, as well as any amendments or extensions to export authorisations for technology, components, material and equipment. [3]

The Office for Nuclear Regulation (ONR) is the statutory body responsible for regulating the conduct and management of the UK's nuclear industry. In the letter from the Minister for Business and Industry to Sir Bernard Jenkin MP of 4th May 2020, it was stated that: *"The ONR would not grant a Nuclear Site Licence to a company with a Board composition allowing undue influence from the shareholders. The ONR would also expect a licensee to visibly demonstrate their direct control over all matters of nuclear safety and security on their licensed site."*

In the ONR's own "Licencing Nuclear Installations" guide, it is advised that the relationship between a parent company and subsidiary must not:

- "*usurp the licensee's authority over the day-to-day operation of the prescribed installations"*
- *"impede a licensee's access to adequate resources to meet its safety obligations"*
- Result in the "*[dominance] by representatives of the group parent or joint venture shareholders"*
- *"divert or dilute the technical skills and experience available"*[4]

Given the far closer connections between Chinese SOEs and their subsidiaries than is usual, there are reasonable concerns that oversight by the ONR alone would fail to adequately regulate the relationship between a Nuclear Installation joint venture and its ultimately Chinese SOE parent company. This is particularly complicated by China's 2017 National Intelligence Law, which states that Chinese "*organisations and citizens shall, in accordance with the law, support, cooperate with and collaborate in national intelligence work".*[5] As a consequence, it is increasingly difficult to delineate between Chinese-owned subsidiaries, Chinese SOEs and the Chinese state.

Moreover, the concern is not merely one of deterring illegal activity through sanction after the fact. Nuclear espionage is already an offence, which is so widespread that international concerns about its occurrence cannot be answered simply by reference to pre-existing regulatory frameworks and enforcement agencies. In order to address these concerns, the UK government must implement safeguards, and cannot rely on the deterrence of punitive action thereafter (which the Chinese rejection of the US

[2] https://www.justice.gov/opa/pr/us-nuclear-engineer-china-general-nuclear-power-company-and-energy-technology-international

[3] https://www.energy.gov/sites/prod/files/2018/10/f56/US_Policy_Framework_on_Civil_Nuclear_Cooperation_with_China.pdf

[4] http://www.onr.org.uk/licensing-nuclear-installations.pdf

[5] https://www.iiss.org/blogs/research-paper/2018/12/emerging-technology-dominance

indictment of CGN demonstrates has little effect anyway). There should also be safeguards to protect UK CNI and UK national security.

Argument

The solution presented in this paper is to grant the government powers over the re-constituted Bradwell Nuclear Company (BNC) through the issuing of a 'Special Share', while also placing specific reporting obligations on the Board of Directors to notify the government under certain conditions.

The purpose of this 'Special Share' and set of obligations would not in themselves impose sanctions on attempted nuclear espionage or prevent threats to CNI or national security, but they would ensure that the government is better informed of any such developments through directly accountable members of BNC, as well as obligatory transparency and reporting requirements. This would act as a deterrent. As the indictment of CGN by the US DOJ demonstrates, CGN employees have been directed by their superiors to engage in acts of nuclear espionage. By explicitly obligating board members to notify HMG, any attempted espionage must therefore either be accomplished without board members' knowledge, rendering it less effective, or necessarily expose board members to legal risk. When Board Members comply with these reporting requirements, detection of any potential espionage will be greatly improved.

This proposal is drawn from the experience of implementing 'Special Shares' introduced in privatised industries from the 1980s onwards, with particular reference to the privatisations of Britoil, NATS and QinetiQ.

Case Studies: QinetiQ and Britoil

QinetiQ is a defence technology company spun off from the Defence Evaluation and Research Agency by the Blair government in 2001. In order to address defence and security concerns with the privatisation of a company key to the UK's interests, HMG retained a 'Special Share', the definition of which was written directly into QinetiQ's Articles of Association.

These grant the owner of the 'Special Share' broad powers to veto any contract, transaction or activity where it would interfere with the control of the company contrary to the defence interests of the UK, as well as the power to ensure that one of the Chief Executive or Chairman was a UK citizen.

The Articles of Association also imposed 'Compliance Principles' on the board of the company, required QinetiQ to implement a system enforcing these principles. These principles related to the impartiality of QinetiQ advice, and the confidential treatment of its assets. The owner of the 'Special Share' also had the power *"to require the board of directors to take action to rectify any omission in the application of the Compliance Principles if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interests of the United Kingdom"* [6]

[6] https://www.qinetiq.com/-/media/Files/About-Us/Corporate-Governance/QinetiQ-Articles-of-Association-adopted-24-July-2019.pdf

Britoil was a North Sea oil company privatised from the British National Oil Corporation in 1981. As was common for privatised industries, the government retained a 'Special Share' granting it the power to prevent the sale of a controlling stake in the company, and directly appoint its board.[7]

The Articles of Association also obligated Directors to give written notice to the government *"in the event of any Director becoming aware of any facts which might lead to the Board taking the view that a person… has obtained or is attempting to obtain, control over the Board or its composition"*

The proposed National Security and Investment Bill announced in the 2019 Queen's Speech would grant a senior minister the power to impose conditions on parties, should there be a "trigger event" in relation to a danger to national security. It is intended that such events should include a "foreign state having significant influence or control" over an entity, or individuals involved[8]. However, CGN is already a Chinese state owned enterprise (SOE), and the aforementioned Chinese National Intelligence Law 2017 allows for the possibility that no new "trigger event" need take place for the Chinese state to exert significant influence or control over CNI, limiting the scope for intervention in the current draft Bill.

The introduction of 'Special Shares' require primary legislation and so could be incorporated into the National Security and Investment Bill announced in the 2019 Queen's Speech.

Treasury view

Not known.

There is a risk that China would withdraw their support from this project if these conditions were imposed. It is now understood that the benefits of economic engagement with China and of China's investment in the UK needs to be assessed against the threat of dependency upon China, giving China the ability to erode vital UK autonomy and to threaten our national security.

Regulatory impact

'Special Shares' were ruled illegal by the European Court of Justice as unfair restrictions on the free movement of capital in 2003. However, with the repeal of sections 1(1A)(1) – (4) of the European Union (Withdrawal Agreement) Act 2020 (which preserves the effect EU legislation for the duration of the Implementation Period) on 31st December 2020, will make it possible to remove any obstacle in statute to the re-introduction of such shares.

A fuller legal analysis has been prepared in the Appendix to this submission.

ENDS

---

[7] https://beta.companieshouse.gov.uk/company/SC077750/filing-history/NDA2MTA4NDVhZGlxemtjeA/document?format=pdf&download=0

[8] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728311/20180717_Statement_of_policy_intent_-_shared_with_comms.pdf

Appendix

Legal commentary on the use of 'Special' or 'golden' share in the structure of a UK company

In Case C-98/01 *Commission v UK*, the ECJ ruled that the existence of a Special Share in BAA PLC which conferred powers on the Secretary of State to control disposals of airports and other strategic changes to the company's governance contravened Article 56(1) EC (as then numbered) on the free movement of capital:

"Article 56: 1. Within the framework of the provisions set out in this Chapter, all restrictions on
the movement of capital between Member States and between Member States and third countries shall be prohibited."

This is because the Special Share interfered with the normal rights of direct investors to participate in the management of a company in which they invest.

However it should be noted that the UK did not seek to justify the Special Share powers in the case of BAA on the grounds in Art.58(1)(b) EC:

"(b) to take all requisite measures to prevent infringements of national law and regulations …
or to take measures which are justified on grounds of public policy or public security."

In subsequent cases the ECJ took a restrictive approach to the application of the public security exception. For example in Case C-326/07 Commission v Italy it objected to an Italian law which purported to allow the government to restrict shareholdings in privatised energy companies on public security grounds:

44 In the instant case, the Italian Republic and the Commission take points of view that differ on the issue whether the criteria applicable to the exercise of the powers of opposition to the acquisitions of shareholdings or to the conclusion of contracts by shareholders representing at least 5% of voting rights, or even a lesser percentage in certain cases, are such that that exercise is proportionate to the objectives pursued and so compatible with the freedom guaranteed by Article 56 EC.

45 It may be noted that the criteria at issue apply to common interests concerning, in particular, the minimum supply of energy resources and goods essential to the public as a whole, the continuity of public service, national defence, the protection of public policy and public security and health emergencies. The pursuit of such interests may, subject to observance of the principle of proportionality, warrant certain restrictions of the exercise of fundamental freedoms (see, inter alia, judgment of 14 February 2008 in Case C-274/06 *Commission* v *Spain*, paragraph 38).

46 However, as noted in paragraphs 42 and 43 above, the first requirement of observance of the principle of proportionality is that the measures taken should be appropriate for the purpose of attaining the objectives pursued.

47 Application of the criteria at issue as they relate to the exercise of the powers of opposition is not appropriate for the purpose of attaining the objectives pursued in the case in point, because there is no link between the criteria and the power.

48 The Court has earlier held that the mere acquisition of a holding of more than 10% of the capital of a company operating in the energy sector or any other acquisition conferring significant influence on such a company cannot, as a general rule, be regarded as a real and serious enough threat to security of supply (*Commission* v *Spain*, paragraphs 38 and 51).

49 In its written pleadings, the Italian Republic has provided no proof or even anything at all to show that the application of the criteria for the exercise of the powers of opposition makes it possible to attain the objectives pursued. At the hearing, that Member State did indeed cite several examples. Thus, it mentioned the possibility that a foreign operator with links to a terrorist organisation might seek to acquire substantial holdings in national companies in a strategic sector. It also raised the possibility that a foreign company controlling international energy transmission networks and having, in the past, used that position to create serious supply problems for bordering countries might buy shares in a national company. According to that Member State, the existence of precedents of that kind could justify opposition to the acquisition by such investors of significant holdings in the national companies concerned.

50 Such considerations do not, however, appear in the Decree of 2004, which mentions no specific objective circumstance.

51 The Court has previously held that a State's powers of intervention such as the powers of opposition in respect of which the criteria at issue determine the conditions for their exercise, which are not qualified by any condition, save for a reference to the protection of national interests, formulated in general terms and without any indication of the specific objective circumstances in which those powers are to be exercised, constitute serious interference with the free movement of capital (see, to that effect, Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraphs 50 and 51).

52 Those considerations are applicable to the present case. Even if the criteria at issue concern different kinds of public interests, they are formulated in a general and imprecise manner. What is more, the lack of any connection between the criteria and the special powers to which they relate increases the uncertainty surrounding the circumstances in which those powers may be exercised and gives them a discretionary nature, having regard to the latitude enjoyed by the national authorities in making use of them. Such latitude is disproportionate in relation to the objectives pursued.

53 Furthermore, the mere statement in Article 1(1) of the Decree of 2004 that the special powers must be used only in accordance with Community law cannot make the use of those criteria consistent with Community law. The general and abstract nature of those criteria is incapable of ensuring that the special powers will be exercised in accordance with the requirements of Community law (see, to that effect, Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paragraphs 63 and 64).

54 Last, while the fact that the exercise of the special powers may be submitted to review by the national court, pursuant to Article 2(1)(a) to (c) of Decree-Law No

332/1994, is essential to the protection of persons having regard to the application of the rules on freedom of establishment, it cannot, on its own, suffice to make good the incompatibility with those rules of the criteria for the application of the special powers.

55 It is therefore to be declared that, by adopting the provisions in Article 1(2) of the Decree of 2004, the Italian Republic has failed to fulfil its obligations under Article 56 EC, in so far as those provisions apply to the special powers provided for by Article 2(1)(a) and (b) of Decree-Law No 332/1994.

However, even on the assumption that Article 56 (subsequently renumbered as Article 63 TFEU) still needs to be complied with, there is a strong argument that the proposed arrangements for a Special Share in Bradwell B are for genuine national security purposes and are proportionate, and therefore would satisfy the public security exception now in Article 65(1)(b) TFEU.

It should be noted that Article 63 TFEU relates to restrictions on movement of capital between member states and third countries as well as between member states, so the fact that China is involved rather than an EU member state does not affect the position.

After 31 December 2020, Articles 63-65 TFEU will cease to apply to the UK as such. However, section 4 of the European Union (Withdrawal) Act 2018 continues in force as part of UK law rights and liabilities to which effect was given by section 2(1) of the 1972 Act, and this includes directly effective Treaty provisions such as those on free movement of goods, services, persons and capital.

Section 8 of the 2018 Act permits the correction of "deficiencies" in retained EU law by statutory instrument. However, widening the scope of the national security exception if, contrary to the above, it does not justify the Special Share in this case, would not seem to amount to a correction of a deficiency in the sense of the 2018 but rather a substantive change in the law which requires primary legislation.

In conclusion, it is probable that the proposed Special Share scheme will not conflict with EU law because the national security justification is very much stronger than in the BAA case or the Commission v Italy case; and if it does conflict with retained EU law there would be no obstacle to changing the law by primary legislation because the UK will no longer be under an external obligation to comply with Art.63 TFEU on the free movement of capital.