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By electronic lodgement

Foreign investment reforms
Submission on 18 September 2020 FATA changes

This submission has been prepared by Herbert Smith Freehills in response to the Australian Government's exposure draft legislation released by Treasury on 18 September 2020 (the **Tranche II Changes**), proposed to give effect to the major reforms to the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (the **Act**) and associated legislation announced on 5 June 2020.

Our submission on the Tranche II Changes is based on our extensive experience advising leading international and domestic businesses on Australia's foreign investment regime and applications to the Foreign Investment Review Board (**FIRB**). Herbert Smith Freehills is a top tier international law firm with a market-leading corporate and capital markets practice in Australia.

1 Overview

(a) The announced rationale for the proposed reforms is to ensure the protection of Australia's national interest against rising national security risks, resulting from changes in technology and the international security environment.

(b) The proposed reforms are extensive, and are not limited to the headline national security measures. We are concerned about the truncated timeline for the Tranche II Changes noting that the potential implications of some of the proposed changes are substantial. We are similarly concerned that due to the limited consultation period, there may be unintended consequences with the Tranche II Changes which are not identified and addressed during the consultation period due to the time limitations. Noting these concerns, it is requested that Treasury consider a delay to the introduction of these changes to 1 January 2022 (rather than the proposed commencement date of 1 January 2021) except for those changes which reintroduce the customary monetary thresholds.

(c) This submission addresses some of the key issues arising from our review of the exposure draft of the Tranche II Changes contained in:

(1) the Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020 (the **draft Fee Imposition Regulations**); and

(2) the Foreign Investment Reform (Protecting Australia's National Security) Regulations 2020 (the **draft National Security Regulations**).

2 Key issues on draft Fee Imposition Regulations

2.1 Substantial increases to foreign investment fees

(a) The stated intention behind the proposed changes to the fee imposition regime is to establish a fairer and simpler framework for foreign investment fees. It appears from our review of the draft Fee Imposition Regulations that this intention is not achieved. Rather, the proposed changes for the fee imposition regime include dramatic increases for foreign investment fees which are drafted in a manner which is unduly complicated and arbitrary.

(b) The COVID-19 pandemic has created unusual challenges for investors seeking to allocate capital across different jurisdictions around the world. Noting the importance of foreign investment to Australia's economy as we move out of the COVID-19 pandemic, it is more important than ever that Australia represents an attractive investment destination for foreign investors seeking to allocate jurisdiction-agnostic capital.

(c) The substantial proposed increases to the foreign investment fees proposed by the draft Fee Imposition Regulations, when taken with other significant proposed changes to Australia's foreign investment rules, create disincentives for foreign investors otherwise looking to allocate capital to Australia. To illustrate this point we note that under the current foreign investment regime, the maximum fee imposed for a FIRB application is $107,100. This maximum fee for a FIRB application is to be increased almost five-fold to $500,000. This is an extraordinary increase in circumstances in which only a relatively small portion of the current foreign investment fees collected by FIRB are actually allocated to FIRB in order to ensure that FIRB is appropriately resourced to review and promptly assess all FIRB applications.

(d) The substantial proposed increases to the foreign investment fees for agricultural land acquisitions are also worthy of mention. The notion that an agricultural land acquisition of $77m should attract a foreign investment fee of $500,000 (which is the same proposed fee for a $2 billion commercial land or business acquisition) appears very hard to justify. This is particularly in the context of the already close scrutiny and conditions associated with agricultural land acquisitions by foreign investors. It is also worth noting in this context that Australia already imposes significant direct and indirect taxes which risk rendering Australia uncompetitive (including substantial stamp duty and the very high Australian corporate tax rate).

2.2 Changes to exemption certificate fees

(a) The current foreign investment regime includes a fee of $36,900 for an exemption certificate. In our view, this is an appropriate fee level for an exemption certificate which offers some value and significant administrative advantages to a foreign investor that is proposing to embark on an extensive acquisition programme.

(b) Unfortunately the exemption certificate fee level is being dramatically increased to make it 75% of the notional fee amount (which takes into account the substantial fee increased proposed by the draft Fee Imposition Regulations). In our view, the benefits of the exemption certificate are significantly reduced if the fee imposed is increased to the fee level proposed.

2.3 Refunds for FIRB application fees

(a) Due to the increasingly complicated foreign investment regime in Australia, vendors of Australian assets are becoming more concerned about deal certainty when dealing with a prospective purchaser that is a foreign investor which requires FIRB approval. In order to deal with this, vendors are regularly requiring that prospective purchasers in a competitive sale process obtain FIRB approval (and thereby incur a FIRB application fee) prior to entering into binding legal documentation. This can often mean that multiple prospective purchasers are seeking FIRB approval when ultimately only one purchaser will be the successful party to acquire the relevant target assets.

(b) The current foreign investment regime appears to have limited opportunities for a prospective purchaser in a competitive sale process to receive a refund of its FIRB application fee in the circumstances referenced above.

(c) Noting the proposed introduction of the call-in power and an enhanced penalty regime, there is a risk that more prospective purchasers will seek FIRB approval even in instances where it may not be strictly required. It is considered that in all of these circumstances, greater consideration needs to be given to refunds of FIRB application fees being provided to prospective purchasers that ultimately do not enter into binding legal documentation with an Australian vendor on a transaction in relation to which a FIRB application has been submitted.

2.4 Fees for internal reorganisations and actions taken by wholly-owned groups

(a) The draft Fee Imposition Regulations propose a fee of $13,200 for actions that satisfy the definition of 'internal reorganisations'. The relevant definition is satisfied if the internal reorganisation involves the acquisition of interests in securities and both the acquiring entity and the target entity are subsidiaries of the same holding company or when the target entity is a subsidiary of the acquiring entity.

(b) As noted in our submission dated 31 August 2020 on the first tranche of proposed changes for Australia's foreign investment regime, we consider that the internal reorganisations of foreign persons, where the ultimate beneficial ownership remains unchanged, should be exempt from the foreign investment regime. Where the ultimate beneficial ownership does not change, the risks imposed from an internal reorganisation are likely to be minimal. The requirement of preparing a FIRB application and seeking approval seems to be onerous and unnecessary for this type of internal reorganisation.

(c) Noting that tax leakage may be an issue to consider in relation to a restructure, it is considered that any tax concerns arising from internal restructures for foreign entities should be regulated through the usual tax system on a non-discriminatory basis with domestic entities, rather than through the foreign investment system.

2.5 De minimis rule

The draft Fee Imposition Regulations propose a fee of $2,000 for actions that require FIRB approval and which involve consideration of less than $75,000. In our view, the notion of a 'de minimis' rule is a welcome development. However, the consideration threshold for the application of the 'de minimis rule' should be substantially higher and more in the order of $1m.

3 Key Issues on National Security Regulations

3.1 Narrowing of moneylending exemption

(a) The current moneylending exemption enables Australian businesses to raise debt from foreign lenders on a secured basis without requiring the foreign lenders to obtain FIRB approval. This deepens the pool of debt capital available to fund the growth of Australian businesses and provides additional liquidity to Australian debt financiers.

(b) Australian infrastructure operators have been significant users of offshore debt capital markets, in particular through US Private Placements and US Rule 144A Offerings.

(c) The proposed changes will adversely affect Australian infrastructure investors, and other businesses that are, or may in future become 'sensitive national security businesses', by imposing additional costs, and timing constraints:

   (1) on overseas debt financiers wishing to join a financing syndicate; and

   (2) on participants in overseas debt capital markets trading Australian-issued debt securities.

(d) The additional transaction costs and the reduced pool of eligible financiers (both in the primary and secondary markets) are expected to lead to increased cost of debt, less favourable financing terms, and fewer funding options for Australian businesses.

(e) Providing an 'exemption certificate' regime for financiers will only partially address this adverse impact, even if the exemption certificates provide broad coverage. Offshore participants operating in offshore debt capital markets may not be willing to incur the cost of complying with Australian foreign investment regulations in order to be able to buy in Australian-issued debt securities, reducing the liquidity of such securities.

(f) We submit that, given the nature of secured financing, the proposed limitation of the moneylending exemption is not necessary to address national security concerns, and that the adverse impact on Australian businesses will outweigh the benefits of having increased visibility of sources of foreign debt capital, and the opportunity to screen.

(g) Nevertheless, recognising the Commonwealth government's intention to limit the moneylending exemption, we suggest that the following be considered:

   (1) that the borrower or issuer of debt securities be able to obtain FIRB approval for a particular facility or debt capital markets issue (or class of facilities or issues), allowing foreign debt financiers to participate freely in the facility and in subsequent trading of debt securities without having to apply to FIRB for approval; or

   (2) that borrowings or issues of securities that meet particular 'safe harbour' criteria (e.g. on borrowings 'ordinary commercial terms', 'issues into the US Private Placement market/US TLB market') are exempt from FIRB notification requirements.

3.2 Call-in power period of 10 years

(a) The proposed call-in power is to apply for a period of 10 years and this time period is intended to provide foreign persons which greater certainty as to the Treasurer's powers and to assist in the foreign person's decision as to whether to voluntarily notify.

(b) Unfortunately, it is our view that a 10 year call-in power does not provide certainty to investors and is likely to have the unintended consequence of strongly encouraging foreign persons to voluntarily notify FIRB in circumstances when it is not strictly required. The existence of a 10 year call-in power, when taken together with the new proposed last resort power, creates a sovereign risk issue – that is, the rules can be changed after material investment decisions – which may deter foreign investment into Australia. We consider that if the call-in power is to be maintained, the appropriate period should be significantly reduced from 10 years to 3 years.

(c) It is also important to ensure that the proposed call-in power does not create any uncertainty as to its potential operation to M&A transactions already undertaken. By way of example, if a foreign investor acquires an asset (such acquisition being the **Initial Acquisition**) which does not require mandatory FIRB approval and then subsequently on-sells this asset to a third party (the **Subsequent Acquisition**), Treasury should not be able to exercise its call-in power in relation to the Initial Acquisition after the Subsequent Acquisition has occurred. We envisage that Treasury would not intend to unwind a historical transaction (such as the Initial Acquisition) in these circumstances for a variety of reasons, including the significant practical difficulties and uncertainty that such a right would create. However, it is considered appropriate to address this issue through clear drafting to avoid any confusion or unintended consequences.

3.3 Reinstating of monetary thresholds

The reinstating of the existing monetary thresholds is a welcome change which is intended to apply on and from 1 January 2020. Whilst it is acknowledged that the COVID-19 pandemic has created significant uncertainty to global investment, we consider it essential that the monetary thresholds are restored on 1 January 2020. Foreign investors and vendors of Australian assets require certainty and the existing nil thresholds have created significant challenges and administrative hurdles for foreign investment into Australia. As a result, the sooner that the reinstatement of the customary monetary thresholds can be definitively confirmed, the better for the Australian economy and foreign investment into Australia.

Yours sincerely

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