Law Society of Scotland

Consultation Response

National Security and Infrastructure Investment Review: Part 2

January 2018

Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

The Society's Competition Law Sub-committee welcomes the opportunity to consider and respond to Part 2 of the Government's green paper: *National security and infrastructure investment review*.[1] The Sub-committee has the following comments to put forward for consideration.

We previously responded to Part 1 of the consultation.[2] The example of the CFIUS scheme in the United States may be instructive in examining of these questions as the concept of national security plays a greater part in the US competition law regime.

Response

7. What are your views about the benefits and costs of amending the current voluntary regime to more clearly separate national security concerns and the competition assessment?

As noted in our previous response, the jurisdictional bases of the two reviews are, and should be, distinct.

However, the use of a voluntary system for national security aspects might be merited just as it is for competition law reviews (please see below).

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/652505/2017_10_16_NSII_Green_Paper_final.pdf

[2] https://www.lawscot.org.uk/media/359138/comp-lss-response-to-national-security-and-infrastructure-review_part-1_nov-17.pdf

8. What are your views about extending the scope of the Government's powers in relation to national security to include a wider range of National Security and Infrastructure Investment Review investments into which Government could intervene?

If national security is considered as a whole, it is anticipated that most infrastructure would be within scope as a matter of jurisdiction in any case. The more important issue is to ensure that such a power would be used properly, and only where truly merited by an objective, substantive and relevant concern. It is essential that the market has confidence that it will be in this way, which turns more on the need to base decisions on evidence, than the extent of the power *per se.* It is also necessary to ensure that its exercise can be properly tested through challenge in the courts where problems arise. Here the UK benefits from strong judicial review and appeal precedents and can draw on the expertise of the courts to ensure that powers are not abused.

We therefore consider that the central issue here might lie more in the checks and balances associated with such a power, rather than its precise definition.

9. Do you agree that the definitions for those investments into which the Government can intervene should be (1) more than 25% of shares or voting rights and/or (2) other means of significant influence or control?

In the context of national security, we note that the key issue may not be merely the type of investment but also the type of investor, which may include factors such as their financial and business record, and also political, business, family and other associations.

Influence and control-based tests may be problematic, as they open the door to potential evasion as does shareholding. For instance, a single board seat might confer strategic knowledge of new technology, but not trigger "control" in the suggested test.[3] Indeed, control-based approaches present issues more generally, seen in the need to adopt concepts of joint control.

The control-based analysis of jurisdiction under EU law is a good example of a rule leading to uncertainty. An alternative approach would have been to identify "triggering events" could be more easily and precisely defined (eg transaction value): defining control led to the development of complex doctrines of joint control that which might not have been needed at all if a size of transaction test been used instead.

This may be instructive in determining how to approach the national security review. Instead, as can be seen from the CFIUS experience, the preferable approach may be to take a more purposive approach. It

[3] which is already used in EU competition law

may be relevant here that the CFIUS system has operated with a much more expansive test based on engagement in “interstate commerce” and no control doctrine as such.

The national security power should be clearly defined to ensure certainty but could also be framed in such a way as to allow the precise circumstances in which it might be applies to evolve alongside future developments in markets, technology, etc.

10. What do you think should constitute significant influence or control in this regime? Can you give examples to support this view?

Please see above – there would seem to be considerable risk in defining jurisdictional limits for their own sake when the focus could instead be on safeguarding national security where necessary while establishing robust checks and balances to prevent abuse of such a power.

11. Do you agree that, if it pursued an expanded ‘call-in’ power, the Government should retain the ability to intervene in an investment after the event for national security reasons? Is three months an appropriate period for this?

Yes, the Government should have the ability to intervene: from a business certainty point of view we consider that three months should be an appropriate period.. We note in this context that it is anticipated that such cases would be exceptional nature and that they should be subject to the checks and balances in the exercise of such a power mentioned above.

12. What are your views about any ‘call-in’ power being expanded to new projects?

As above, an arbitrary jurisdictional rule that applies only to certain classes of transactions presents the prospect of a loophole.

13. What are your views about any ‘call-in’ power being expanded to bare asset sales?

As above, an arbitrary jurisdictional rule that applies only to certain classes of transactions presents the prospect of a loophole.

14. How could the Government best ensure that the expanded call-in power is exercised in a proportionate way and to provide sufficient transparency and clarity to businesses?

The circumstances in which an expanded call-in power could be used would need to be clearly defined. As above, the criteria should be exercise only where there is a substantive and relevant concern, to be determined according to objective criteria. The important consideration is not the type of transaction but the underlying subject matter or nature of the project.

15. What are your views on the merits of a mandatory notification regime? What are your views on the potential benefits and costs of a mandatory regime?

We do not think a mandatory regime would be appropriate in the UK context, particularly because other merger regime cases operate on the basis of voluntary notification. It is important to recognise that there is nothing inherent in a voluntary regime that would prevent a merger/acquisition from being assessed or investigated by the relevant authorities.

However, if a voluntary notification national security scheme were to be introduced, it would require companies to consider specific new criteria. An introductory period giving an option to notify even where no problem was anticipated, could be helpful in the interests of legal certainty.

We also note that very few cases are likely to raise true national security concerns.[4] There would seem to be a significant prospect of a mandatory regime being overly burdensome for both the regulator and regulated businesses in relation to the rarity of cases with a true concern.

This suggests that there may be substantial drawbacks to a mandatory regime, especially if based on the export lists which are likely to be over-inclusive in this regard. Instead, a clearly defined and more limited power to review could be preferable.

Another way to put the point is that the legal certainty point can be over-emphasised when the focus of enquiry lies in a handful of rare cases raising serious public interest concerns: under such conditions, a voluntary regime may be appropriate, and the most important point might simply be defining a power independent of the EA powers to address these rather different concerns.

If there is concern about gaining a complete picture via mandatory notification, a few points might be made: (i) that monitoring of the most sensitive technology should happen anyway, regardless of notification, as part of defence contingency planning, and (ii) that truly nefarious purchases are likely to be masked anyway.

16. Do you have views about the draft definitions of essential functions in Annex C? Would they be appropriate for the scope of any future mandatory regime?

Some further information on why only economically regulated “dominant” airports are included would be helpful. Given the breadth of those included in other sectors, it seems anomalous that, for example, a relatively small (ie not "Big 6") energy supplier could be covered, but major airports such as eg Edinburgh, Glasgow, Manchester or Birmingham, would not.

It also unclear why energy suppliers who do not operate networks, but just take responsibility for billing and metering etc are included, but water suppliers who perform a similar role in respect of business water

[4] The Jackson paper on CFIUS, for instance, suggests that only approximately 1000 such cases have arisen over the past decade, even on a very inclusive counting method. Of these one was blocked and 62 notices were withdrawn during investigation.

customers are not. Similar sector-specific protections are already present in either case. We note that water networks have their own special merger regime, which explains them being omitted.

In relation to financial services, the case of the London Stock Exchange might merit further consideration. It is the sole UK stock market and therefore the competition safeguard identified in relation to other sectors would not apply.

17. Do you have views on whether certain parts of the Government and Emergency services sectors should be covered by a mandatory regime?

There may be other functions which are in the private sector but which support existing police and security functions which should be covered.

18. Are there other sectors to which any mandatory notification regime (if introduced) should apply?

We have no comments at this stage.

19. What are your views about the potential power for Government specifying to which businesses or assets a mandatory regime should apply? How could this power best be designed?

Please see above.

20. What are your views about the potential power for Government to bring specific plots of land into scope of a mandatory regime?

Please see above.

21. Do you have any views about how sanctions for non-compliance with a mandatory regime should operate, including how compliance could best be incentivised?

We have no comments at this stage.

22. What are your views on the relative merits of introducing either an expanded call-in power or a mandatory notification regime for specific businesses or assets, or both an expanded call-in power and a mandatory notification regime?

As above, a mandatory review may not be necessary. An expanded call-in power might potentially be merited, but there is no reason in principle why the power to review for national security reasons cannot simply be created, and applied sparingly in the rare cases where it proves relevant, without regard to special sectoral lists.

23. Do you have any views about the introduction of an information-related power?

Information gathering powers are commonly used in the regulated industries and could helpfully bolster the review if carefully drafted.

24. Would public guidance about the assessment process be useful? If so, what issues could it most usefully cover?

Guidance on assessment would be helpful.

25. Do you consider the proposed approach to Government intervention to be appropriate for a wholly national security-related regime?

The proposal is carefully tailored as it stands; it could be even clearer on the point by expressly creating a power couched in national security terms, with checks and balances to ensure that a true security issue exists.

26. Do you have any views about how any new reforms can best be designed to interact effectively and in an administratively efficient manner alongside any competition assessment being conducted by the CMA, the existing public interest regime and other corporate reporting requirements?

The experience with public interest mergers, in which different parties handle different aspects of the cases, seems a very sensible way to introduce checks and balances in decision making.

27. Do you have any views about how the reforms can be designed to be as transparent as possible for investors and companies given the national security focus?

Please see above: clarity may be best served by a robustly-defined national security power that is sparingly used. The national security power should be clearly defined to ensure certainty but could also be framed in such a way as to allow the precise circumstances in which it might be applies to evolve alongside future developments in markets, technology, etc.

28. If you have experience investing in countries with foreign investment regimes, could you describe the costs and benefits involved, including familiarisation, administrative and legal costs and the costs of any delays?

Not applicable.

29. What impact, if any, do you anticipate these proposals having on the capital market or UK infrastructure businesses' ability to raise financing?

We have no comment on this question.

30. Are there any other important costs and benefits you haven't already discussed from adopting these reforms that could inform the Government's analysis?

We have no comment on this question.

For further information, please contact:
Carolyn Thurston Smith
Policy Team
Law Society of Scotland
DD: 0131 476 8205
carolynthurstonsmith@lawscot.org.uk