SECOND RESPONSE OF THE CITY OF LONDON LAW SOCIETY COMPETITION LAW COMMITTEE TO THE GREEN PAPER ON THE GOVERNMENT'S REVIEW OF THE NATIONAL SECURITY IMPLICATIONS OF FOREIGN OWNERSHIP OR CONTROL

This response is submitted by the Competition Law Committee of the City of London Law Society (**CLLS**) in response to Questions 7 to 30 (the **long term reforms**) of the Green Paper on the Government's review of the national security implications of foreign ownership or control, published on 17 October 2017 (the **Green Paper**).

The CLLS represents approximately 15,000 City solicitors through individual and corporate membership including some of the largest international law firms in the world. The Competition Law Committee comprises leading solicitors specialising in UK and EU competition law in a number of law firms based in the City of London, who act for UK and international businesses, financial institutions and regulatory and governmental bodies in relation to competition law matters.

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SUMMARY

- We strongly favour a voluntary regime for all transactions raising potential national security concerns. Such a regime would retain the flexibility, efficiency and lower cost for businesses and taxpayers of the current merger control regime, while allowing businesses the choice of obtaining certainty by making a filing. The mergers intelligence unit of the Competition and Markets Authority (**CMA**) has an excellent track record of identifying mergers to be called in for review on competition grounds. As a similar unit could be set up for transactions raising national security concerns (which could liaise with the CMA's mergers intelligence unit), we do not consider there to be a significant risk of missed transactions under a voluntary regime.

- A voluntary regime should nevertheless be based on jurisdictional criteria that limit the scope of affected transactions to those that have potential to give rise to national security concerns. These should include quantitative thresholds to exclude insignificant transactions, based on turnover or, potentially, transaction value. We query the rationale for applying such a regime to acquisitions by domestic investors, given that the potential national security risks identified in the Green Paper all relate to issues arising from foreign ownership.

- Other essential features of a voluntary regime include transparency (with a commitment to publishing as much information as possible, including, as a minimum details of the transactions notified and the Government department that raises a national security concern), a carefully defined substantive test and a transparent and predictable procedure. We have set out below and in our response to the consultation on the short term reforms a list of factors that should be included in public guidance for both a voluntary and mandatory filing regime.

- We accept that it is reasonable in principle to include a wider range of transactions within the scope of the proposed regime than are covered by the current merger control public interest provisions of the Enterprise Act 2002 (**EA02**), provided they are appropriately defined and limited. We have made below some suggestions for how to do so, along with certain additional factors that will need to be considered.

- As regards the jurisdictional test of control, we favour a material influence test for a voluntary regime, given its familiarity and the body of case law that exists to guide its interpretation. However, that test would be too subjective for a mandatory regime in which penalties are imposed for failure to file. If the Government does decide to introduce a mandatory regime, we would suggest a modified version of the test for significant influence or control for the purposes of the Register of People with Significant Control (**PSC**).

- If the Government does decide to introduce a mandatory regime, the Government will need to consider whether there should be an automatic standstill obligation until the transaction is approved on national security grounds. As there is no automatic standstill obligation under the UK merger control regime, we recommend that this be avoided under the national security regime (as this would create significant divergence between the two regimes and uncertainty for businesses as to what would constitute "gun jumping" in a national security context). Instead, concerns that national security risks may arise prior to the end of the review period could be addressed by powers to impose interim orders in appropriate cases, coupled with the possibility of appropriate derogations.

- A mandatory regime should incorporate clearer and tighter definitions of the covered transactions (we make some suggestions below for how to do that), a register of proximate land within the scope of the regime, appropriate exceptions and derogations from the filing obligations and a principle of non-retroactivity for individual businesses and assets that are brought within the scope of the regime. It should also be accompanied by extensive guidance on the jurisdictional and substantive criteria, due process rights for merging parties (including the right to seek judicial review of decisions). With a mandatory regime, there may be a case for civil penalties for businesses that fail to file, but not criminal or individual penalties (for the reasons set out below).

- Both a voluntary regime and any mandatory filing regime should, in our view, be entirely standalone and separate to the regime of the EA02. We do not perceive any compelling need for detailed interaction between the regimes, save that it will be important that merging parties are able to coordinate the timing of competition and national security clearances, should they choose to do so. In the event that a standalone regime is introduced, the applicability of the existing public interest provisions in the EA02 to national security will be redundant and should be removed.

Question 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?

1. We welcome in principle the proposal to separate more clearly the regime for assessing national security concerns and the assessment of competition issues under the merger control regime. The current arrangements under the EA02 require the CMA to summarise representations received in respect of the relevant public interest consideration and (if a Phase 2 reference is initiated) to advise on whether the merger may be expected to operate against the public interest and any appropriate remedies. Given that the CMA does not have any specialist expertise in assessing national security concerns[1], its role in the process is somewhat incongruous, and consumes resources that would be better deployed in carrying out its competition remit.

2. The above consideration applies to both the "normal" public interest regime and the special public interest regime. We therefore favour a stand-alone national security regime that is entirely outside the EA02, and in which the CMA plays no role.

3. As regards the benefits of a voluntary regime, we consider that these substantially outweigh the putative benefits of a mandatory filing system, while imposing much lower costs. The benefits of a voluntary regime include:

    (a) <u>Flexibility and legal certainty</u>. Contrary to the statement in paragraph 116 of the Green Paper, we do not consider that an appropriately defined voluntary regime would necessarily create uncertainty for businesses, provided that businesses that require certainty can choose to make a filing prior to closing. The key attraction of a voluntary regime is that it also allows merging parties to choose to take (and appropriately allocate) the risk of not making a filing prior to closing. It is clear from the favourable attitude of businesses to the UK's voluntary merger control regime that they value this choice, as it allows for the material costs and delays of filing to be avoided if competition or public interest concerns are highly unlikely to arise, or if it is agreed that the purchaser will assume the risk that remedies are imposed to address any such concerns. The same would be true for a national security screening regime, particularly given the proposed potential breadth of the regime. Any uncertainty as to whether a particular transaction may fall within the scope of

[1] While a Phase 2 reference has not been made on national security grounds to date, we note that the CMA does not have an explicit power to add a member to the Phase 2 Inquiry Group to specifically advise on public interest issues in a merger context (unlike the market investigation regime).

the regime can be addressed (as is also the case for a mandatory regime) by implementing clear and objective jurisdictional criteria and guidelines. In the US, the Committee for Foreign Investment in the US (**CFIUS**) has operated an effective voluntary filing regime for many years.

(b) Lower cost. A mandatory regime would impose filing burdens on a relatively large number of transactions, the great majority of which would (as the Green Paper acknowledges) pose no national security issues at all. The Green Paper estimates that a mandatory regime could catch up to 100 transactions per year; almost double the number of transactions per year that are reviewed on competition grounds under the voluntary merger control regime. Our view is that the number of affected transactions is likely to be even higher. In contrast, the very low volume of mergers that have raised national security issues under the current regime (only seven over a period of nearly 15 years) indicates that a mandatory filing regime would be disproportionate and inefficient. The lower costs of a voluntary regime would benefit both business and Government (and, indirectly, taxpayers).

(c) No significant risk of missed transactions. It is widely recognised that the CMA's mergers intelligence unit has an excellent track record of identifying potentially anticompetitive mergers to be called in for review, even if not notified. A similar system could be implemented for a standalone national security system, drawing on the CMA's expertise in this area. As such, we do not consider there to be a considerable risk of missed transactions under a voluntary regime.

4. We consider that an effective voluntary regime should have the following features.

(i) *Clear and objective jurisdictional criteria*

5. The jurisdictional criteria should limit the scope of affected transactions to those that have potential to give rise to national security concerns and with a clear nexus to the UK. In this respect, we consider that the regime should have objective quantitative thresholds to ensure that insignificant transactions are excluded from its scope. These could include:

(a) for acquisitions of existing businesses, thresholds based on the target's UK turnover in respect of the business giving rise to potential national security concerns or the value of the transaction, i.e. the consideration payable for the target business;[2]

(b) for acquisitions of bare assets, thresholds based on the value of the transaction;

(c) for new projects, thresholds based on the value of the transaction (including the value of the investment to be contributed to the project in respect of the UK); and

[2] In order to ensure a UK nexus for transactions involving targets with multinational operations, the Government would need to design rules to allocate an appropriate proportion of the overall transaction value to the UK, while maintaining clear and objectives rules for determining jurisdiction.

(d) for land proximate to sensitive sites, we recommend the creation of a register of such land that could be checked by merging parties.

6. The Government should also consider adopting different thresholds according to whether the investor is from a jurisdiction with which the UK has a free trade agreement or is a State owned entity (as is the case under Australia's Foreign Acquisitions and Takeovers Act 2015). As a related point, we query the rationale for applying the regime to acquisitions by domestic investors, given that the potential national security risks identified in the Green Paper all relate to issues arising from foreign ownership.

(ii) *Transparency*

7. We recognise that in many cases it will not be possible to publish full details of the national security concerns that are considered under the new regime. However, our view is that it ought to be possible to maintain some degree of transparency that would benefit the efficacy and predictability of the review process, and that having this transparency will be important to the operation of a voluntary regime so that businesses are as clear as possible when a review is required, and so can avoid unnecessary costs on either the analysis or a filing. For example, publishing details of the transactions that are notified or called in for assessment would assist merging parties in determining whether their transaction might raise national security issues, and publication of the identity of the Government department that raised a national security concern would help merging parties to identify the appropriate Government stakeholders with which to engage.

8. In addition, as noted in our responses to Questions 14 and 24 below, published guidance on procedural and substantive aspects will be vital to the effective operation of the regime. In this respect, we consider that a statutory duty to publish guidance should be included in the primary legislation that creates the regime.

9. The need for transparency is partly to ensure a consistent, reasoned approach by the Government in applying these rules. Transparency is also of vital importance to parties seeking to identify whether a transaction is eligible for review (whether to avoid penalties in a mandatory regime or to appropriately judge risk without a chilling effect on business in a voluntary regime).

(iii) *A substantive test*

10. We recommend that the primary legislation incorporates a clear test for what is considered to be a national security issue, in the same way that the merger control regime benefits from the use of a "substantial lessening of competition" test. This would guard against the regime becoming overly politicised in the future. Such a test could be defined by reference to the three categories of risk set out in paragraph 45 of the Green Paper.

(iv) *A transparent and predictable procedure*

11. A transparent and predictable procedure will be critical to ensure that any new foreign investment regime does not unnecessarily deter such investment. In this respect, the regime should have a defined, statutory timetable for clearance, similar to that which

applies under the merger control regime. A simple commitment to issue "rapid approval" (paragraph 129 of the Green Paper) would not offer sufficient certainty to allow for efficient transaction planning and financing.

Question 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 investments into which Government could intervene?

12. We accept that it is reasonable in principle to include a wider range of transactions within the scope of the proposed regime than are covered by the current merger control public interest provisions of the EA02, provided those transactions are appropriately defined and limited, as discussed in more detail below.

Question 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?

13. We recognise that test for material influence under the EA02 – which relates to influence over commercial policy - may always not equate to the type of influence that is liable to give rise to national security issues. However, we consider that in most cases it will, as influence over a target's commercial policy will also entail influence over its management and staff, which is the fundamental national security issue. The only potential adjustment to the test that the Government might consider is whether it is necessary to add a separate alternative criterion that would be satisfied if the foreign investor has access to sensitive sites or to commercially sensitive information[3] as a result of its acquisition of an interest, notwithstanding its lack of material influence over the target. In our experience, we consider that this will only rarely be the case in practice, particularly if the investor does not have the right to appoint a board director or observer.

14. Applying a material influence test would have the advantage of familiarity and a relatively deep body of EA02 case law to guide interpretation of the test. However, we recognise that using the material influence test would mean that there would be two independent bodies interpreting the same concept, each having the potential to impact on the other (or, if not, there being the potential for the meaning of the same term to diverge between the two regimes). In practice, such an approach has proven workable in the water sector, where Ofwat applies a test of material influence in determining the "ultimate controller" of a regulated water company.[4] However, to the extent that additional flexibility is required in a national security context, it will be important that this is clearly set out in the legal test. For example, as suggested in paragraph 13 above, it may be appropriate for the national security test to apply to acquisitions of material influence over the policy of a body corporate or person

[3] As regards the definition of commercially sensitive information, this should exclude general or consolidated financial information of the type that is typically provided to minority interest investors or limited partners in an investment fund.

[4] The 'Ultimate Controller' is defined in the licences of regulated companies in the water sector as "any person who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of the Water Services Regulation Authority) in a position to control, or to exercise material influence over, the policy or affairs of the Appointee or of any holding company of the Appointee".

carrying on an enterprise (thereby reflecting the EA02 test)[5], with a separate limb to cover additional situations (if any) where the acquisition provides the investor with access to sensitive sites or information.

15. In contrast, we consider that the criteria relating to the PSC Register are untested and in some instances have little bearing on the type of influence that is relevant for a national security review. The experience of CLLS members is that the application of the PSC has also given rise to considerable market uncertainty, due to the relatively limited published guidance and the lack of a body of interpretative case law. This is reflected in the Companies House Strategy for 2017 to 2020,[6] which has as one of its targets the reduction of incorrect PSC information on the register; and the following commentary in the Companies House Business Plan 2017 to 2018: "*We recognise that, for some customers, the legislation can appear complex and that they need support in getting it right*."[7]

16. Consistent with the application of the material influence test, we also counsel against the use of an absolute shareholding threshold of 25%. In particular, this would catch purely passive interests (with no voting rights attached) that do not afford their holders the opportunity to engage in conduct of the type described in paragraph 46 of the Green Paper. Moreover, while there may be more merit in applying a threshold based on 25% of the voting rights in a business, even that would be of only indirect relevance, as a private company's governance arrangements may be such that a holder of 25% of the voting rights has no meaningful influence or governance rights in practice.

17. As the EA02 test for material influence focuses on the degree of influence irrespective of the absolute level of shareholding or economic interest, our view is that it is better suited to define the jurisdictional scope of the proposed national security regime. Given how the material influence test has been applied in practice, a share of voting rights of over 25% is likely to be seen as conferring the ability materially to influence policy. Although there is no presumption of material influence below 25%, the CMA may examine any shareholding of 15% or more in order to see whether the holder might be able materially to influence the company's policy. Exceptionally, a shareholding of less than 15% might attract scrutiny where other factors indicating the ability to exercise material influence over policy are present, including factors such as board representation. Similar factors are likely to be relevant to potential national security concerns.

18. However, we consider that the material influence test would only be appropriate in the context of a voluntary regime where there are no direct penalties attaching to the assessment of whether the thresholds for notification are met. For a regime to work on a mandatory basis it is essential that there are "bright line" tests that can be applied by businesses to establish whether or not a notification is required (as is the case for merger control filings in jurisdictions such as the EU where filing is mandatory). As

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5 Section 26(3) EA02.

6 Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/609467/Companies_House_Strategy_2017-2020.pdf

7 Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/609263/Companies_House_Business_Plan_2017-18.pdf

set out in response to Question 15 below, the material influence test would be too subjective for a mandatory regime in which penalties are imposed for failure to file.

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

19. Please refer to our answer to Question 9 above.

Question 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?

20. We recognise that this is an essential feature of a voluntary regime. However, it is unclear from the information in the Green Paper how the three month period would operate and we will therefore comment in more detail when the Government publishes its White Paper on the proposed reforms. Our initial observations are that:

(a) the call in period should be as short as possible and should be combined with a clear statutory timetable for the review period after a transaction has been called in and sufficient information provided; and

(b) the Government should consider what events should trigger the start of the three month period, in addition to those provided for under the merger control regime (i.e. notice of material facts to the review body or publicity in the national or trade press). For instance, for land that is proximate to a sensitive site, registration of an interest in the land registry should also be a trigger.

Question 12: What are your views about any 'call-in' power being expanded to new projects?

21. We recognise that it is reasonable in principle to include new projects within the scope of the regime. Indeed, most merger control regimes (including the EU Merger Regulation) capture greenfield joint ventures provided they will give rise to a structural change in the market. However, the definition of a new project should be carefully limited so as not to catch contractual arrangements that fall short of the creation of a new business, such as contractual cooperation agreements or financing arrangements. In particular, we recommend that it catches only projects carried out through a corporate legal entity and which would constitute an "enterprise" within the well-established definition in the EA02.

Question 13: What are your views about any 'call-in' power being expanded to bare asset sales?

22. Expanding the call-in power to catch bare assets raises some complex issues and has the potential to cause substantial uncertainty unless that power is tightly circumscribed. Some of the issues that will need to be considered include the following:

(a) How to define the types of bare assets that will be within the scope of the regime? In particular, assets should only come within the scope of the regime if they are located in the UK and are either unique and irreplaceable in some way, or if they otherwise have the potential to be used for disruptive or destructive actions or espionage. Assets that can be readily sourced from elsewhere (in the UK or another country) or which are liable to be exported should not be within the scope of the new regime.

One possible way to limit the scope of the regime in this respect would be to use the list of assets and IP that the Government prepares for the purposes of the short term reforms.[8] For IP, the Government might also consider the list of technology which may be subject to national security restrictions under sections 22 and 23 of the Patents Act 1977, but noting that the redacted version of that list which is currently publicly available[9] would mean that some IP owners would be unable to ascertain if their technology is within scope.

(b) Avoiding duplication or overlap with the export control regime.

(c) Implementing an appropriate materiality threshold, e.g. based on the transaction value.

(d) For intellectual property rights, will the regime apply only to assignments or also to (exclusive or non-exclusive) licensing? How could such transactions be effectively monitored?

(e) Defining an appropriate nexus with the UK. In particular, would only IP that is valid in the UK be covered, or also portfolios of foreign patents held by a UK business? If the latter, what would be the national security justification for including these?

(f) For moveable assets, the regime would need to be designed to minimise incentives for asset owners to avoid locating their assets in the UK in the first place.

Question 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?

23. In our response to Question 5 of the consultation on the short term reforms we set out a detailed list of factors that should be built into the rules and covered in guidance on procedure and the approach to substantive assessment. It will be equally important that guidance in respect of the long term reforms also covers those areas.

24. As a more general point, the success of any new regime will depend on it being applied in a way that is fair, proportionate, reasonably predictable and as depoliticised and transparent as possible. In that respect it will be important that parties to mergers that are prohibited or subject to remedies on national security grounds have a statutory right to be given reasons for the decision (even if those reasons cannot be published in full) and are able to seek judicial review of it. It will also be important that as much

8 See our response to Question 1 of the Green Paper consultation in relation to the short term proposals.

9 Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307009/p-securitylist.pdf

as possible of the decision is published, so as to be available as guidance for parties considering future transactions.

Question 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?

25. Please see our response to Question 7, which sets out the reasons why we strongly favour a voluntary filing regime, and the considerable disadvantages that we perceive in a mandatory regime.

26. For the reasons discussed at paragraph 18 above, if the Government were minded to adopt a mandatory regime this would necessitate a radically different approach to defining the jurisdictional limits of the regime, applying some form of "bright line" test so that businesses can assess with certainty whether they are inside or outside of the regime. As such, if penalties are to apply for a failure to notify then the test for control would need to be much more precise, clear and objective than either of the material influence test under the EA02 or the significant influence or control test that is currently applied for the purposes of the PSC Register. We favour a modified version of the PSC test which focuses on absolute veto rights over any of the decisions defined in an exhaustive list (rather than the illustrative examples given in the Draft Statutory Guidance on the meaning of that test).[10]

27. We note that if a mandatory regime is introduced, the Government is minded to prohibit transactions that are subject to mandatory filing from taking legal effect until clearance is obtained. In our view, it would be disproportionate to introduce such a standstill obligation. As there is no automatic standstill obligation under the UK merger control regime, this would create significant divergence between the two regimes and uncertainty for businesses. Experience of the UK merger control regime has shown that a prohibition on closing is unnecessary as closing does not, in itself, pre-empt the availability of effective remedies.[11] Moreover, integration, business conduct and disclosures of commercially sensitive information prior to clearance can be effectively controlled through the use of interim enforcement orders, coupled with appropriate procedures for obtaining derogations.

28. If an automatic standstill obligation is imposed in a mandatory regime, this should be subject to appropriate exceptions (e.g. for public takeovers and stake building through acquisitions of listed securities) and the possibility of individual derogations in appropriate circumstances (e.g. where implementation is necessary to preserve the financial viability of the target or in certain bidding scenarios), in line with international best practice. There would also be a need for clear guidance that normal commercial activities, such as standard commercial due diligence and pre-completion integration planning would not constitute a breach of the standstill obligation (or any interim enforcement order).

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[10] Draft Statutory Guidance in the meaning of "significant influence or control" over companies in the context of the register of people with significant control, June 2017, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621687/psc-statutory-guidance-companies.pdf

[11] While the CMA now has the power to impose an ad-hoc prohibition on closing, it has indicated that it would only do so in exceptional circumstances and, indeed, has not done so to date.

Question 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?

29. The draft definitions in Annex C appear to us to be too broad for any future mandatory regime and would result in a large number of transactions being notifiable, which do not raise national security concerns. For the reasons set out above, we strongly recommend a voluntary regime.

30. We have the following specific comments on the definitions proposed:

    (a) A number of the definitions contain quantitative criteria that will need to be clarified. For instance, for "upstream gas and petroleum infrastructure which has a throughput of more than 20 million gallons of oil equivalent per annum", how would this criterion be applied if that threshold was exceeded in some recent years, but not others?

    (b) Some definitions contain no quantitative criteria. For instance, "energy networks that deliver secure, reliable electricity and gas to customers, ensuring continued supply as far as possible on the supply chain" would catch very small networks (e.g. those operated by independent gas transporters serving a single residential housing estate).

    (c) Some contain subjective criteria that may be difficult to apply when determining whether a filing is required. As discussed above, in circumstances where a failure to file may incur penalties, subjective criteria should be avoided. For instance, it is unclear whether "gas and electricity interconnectors, long range gas storage terminals and gas reception terminals" are covered only to the extent that they "contribute to the security of supply" and, if so, when that will be the case. Other examples include the requirement that large scale energy generators "have the capacity to significantly impact the balancing of the electricity system if disrupted" and the requirement that energy distribution networks be "secure and reliable".

    (d) It is not clear what business activities are covered by the definition of essential functions for the Government sector.

31. In addition, we recommend that the legislation governing any mandatory filing regime includes a power for the Government to issue derogations from the filing requirements either for individual transactions or for a particular category of essential functions, in light of experience gained from operation of the regime.

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

32. While we note that internal processes for Government procurement could provide a way to address national security risks in these areas, we also agree that it may be preferable to subject foreign investment in these functions to a consistent and relatively depoliticised foreign investment screening regime. However, our view is that this should be limited to sales of interests in a State owned business (e.g. privatisations). It should not extend to outsourcing and other contractual procurements, as this will (i) introduce considerable complexity in describing the

limits of the regime and assessing whether a transaction falls within the regime and (ii) in the context of a contractual arrangement, it is within the power of the entity that is letting the contract to specify the terms on which the contract will be let and determine the identity of the counterparty: internal procurement procedures are therefore better suited to regulate these and the relevant agreements can contain standard change of control provisions.

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

33. We do not consider that any sectors should be subject to a mandatory notification regime.

Question 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?

34. We understand that this refers to the possibility of empowering the Government to include certain individual businesses or assets in the scope of the mandatory regime, even though they are not active in any defined sector and perform none of the defined essential functions.[12]

35. We are concerned that this power would give (and/or would be perceived to give) the Government excessively wide powers to intervene in any transaction, after it has been agreed and in a way that could not be predicted by the merging parties. This would dis-incentivise inward investment into the UK. We therefore recommend that any addition of individual businesses or assets should not apply retroactively, such that filings are required for transactions that were agreed before the date of addition. Moreover, if the names of covered businesses or assets are not published (because publication would give rise to clear national security threats or other public interest reasons not to do so), then the fact of its inclusion must at least be disclosed to the owner of the covered asset or business, who must in turn be permitted and, indeed, subject to an obligation to disclose that fact to any foreign investor so that the investor can comply with the mandatory filing obligation.

36. An alternative to maintaining a list of businesses which are outside the scope of the Annex C essential functions but which fall within the mandatory regime would be for the Government to maintain a complete list of all businesses in respect of which foreign investment would trigger a mandatory filing, i.e. those within the scope of Annex C as well as those individual businesses or assets outside that scope. That would provide a greater level of business certainty and reduce the transaction costs involved in assessing whether a particular business is within the scope of the filing regime. We do not consider that compiling and maintaining such a list would be excessively costly or onerous, particularly when compared to the counterfactual of requiring businesses to make this assessment in circumstances where they are unlikely to have complete information on the likely concerns of Government (which may change over time), and may also not have complete information on every aspect of the activities of the business that is being acquired. We recognise that this approach is

[12] Paragraph 136 of the Green Paper.

not without challenges, which is why, on balance, we strongly support a voluntary system.[13]

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

37. If specific plots of land are brought into the scope of a mandatory regime, we consider that the Government should maintain a register of land that is proximate to sensitive Government sites in the UK, so that parties can identify and assess proximity risk. Otherwise it will not be possible for investors to comply with a mandatory filing obligation.

Question 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?

38. In our view, the best way to incentivise compliance would be to have light touch filing requirements (e.g. a description of the transaction, identification of the foreign investor and a summary of the target's business activities in the relevant area of critical infrastructure), no filing fees and a swift clearance process.

39. We submit that neither criminal penalties nor civil penalties for individuals would be appropriate for a failure to notify or (in the event that standstill obligations are imposed) implementation of a transaction prior to clearance. It is unlikely that a failure to notify would be, or could be demonstrated to be, the fault of a particular individual. In addition, the absence of comparable criminal offences in other jurisdictions would mean that it would be difficult to enforce criminal penalties, as extradition of the relevant individuals would not be possible. Moreover, an inadvertent failure to file would give rise to disproportionate implications for merging parties under the Proceeds of Crime Act 2002, with attendant adverse effects on incentives to invest in the UK.

40. For consistency, we suggest aligning penalties with the civil penalties that apply for breach of an interim order under the merger control regime, i.e. 5% of worldwide turnover.[14]

Question 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?

41. In our view, any foreign investment regime should be based on a voluntary filing regime, for the reasons set out in response to Question 7. If the Government takes the view that it is likely to want to review any acquisition of a business performing any of the essential functions described in Annex C of the Green Paper, it could achieve a comparable effect to a mandatory filing regime by retaining a voluntary regime, but issuing guidance that that it is highly likely to call in such transactions. Such a solution would preserve the flexibility of the voluntary regime – including the possibility for parties to proceed unhindered by filing and standstill obligations in

[13] See our response to Question 22.

[14] Section 94A(2) EA02.

cases where it is self-evident that no national security concerns arise – while providing appropriate incentives to notify in all other cases. It would also minimise the costs of operating the regime for the Government, taxpayers and businesses. Acknowledging that there are downsides in both approaches, adopting both an expanded call-in power and a mandatory regime would, in our view, ensure that the overall regime would suffer from the sum total of both sets of disadvantages, without doubling the potential upsides.

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

42. We recognise that information gathering powers would be necessary. However, we consider that the proposed test for the use of such powers (where "necessary and proportionate for reasons of national security") lacks a sufficient link to the purpose of reviewing the transaction in question, and could be used, for example, to gather information considered useful by the Government, but which is not strictly relevant to the national security issues raised by a transaction. A better test, in our view, would be for information gathering powers to be exercisable where reasonable and proportionate for the administration of the regime.

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

43. Public guidance would be not only useful but necessary. In our response to Question 5 of the consultation on the short term reforms we set out a detailed list of factors that should be covered in guidance on procedure and the approach to substantive assessment. It will be equally important that guidance in respect of the long term reforms also covers those areas.

44. Additional guidance that would be required for a mandatory regime includes:

(a) detailed clarification of the jurisdictional thresholds, including guidance on the definitions of essential functions to which the regime applies and the test for control;

(b) detailed guidance on the application of any standstill obligations and exceptions or derogations to those obligations; and

(c) guidance on the Government's policy for imposing penalties for a failure to notify or breach of standstill obligations.

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

45. We agree with the proposal that the Secretary of State (**SoS**) should have the same powers to impose remedies as are available under Schedule 8 of the EA02, including powers to prohibit a transaction, impose remedies or require the purchaser to sell the entirety of the acquired business. As with the EA02, there should be no ability to require a seller to undo a completed transaction and reacquire assets that it has sold (this would be wholly impractical and, in some cases, financially impossible). Also as is the case under the EA02, there should be a requirement that any remedies imposed

are reasonable and proportionate to address a national security concern that is clearly identified and appropriately substantiated, and that merging parties have rights to be consulted on the scope of any proposed remedies and the right to seek judicial review of remedy decisions.

Question 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?

46. For the reasons set out in our response to Question 7, we favour an entirely new, standalone regime contained in legislation that is separate to the EA02. We do not consider there to be any compelling need for detailed interaction between the merger control (competition) regime and a foreign investment screening regime, given that they will have different purposes and different decision makers.

47. What would be important, however, is that merging parties are able to coordinate the timing of the two processes, if they so desire. So, for example, it should not be the case that foreign investment clearance can only be granted after the CMA has issued a clearance decision under the EA02.

48. We recognise that there are hypothetical scenarios in which the CMA and the body responsible for national security screening might issue remedies that conflict or are otherwise inconsistent and that some coordination in the area of remedies may therefore be beneficial in certain cases. However, we consider that such cases are likely to be rare and would not justify a general requirement to coordinate the timing and procedure of competition and national security assessments to ensure simultaneous remedy assessment by the two regulators.

49. One aspect of interaction between the two regimes that it may be desirable to maintain is the power of the SoS to intervene to prevent a reference on competition grounds if he or she is satisfied that a transaction should be allowed to proceed notwithstanding any impact on competition, on the basis that any anticompetitive outcome would be justified by one or more national security considerations.[15]

Question 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?

50. Please see our responses to Questions 7, 14, 19 and 24.

Question 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?

51. Not applicable.

[15] Section 45(6) EA02.

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

52. In our view, there is a clear potential for the regime to have adverse effects for financing of assets and infrastructure that are within the scope of the regime. While limiting investments by foreign investors raising national security concerns should not, in itself, deprive infrastructure of a significant source of funding, imposing investment restrictions will necessarily affect the ability of investors (including domestic investors) that do not raise national security concerns to exit their investments, which may, in turn, limit their incentives to invest in the first place. Similarly, businesses making decisions on the location of bare assets or projects falling within the scope of the regime may decide to locate them, where possible, in a jurisdiction that does not fetter their ability to sell out of those investments.

53. The key to mitigating those adverse effects is to make the regime as transparent, predictable, proportionate and depoliticised as possible. A sensibly limited and applied regime that is focused on transactions that can be readily understood to raise national security considerations, and which operates in a similar way to other international precedents, should not have a disproportionately negative impact on investment. By contrast, it seems unavoidable that a regime that is overly wide in scope, lacks transparency, is unpredictably applied and enforced, or perceived to be subject to political influence, will have a serious adverse effects on the ability of UK business to raise financing.

54. Moreover, the regime should be designed to exclude financing arrangements from its scope. For instance, a lender that has security over an asset, but no power to control or influence the use of that asset, should not see its financing arrangements brought within the scope of the regime unless and until there is a default that triggers a right for the lender to obtain such control. Even then, lenders that are already subject to regulation by the Financial Conduct Authority should be assumed not to pose national security risks.

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?

55. The proposed reforms will impose significant costs on businesses in a range of industry sectors, as well as on taxpayers. We recognise that the extent of those costs will vary depending on the chosen scope and features of the regime and that the Government intends to provide a monetised assessment of the costs of any new regime "at the final stage".[16] However, it appears from the impact assessment accompanying the Green Paper (the **Impact Assessment**) that the Government intends to carry out this more detailed analysis only after the "final shape of reforms and any accompanying guidance" has been decided, and on the basis of those final reforms. It seems to us that the Government ought to have a more precise understanding of the likely level of costs attaching to the various options for reform before deciding which of those options to select.

56. In our view, the assessment of costs that is contained in the Impact Assessment is not sufficient in this respect, as it purports to provide no more than a "high level

[16] Impact Assessment, page 2.

qualitative assessment". In addition, it focuses solely on the direct costs for Government, foreign investors and businesses that notify their transactions under the proposed regime, while omitting consideration of various other direct and indirect costs, such as the costs for investors that do not raise national security concerns (see paragraph 52 above) and the legal and administrative costs for businesses that are outside the regime or which decide not to notify, in terms of assessing their position and risks.

57. We also consider that the Government's expectation (set out on page 17 of the Impact Assessment) that the costs to "in scope" businesses would be "relatively small" is erroneous. As noted in our response to the first consultation, many of the UK businesses that would fall within the scope of the regime are small businesses for which the legal and administrative costs of compliance may represent a substantial proportion of their annual turnover.

58. Consequently, we submit that the Government should do more to quantify the relevant costs for businesses and Government before making decisions about the scope of the regime. For instance, it ought to be possible to draw on experience with the mergers regime to identify more precisely the costs per transaction for affected businesses, and the likely costs associated with operating a reviewing agency, and to take them into account at this stage.

City of London Law Society Competition Law Committee
9 January 2018