Law Society of Scotland

Consultation Response

National Security and Infrastructure Investment Review: Part 1

November 2017

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 1 of the Government's consultation *National security and infrastructure investment review*.[1] The Sub-committee has the following comments to put forward for consideration.

We will respond to Part 2 of the consultation in due course.

Response

1. Do you think the proposed definitions for the dual-use and military and advanced technology sectors provide sufficient clarity and certainty to businesses and investors?

We consider that the proposed use of existing export control lists would lend immediate clarity in the case of dual-use products. However, we do not consider that the definition of "advanced technology sector" is sufficiently clearly defined to provide investors with the requisite certainty. . This stems, in particular from the fact that quantum-based technology is developing very quickly and there is potential for its application in many sectors. In addition, there is not sufficient precedent in this area to rely on. As such, Government guidance on the scope of the application of the proposed changes – and in particular on the scope of the application to the 'advanced technology sector' – may be beneficial for the parties operating in these sectors and their advisers. Introducing guidance in this respect should be driven by objectives of legal certainty and cost-effective self-assessment, so that the parties could assess whether a merger notification is required.

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

At the same time, an important issue arises in that the above definitions may be under- or over-inclusive, depending on context: for example, a sensitive computing technology might not fall within the above definition, and a dual-use regime based essentially on weapons control may not align with more nuanced national security considerations from industrial consolidation, which have sometime arisen in relation to technologies and partners who would not be so covered.

In short, it may be preferable instead to develop a free-standing concept of national security to apply to such cases. There is no reason in principle why this could not be defined in law, the key point perhaps being a separation of powers to prevent protectionist abuse.[2]

2. Do you think the scope of the new thresholds should reflect updates to the relevant Strategic Export Control lists? Do you think that enterprises that design or manufacture items subject to temporary export controls should also be in scope?

If the lists approach is adopted then it is important that such updates should be reflected. Another potential approach could be to set up a process of checks and balances by which a more flexible definition could be defined with consistency.

One of the recommendations of the National strategy for quantum technologies was to "incentivise private investment, including through roadmapping and demonstration, and support early adopters of these new technologies as they emerge over differing timescales."[3] Consideration should be given as to how the proposed introduction of merger control changes will impact this and other objectives / recommendations of the UK strategy in this area – in particular if investors will find it difficult to assess whether they would fall within the regime as proposed.

There may also be a link here to the discussion around costs and benefit (see question 6). We note that wider considerations may need to be taken into account: for example the costs of merger control analysis

[2] We note that the experience of the Committee on Foreign Investment in the United States may be instructive in this regard - see eg *Ralls vs. the Committee on Foreign Investment in the United States* 758 F.3d 296 (D.C. Cir. 2014), a D.C. District Court judgment confirming due process requirements associated with the exercise of discretions related to a free-standing concept of "national security" under US law. The case contains a helpful summary of the CFIUS process. The extensive American experience may be read as suggesting the importance of tasking different parties with different parts of the process of defining the concept of national security in each case. The recently updated Congressional Research Office paper on CFIUS (last update Oct. 11, 2017) explores this in further detail: https://fas.org/sgp/crs/natsec/RL33388.pdf

[3] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414788/Strategy_QuantumTechnology_T15-080_final.pdf at p4

for a developing venture/business (with £1 million or more turnover) could be significant and there may be a question as to whether that cost is justified by the national security objectives in all cases that could be caught.

3. Are the proposed definitions sufficiently focused on sectors where national security concerns may arise? If not, what amended definitions would help achieve this?

We are concerned that the £1 million threshold appears to be an arbitrary figure and is not clearly supported by any evidence-based analysis. The Impact Assessment states that the rationale for reducing the threshold is "because, in some specified sectors, it is feasible for a small company to hold the rights to key technologies which are critical for defence or underpin the operation of key systems within the economy." However, if this rationale is used, we do not consider that a turnover threshold is the appropriate measure to use.

We would therefore encourage BEIS to undertake a detailed empirical analysis of the potential benefits and disadvantages of this part of the proposal. This should include, amongst other factors, the assessment of increased workload on the CMA as a result of the proposed change and how it will be managed. Comparison with the Australian, US, French and Canadian approaches is a useful one and could be developed further to analyse how these apply in practice (see also questions 4 and 6).

We also note that the OECD commentary on this topic may be instructive. The OECD has made a number of points in relation to low merger thresholds which are outlined below, albeit in relation to general merger thresholds with consumer welfare concerns in mind, and not those applicable in specifically defined sectors. Nonetheless, a Green Paper suggesting such a drastic reduction in thresholds should at least recognise (if not address) some of these points:

- Unduly low merger thresholds capture more mergers in a notification scheme but may not reflect a corresponding increase in the number of questionable mergers pursued or in overall consumer welfare;
- Moreover, reviewing more mergers increases costs on business, creates market uncertainty, and stretches agency resources; and
- Conversely, well-tuned notification thresholds designed to focus on significant matters - particularly those based on objectively quantifiable criteria related to combined party or target party assets and/or sales - focus agency resources on matters which are likely to materially affect the reviewing jurisdiction's economy and "ensure that notification will not be required for transactions lacking a potentially material effect on the local economy."[4]

[4] See http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WP3/WD(2016)26&docLanguage=En

As above, a more flexible definition subject to safeguards might prove more targeted: if the concern in a case truly is national security, a concept of national security geared to the approval of a number of stakeholders would allow intervention in a true national security case but not in other circumstances.

4. Do you agree that the new jurisdictional tests in the Enterprise Act 2002 for businesses in the above defined sectors should be:
• a turnover of over £1 million, rather than £70 million as now;
and/or • a merger or takeover involving a target with 25% or more share of supply (i.e. with no need for an increase), or which meets the current test of creating or enhancing a share of supply of 25% or more.

The paper is correct to identify a gap in the existing jurisdictional position where the Enterprise Act tests are not met: in such cases jurisdiction is indeed fragmented. It is arguable that the share of supply test affords extremely broad discretion: see eg the *Yorkshire Buses*[5] case. The case indicates that a plausible definition of a supply suffices for jurisdiction and therefore it will almost always be possible to claim that a sensitive defence component falls within the existing 25% test: if the test is not met, there would normally be alternative products and thus presumably a limited concern.

The exception would be a transaction under the turnover threshold, and in which there is no increment in share of supply. This can occasionally arise, eg in the transfer of a monopoly not meeting the turnover threshold. Here, the national security concern could be legitimate despite only a modest concern in terms of competition.

A potential issue does arise, however, with the level of the threshold. We are concerned that this may simply move the arbitrary cut-off, rather than eliminate it. We would emphasise that it will still be possible for an issue to arise below the threshold. For this reason, a free-standing concept of national security may be preferable, subject to thorough consideration and a precise definition to give certainty as to its application.[6] We also note that reliance on Enterprise Act tests arguably could apply an antitrust-derived concept to a security concern despite the different status and nature of the concerns engaged. One possible issue is that jurisdictional limitations which may be appropriate in the private economy could be carried over to the national security context where they would be inappropriate.

[5] *R v Monopolies and Mergers Commission, ex p South Yorkshire Transport Ltd* [1993] 1 WLR 23, [1993] 1 All ER 289

[6] In this, it is notable that the CFIUS jurisdiction is engaged by transactions involving "interstate commerce" in the presence of "credible evidence" of a national security concern rather than by tests designed to address market power issues in the consumer economy (here, the Clayton Act as amended).

We therefore consider that a jurisdictional rule should not simply carry over the Enterprise Act concepts but should rather be geared to the quite different concerns engaged by the preservation of peace, security and liberty in the United Kingdom.

5. Would Government guidance in relation to its views about the amendments, including their solely national security focus, be useful? If so, what would it most helpfully cover?

We appreciate that there may be circumstances where eg the financial stability of the UK (ie national security) may override ordinary considerations of a robust competition policy. However, any deviation from the normal rules of competition – ie how, or in which specific circumstances, powers in relation to national security would be exercised - must be clearly set out as a matter of law to provide the requisite legal certainty for businesses and investors. Guidance may be helpful to assist in interpretation but should not form the basis of the rules themselves: these should be subjected to the proper process of Parliamentary scrutiny.

6. What do you think are the most important costs and benefits from the proposed threshold changes to the Enterprise Act 2002 for the defined sectors? What could be the potential size of these costs and benefits?

The costs and benefits depend considerably on the quality of analysis undertaken where the thresholds are triggered: if market-friendly enforcement follows, there is little concern and could be considerable benefit. Quantification may be a particular challenge here to the extent that national security interests (e.g. bodily integrity; personal liberty) may be especially difficult to quantify.

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