BEIS: National Security and Infrastructure Investment Review (Proposals for short-term reforms)

Consultation response from the

Centre for Competition Policy

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

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CCP Response to BEIS National Security and Infrastructure Investment Review (Proposals for short-term reforms)

I welcome the opportunity to respond to the first phase of BEIS's National Security and Infrastructure Investment (NSII) Review, in relation to the proposals for short-term reforms encompassed in Chapter 7 of the Green Paper and secondary legislation. The public interest regime in UK merger control is an area that I have had a specialist research interest in over the past 6 years and, of course, it is an area that has attracted increasing attention during that time. The 'national security' ground (provided by section 58(1) Enterprise Act 2002) has been the least 'controversial' of the named public interest grounds in practice. This is because section 58(1) reflects the paramount importance that the UK affords to the safety and security of its citizens; and such national security provisions are common in the merger control and foreign takeover laws of various jurisdictions worldwide. However, with any extension of the public interest grounds (be it in terms of their number or the scope of their application), there comes a risk of contaminating the predictability and certainty that is afforded by the UK's default competition-based merger regime. As such, it is important that any changes to the existing regime are legitimate and proportionate.

1. The Green Paper rightly notes that the rules pertaining to national security in UK merger control should enable the Government to fulfil its duty of safeguarding the country's national security. This was an explicit rationale behind the insertion of section 58(1) during the drafting of the Enterprise Act 2002 and, as such, it is entirely logical that the Government should seek to review this intervention power if there is a suggestion that advances in technology and data-rich industries have rendered it 'unfit for purpose'. Indeed, an 'updating' of the existing provisions may be well-timed as other jurisdictions, including the EU, currently discuss how best to manage foreign direct investment in an era of globalisation.

2. It is not my place to say whether there is sufficient evidence to indicate that there is now an increased risk of 'espionage, sabotage or inappropriate leverage' arising out of the ownership or control of critical businesses or infrastructure. However, I am mindful that technological advances and the modern-day corporate role of personal (and often sensitive) data have, inter alia, presented a justifiable basis on which to revisit the existing national security provisions.

3. It is also encouraging to read that the Government is wary of the need to proceed with caution on any proposed changes to the regime. I completely concur with the Secretary of State's view that mergers and takeovers should continue to be conducted in an orderly and transparent way, conducive to a stable policy environment with regards to investment. Moreover, I am pleased to learn that the Government's reforms will go no further than what is '*necessary* and *proportionate* […] to protect national security'. The principles underpinning this review (as specified on page 8 of the Green Paper) are a testament to the Government having listened to the reservations that many have voiced over the prospect of amending

the public interest provisions in recent months. These principles should act as a beacon to guide the consultation process and the Government should be commended for explicitly acknowledging these at this early stage.

4. I am sure the Government itself is mindful of this, but I would stress that the impact of the Green Paper's proposed short-term reforms cannot be divorced from the long-term aspects of the Review. The two speak to each other and I would suspect that my response to the questions relating to the long-term options for reform would differ depending on how the Government chooses to proceed with its short-term reforms. Moreover, this review takes place after and amidst a number of other public consultations that have the potential to inform how the Government wishes to proceed with the national security provisions and the public interest regime as a whole, including: **(i)** the Takeover Panel's recent consultation on amendments to the Takeover Code;[1] **(ii)** the Government's Green Paper consultation on 'Building our Industrial Strategy'; **(iii)** the BEIS Committee's Industrial Strategy inquiry (2016-17); and **(iv)** the Lords' EU Internal Market Sub-Committee inquiry on 'UK Competition Policy Post-Brexit'. To avoid a segregated response to an important issue, I hope that the forthcoming White Paper on the NSII Review will incorporate and consolidate the various discussions that have taken place in these other fora.

5. Part of the purpose of these reforms, according to the Green Paper, is to 'strengthen [the UK's] powers for scrutinising the national security implications of particular types of investments'.[2] I concede that mergers invoking the 'national security' public interest ground under section 58(1) Enterprise Act 2002 need not involve a foreign bidder for a UK-based firm, but it is worth noting that all 7 of the national security referrals to date have indeed involved foreign bidders. The Green Paper proposals therefore, de facto, relate to foreign investment specifically, and should be seen as such in order to ground the NSII Review within the debates that have taken place in the consultations referred to in Paragraph 2 (above). There is a lack of consensus on the case for 'strengthening' the UK's powers with regard to scrutinising foreign investment,[3] as is clear from the responses to the BEIS Committee's Industrial Strategy inquiry (2016-17): 53 of the 170 written responses received by the Committee before the consultation deadline referenced the Government's policy on foreign takeovers and, of these, 25 (47.17%) opposed stricter FDI review, 23 (43.40%) favoured it, 3 (5.66%) were neutral, and 2 (3.77%) did not disclose their position.

[1] The Takeover Panel's independence from Government clearly means that the recent consultation on the Takeover Code cannot be consolidated into the NSII Review (nor should it, in my opinion). But, insofar as the NSII Impact Assessment should seek to predict the potential short and long-term effects of the NSII reforms on e.g. FDI activity, any interim changes to the Takeover Code could also have an impact in this regard.

[2] Department of Business, Energy & Industrial Strategy, *National Security and Infrastructure Investment Review* (Green Paper, 2017) 4.

[3] As the Green Paper alludes to an extension of the Government's existing powers (by way of jurisdictional reform relating to the turnover threshold and share of supply test), I would argue that this does in turn amount to a 'strengthening' of these powers.

6. A notable omission from the NSII Green Paper is any reference to Brexit, which appears to suggest that this consultation proceeds on the working assumption that the UK merger control regime will be in no way confined by the EU Merger Regulation (EUMR) in the future. My CCP colleagues and I have explored the potential implications of a 'hard' Brexit on UK merger control,[4] but a 'soft' or 'parboiled' Brexit outcome would present a different set of issues if the UK remained party to the EUMR. I do not feel that the current rhetoric of Brexit negotiations is enough to dispel the possibility that the proposed NSII reforms will be introduced while the application of the UK merger rules are still subject to EU scrutiny (where the merger has an EU dimension). This scenario is unlikely to be an issue in terms of the Green Paper's short-term proposals that seek to scrutinise 'small' mergers, which are unlikely to amount to having EU dimension. However, in the event that a larger merger (with EU dimension) raises national security concerns in, for example, quantum-based technology, the UK would need to apply for jurisdiction to rule on the public interest dimension of the merger under Article 21(4) EUMR. Article 21(4) applications on national security grounds are routinely granted by the European Commission, but these typically relate to 'traditional' national security concerns (i.e. mergers involving military contracts, rather than technology companies). It will be for the Commission to decide on a case-by-case basis whether an application is based on a legitimate claim of national security, so it is strange that the Green Paper does not afford mention to the consistency between the proposed reforms and EU law. The EU Parliament is also currently debating new draft legislation on reviewing FDI which, again, may have implications for the UK regime before Brexit materialises (or in the event of a 'less-than-hard' Brexit). Further implications arise from a future trade agreement between the UK and the EU, but I will deal with this issue in my response to the Green Paper's long-term options for reform.

7. The 'national security' exception to the competition-based assessment process is a legitimate one. But, for that reason, it is key that the Green Paper's short-term reforms do not permit (nor be perceived to permit) the Government to use any newfound powers over mergers in the advanced technology sector to pursue its new industrial strategy. This would clearly be illegitimate and would amount to an extension of the public interest 'via the back door'. The definition of 'national security' (within the 2002 Act) and of 'public safety' (under EU law, by virtue of section 58(2) of the 2002 Act) should set the standard on whether mergers in these sectors are at all likely to raise national security concerns in the future. This would, in practice, be determined on a case-by-case basis by the Competition and Markets Authority (on advice from the Ministry of Defence and/or the Home Office), which would then advise the BEIS Secretary (who would take the final decision). As the additional advisory input from government in national security cases typically comes from the MoD or Home Office, it appears that this will negate the possibility of industrial strategy concerns entering into the decision-making process (although, this does remain a prospect so long as the BEIS Secretary is the ultimate arbiter). There may therefore be a case for following a similar route to that taken in media public interest mergers (where the DCMS Secretary is the ultimate decision-maker);

[4] Bruce Lyons, David Reader and Andreas Stephan, 'UK competition policy post-Brexit: taking back control while resisting siren calls' (2017) 5(3) Journal of Antitrust Enforcement 347, 351-359. (Link).

meaning that the Defence Secretary or Home Secretary would have competence over national security cases.