

Business, Innovation and Skills Committee: Industrial Strategy Inquiry

Consultation response from the Centre for Competition Policy

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This consultation response has been drafted by a named academic member of the Centre, who retains responsibility for its content.

The Centre for Competition Policy (CCP)

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Consultation Response

Executive Summary

- ✦ It is important for policy makers to have a more precise understanding of the benefits that the UK derives from foreign investment and foreign takeovers in particular.
- ✦ Given the effects that they may have on firms' incentives to merge, proposals to reform the public interest provisions under the Enterprise Act 2002 should be subjected to a thorough impact assessment.
- ✦ Further corporate governance reform under the Takeover Code may be preferable to extending the public interest provisions, in terms of limiting potential distortions to competition within markets.
- ✦ Brexit may open the door to 'public interest lobbying' in the UK, and it is important that measures are put in place to preserve the primacy of a competition-based merger regime.

1. Introductory Remarks

1.1 The author welcomes the opportunity to respond to the Select Committee's inquiry into the Government's industrial strategy. I am a Senior Research Associate at the Centre for Competition Policy (CCP) at the University of East Anglia, where I undertake specialist legal research in the areas of competition policy and regulation. My PhD thesis, entitled 'Revisiting the Role of the Public Interest in Merger Control' (UEA, 2011-2015),¹ draws insights from merger regimes around the world to propose a framework for accommodating so-called 'public interest' criteria within merger assessments. This research has identified a number of strategies that countries have adopted in order to give effect to public interest objectives, while minimising the disruption that such criteria can cause to competitive markets. As such, the main focus of my written evidence will centre on the Committee's question relating to foreign takeovers and government intervention.

1.2 Before addressing the substantive issues in the Terms of Reference, if I may first offer a word of caution regarding the ambiguity and speculation that currently surrounds the Government's new industrial plan. Even in the short space of time that has elapsed since Theresa May entered Number 10, the Government has made a series of policy statements concerning how foreign investment and foreign takeovers are to be scrutinised in the future. Of particular note are: (i) comments

¹ David Reader, 'Revisiting the Role of the Public Interest in Merger Control' (DPhil thesis, University of East Anglia 2015), *available upon request* (e: d.reader@uea.ac.uk).

made by the Prime Minister’s spokesperson in the wake of SoftBank’s £24.3bn bid for ARM Holdings in July, which revealed the Government’s plan to adopt a ‘case-by-case’ approach to assessing foreign takeovers on ‘national interest’ grounds;² and (ii) a statement from the new Business Secretary, Greg Clark MP, on the decision to proceed with the Hinkley Point C nuclear power plant, where he announced the Government’s intentions to review the public interest regime under the Enterprise Act 2002 and to introduce ‘a cross-cutting national security requirement’ for ownership of critical infrastructure.³

- 1.3 Although these statements offer a general indication of the Government’s intentions to broaden the scope of public interest considerations within UK merger control, they do not provide sufficient detail on the form that this new test will take, whether it will apply only to specific markets, or whether it will positively discriminate between domestic and foreign bidders. These are issues that need to be explored in detail during consultations on any potential reform.
- 1.4 For context, it is important to note that the UK is one of the 81.3% of merger regimes worldwide that choose to assign a ‘restricted’ role to public interest criteria, either by (i) avoiding public interest criteria entirely, or (ii) framing the public interest criteria narrowly (either in sector-specific policy or as an exception to a competition-based substantive test).⁴ Although there is no suggestion that the UK is set to return to a broad public interest test (as witnessed under the Fair Trading Act 1973), it does appear that the role of the public interest is set to increase for mergers of a particular variety.

2. Response to Q.2: *Interventionism and preventing foreign takeovers*

- 2.1 The question of how ‘interventionist’ the Government should be in implementing an industrial strategy has no straightforward answer, particularly with regard to the scrutiny of foreign takeovers, which continues to divide opinion. Although it is well-documented that foreign direct investment (FDI) has the potential to deliver long-term economic benefits to host countries,⁵ the underlying intuition that FDI drives economic growth is still a long way from receiving universal acceptance.⁶ Equally, public perceptions of foreign takeovers in the UK appear

² George Parker and Yukako Ono, ‘[ARM takeover puts focus on UK’s industrial strategy](#)’ (*Financial Times*, 18 July 2016).

³ Greg Clark MP, ‘[Hinkley Point C](#)’ (Oral statement to Parliament, House of Commons, 15 September 2016).

⁴ David Reader, ‘Accommodating Public Interest Considerations in Domestic Merger Control: Empirical Insights’ (2016) CCP Working Paper 16-3, 19, available [here](#). For a summarised version of the paper’s key findings, see David Reader, ‘Accommodating ‘public interest’ considerations in merger control’ (2016) 31 CCP Research Bulletin 10, available [here](#).

⁵ See e.g. Sourafel Girma, David Greenaway and Katharine Wakelin, ‘[Who Benefits from Foreign Direct Investment in the UK?](#)’ (2001) *Scottish Journal of Political Economy* 119.

⁶ For a good example of empirical work on this point, which also suggests that developed countries can derive a greater benefit from FDI, see Laura Alfaro, Areendam Chanda, Sebnem Kalemli-Ozcan

somewhat negative; for example, an admittedly small-scale survey of UK public attitudes in 2014 found that only 39/100 respondents considered foreign investment to be ‘desirable’, in contrast to 53/100 who deemed it ‘undesirable’.⁷ Indeed, a deep-set suspicion of foreign takeovers appears to have emerged amongst a significant proportion of the population as a result the headline-grabbing media coverage of foreign bids for so-called ‘crown jewel’ firms, such as Cadbury⁸ and AstraZeneca.⁹

2.2 In his 2012 independent review of the UK’s economic growth, Lord Heseltine advised the Government to show a greater willingness to use its public interest powers under the Enterprise Act 2002, in the belief that this would (i) aid the Government’s negotiating efforts with prospective foreign investors seeking to invest in strategic industries, and (ii) to discourage unwanted investment in exceptional cases.¹⁰ In reaching this conclusion, Lord Heseltine – by his own admission – rejected the proposition that threatening to use these public interest powers would ‘harm the flow of investment to the UK’,¹¹ citing Australia, France and the US as examples of free markets that also scrutinise foreign takeovers.¹² In its response to the Heseltine Review, the Coalition Government rejected the recommendation outright,¹³ noting that it was already committed to engaging with foreign firms to promote investment which benefits the economy.¹⁴

2.3 The “open for business” rhetoric of the Coalition Government – or, more specifically, its Conservative Party wing – again came under scrutiny in 2014 when US pharmaceutical giant Pfizer lodged a bid for its UK-listed counterpart AstraZeneca. At the time, one of the most prominent voices calling for a tougher stance on foreign takeovers that threaten the national interest was that of the

and Selin Sayek, ‘[Does foreign direct investment promote growth? Exploring the role of financial markets on linkages](#)’ (2010) *Journal of Development Economics* 242.

⁷ Pew Research Center, ‘[Faith and Skepticism about Trade, Foreign Investment](#)’ (*Global Attitudes & Trends*, 16 September 2014).

⁸ In addition to *employment*, the Kraft/Cadbury merger in 2010 also raised concerns over *food security*, although neither provided direct grounds for a public interest intervention under the Enterprise Act 2002; see Business, Innovation and Skills Committee, *Mergers, acquisitions and takeovers: the takeover of Cadbury by Kraft* (HC 2009-10, 234), Ev 48.

⁹ Pfizer’s ultimately unsuccessful bid for AstraZeneca in 2014 was met with strong opposition from MPs both within and outside Government, where Pfizer’s questionable track record for asset-stripping had generated anxieties over *the retention of skilled jobs* and *R&D investment*. For an overview of Pfizer’s commitments and Business Secretary Vince Cable’s proposals to reform the UK Takeover Code as a result of the bid, see David Reader, ‘Pfizer/AstraZeneca and the Public Interest: Do UK Foreign Takeover Proposals Prescribe an Effective Remedy?’ (2014) 10(1) *CPI Antitrust Chronicle*, available [here](#).

¹⁰ Department for Business, Innovation and Skills, ‘No stone unturned: in pursuit of growth - Lord Heseltine review’ (Independent report, BIS 2012), paras 5.102-5.111 and Recommendation 73.

¹¹ *ibid*, para 5.109.

¹² *ibid*, paras 5.109-5.110.

¹³ Indeed, of the 89 recommendations that Lord Heseltine put forward in his report, this was one of only five recommendations that the Government rejected outright; Department for Business, Innovation and Skills, [Government’s response to the Heseltine review](#) (Cm 8587, 2013) 59.

¹⁴ *ibid*, para 1.48.

Business Secretary, Vince Cable MP. Sir Vince proposed numerous safeguards to counteract these perceived threats, including: (i) to remove the “wobble room” under the Takeover Code that seemingly allowed firms to renege on their pre-takeover commitments, (ii) to introduce financial penalties for firms who fail to honour their commitments, and (iii) to amend the public interest provisions under the Enterprise Act 2002 as a ‘last resort’ to protect the national interest.¹⁵ As a consequence, changes to the Takeover Code in early-2015 appeared to address the “wobble room” concern by clarifying much of the uncertainty surrounding the ‘binding’ nature of commitments.¹⁶ However, this in itself appeared insufficient to appease growing concerns within the Labour Party and the Liberal Democrats, who each included pledges for a ‘stronger public interest test’ in their 2015 General Election Manifestos.¹⁷ In contrast, the Conservative Party manifesto remained silent on the matter – but recent events appear to indicate that a cross-party consensus may now be emerging.

2.4 Only a few months on from replacing David Cameron as Prime Minister, Theresa May looks set to steer her Government towards a strikingly different approach to foreign takeover assessment. Choosing the launch event of her leadership campaign as the platform on which to reveal her plans for a new industrial strategy that would allow the UK to oppose foreign takeovers in strategic sectors is, in itself, a testament to the importance that the Prime Minister attributes to reforming the existing procedure.¹⁸ Additional comments by the PM’s spokesperson and the new Business Secretary (as noted in paragraph 1.2, above) confirm the Conservative Government’s intentions to place the ‘national interest’ at the heart of its foreign investment scrutiny.

2.5 Reflecting on the abovementioned developments of how foreign takeovers are assessed in the UK, a number of important themes emerge, each of which should be afforded careful consideration in any consultation to revise the UK’s merger control and takeover rules:

2.5.1 The long-term economic benefit that the UK derives from FDI (and foreign takeovers in particular) is unclear, while short and medium-term public interest concerns may distort perceptions. Although these benefits and harms are often difficult to predict and quantify, it is important that the consultation process engages fully with their underlying economic principles.

¹⁵ Vince Cable, ‘[Strengthening confidence in the UK’s takeover laws](#)’ (*Liberal Democrat Voice*, 13 July 2014). For my review of these proposals, see Reader (n 9).

¹⁶ The Takeover Code now distinguishes between ‘post-offer undertakings’ (Rule 19.5) and ‘post-offer intention statements’ (Rule 19.6); the former amounts to a binding *commitment* for the firm to take a particular course of action, whereas the latter need only be an accurate expression of the firm’s *intentions* at the time the statement was made.

¹⁷ Labour Party, ‘[Britain can be better](#)’ (Labour 2015 General Election Manifesto, April 2015) 21; Liberal Democrat Party, ‘[Stronger Economy. Fairer Society. Opportunity for Everyone](#)’ (Liberal Democrat 2015 General Election Manifesto, April 2015) 35.

¹⁸ Theresa May MP, ‘[We can make Britain a country that works for everyone](#)’ (Conservative Leadership Campaign Launch, Birmingham, 11 July 2016).

- 2.5.2 Having developed a general comprehension of the net benefit that FDI delivers for the UK, the consultation should seek to determine the impact (if any) that a change to the existing merger control and takeover rules would have on foreign investment into the UK.¹⁹ This would act to identify the relationship between certain rule changes and the overall net benefit.
- 2.5.3 In addition to undertaking an impact assessment of the effect that a new public interest or national security test will have on investment activity, the consultation might also afford consideration to the effect a new test will have on what acquiring firms are willing to pay for UK targets. Uncertain regulatory conditions may reduce incentives to offer premiums for UK companies.²⁰
- 2.5.4 In addition to consulting on plans to expand the grounds on which it may intervene in merger assessments to serve the public interest, the Government should extend the scope of its consultation to include consideration of further corporate governance reform under the Takeover Code, which may offer an alternative means by which to safeguard the national interest while limiting potential distortions to competition within markets.²¹
- 2.5.5 Public statements by senior politicians can prove exceedingly influential as a means for shaping an industrial strategy in lieu of statutory/procedural reform. For example, even though the public interest provisions under the Enterprise Act 2002 remain unaltered for the time being, Theresa May's reference to a 'national interest' test for foreign takeovers may have prompted prospective foreign acquirers to re-evaluate their bids (or their decision to bid) for UK firms.²² It is important not to underestimate the potential significance of these statements which, at an extreme level, can act to create a protectionist merger regime 'via the back door'. Public statements are no substitute for a transparent merger regime, which is based on clear and specific assessment criteria, and which is applied consistently by a designated decision-maker.

¹⁹ A particular fear of the author is that a broadly-framed 'national interest' test that is applied by an overly-interventionist Government on a case-by-case basis would create a merger regime that lacks the transparency and consistency to attract investors that are more risk-averse.

²⁰ This may constitute an opportunity cost for shareholders, but a counter-view is that the higher premiums offered for UK firms can lead the acquiring firm to accrue high debts and over-valued assets, which is to the overall detriment of the merged firm, see Aeron Davis and others, 'Takeovers and the Public Interest: Responsible Capitalism in Practice' (2013) Policy Network Paper, 11.

²¹ For a compelling argument on the advantages of pursuing corporate governance reform over extending the application of public interest criteria, see Andreas Stephan, 'Did Lloyds/HBOS mark the failure of an enduring economics-based system of merger regulation?' (2011) 62(4) Northern Ireland Legal Quarterly 539, 548.

²² Even before the 2015 General Election, the Financial Times reported that members of the Conservative wing of the Coalition Government had issued a 'hands-off' warning to prospective bidders for BP plc, citing their intentions to 'make their opposition so clear that any foreign bidder would be deterred from actually making a bid'; George Parker and Christopher Adams, 'UK government warns BP over potential takeover' (*Financial Times*, 26 April 2015).

- 2.5.6 The applicability of EU competition law within the UK (both in the lead up to Brexit and in its aftermath) represents a key consideration in respect of merger control. Although the EU Merger Regulation affords scope for the UK to assume competence over certain EU-level mergers on *legitimate national interest* grounds, these grounds are narrowly-defined and competence is only rarely granted by the European Commission. If Brexit does indeed signal an end to ‘one-stop’ merger control,²³ it would leave decision-makers (both ministers and, potentially, the Competition and Markets Authority itself) more prone to arguments from public interest lobbyists.²⁴ To this end, it is paramount that the consultation considers ways to preserve the primacy of a competition-based merger regime post-Brexit.
- 2.5.7 A consultation on the public interest provisions of the Enterprise Act 2002 offers another opportunity to resolve the outstanding issues regarding public interest decision-making in media plurality cases. This is an issue that appears to have been “kicked into the long grass” since publication of a review by the Communications Committee of the House of Lords.²⁵

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²³ At which point, mergers involving a UK firm and a Union dimension would be subject to separate investigations by the Competition and Markets Authority and the European Commission.

²⁴ David Reader, ‘Mergers and the Public Interest: the hardest nut to crack for CMA’s new Chief Executive?’ (*Competition Policy Blog*, 24 May 2016), available [here](#).

²⁵ For my critique of the Lords’ proposals, see David Reader, ‘Does Ofcom Offer a Credible Solution to Bias in Media Public Interest Mergers in the United Kingdom?’ (2014) 4(1) *CPI Antitrust Chronicle*, available [here](#).

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