MinterEllison

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Manager
Policy Framework Unit, Foreign Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

BY EMAIL: FIRBStakeholders@treasury.gov.au

Dear Sir/Madam

Evaluation of the 2021 foreign investment reforms: Impact on global transactions

1. MinterEllison is Australia's largest law firm providing legal and consulting services through a global network of affiliated firms and associated companies.

2. We value the opportunity to provide feedback and comments in respect of the recent foreign investment reforms made under the *Foreign Investment Reform (Protecting Australia's National Security) Act 2020* (Cth).

3. The MinterEllison foreign investment and trade team, based in Canberra, has a longstanding and productive working relationship with the Foreign Investment Division of the Department of the Treasury (**Treasury**) to facilitate foreign investment into Australia.

4. MinterEllison's clients are across all sectors of the economy, including technology, agriculture, energy and resources, health, financial services, real estate, infrastructure, transport and education industries. Our client base includes many local companies with some foreign ownership as well as offshore investors, representing private capital or that are publicly listed.

5. Acknowledging the ongoing consultation of Treasury with many locally based industry bodies, including the Law Council of Australia (of which MinterEllison is a member), this submission focusses on the reach and impact of Australia's foreign investment regime on global, offshore transactions.

6. In our experience, many of these transactions involve only a very small Australian component but are caught by the arguably too broad reach of the rules. This may have unintended consequences for the delicate balance in protecting Australia's national interest while also facilitating the efficient flow of global trade and investment.

7. We have worked with many international law firms across North America, UK & Europe, the Middle East and Asia in respect of Australia's foreign investment regime. We have consulted with as many of them as possible for input on their broader experience with the Foreign Investment Review Board (**FIRB**) screening and review process in preparing this submission.

Background

8. The Australian foreign investment regime is one of the broadest regimes in the world as it applies not just to transactions in Australia, but also to some transactions that occur offshore and upstream of an Australian company or business.

9. Very often, transactions involving offshore financial sponsors and their portfolio companies acquiring another offshore company are required to undergo mandatory screening in Australia, even where there is only a minimal Australian business. While there are existing exemptions and administrative pathways that assist for some transactions, international investors and their foreign advisors still find it challenging to apply the regime to their transactions in practice.

10. Many such transactions are caught, for example, because of:

    (a) the breadth of the 'foreign government investor' test;

    (b) the limitations of the existing 'de minimis exemption' for FGIs, particularly in relation to the scope of the concepts of 'sensitive business' and 'national security business';

    (c) the breadth of the concept of 'national security business';

    (d) the breadth of the definition of 'Australian media business'; and

    (e) the application of the 'tracing' rules and the 'Australian land entity' tests.

11. In our experience, investors appreciate the need for Australia to protect its national interest and national security and will always look to comply with regulatory regimes as they apply to a transaction.

12. Nonetheless, there are certain areas where the rules could be amended to remove some transactions from the ambit of the mandatory filing regime without undermining those policy objectives. Appropriate narrowing of the above definitions and concepts, at least in the case of offshore transactions, is one such area – the call-in regime could still apply if necessary, and investors could make an informed decision whether to seek clearance on a voluntary basis.

13. It is considered somewhat perplexing by many that Australia's regime purports to apply on a mandatory basis to so many offshore transactions without much clarity on the Australian Government's ability to meaningfully intervene if such a transaction proceeds without a filing and related clearance.

14. In addition, the key practical challenges, confirmed by our informal survey, relate to a perceived lack of clarity and certainty when managing regulatory filings in Australia. That is, key priorities for foreign investors in relation to their regulatory filing and approval obligations are:

    (a) clarity as to whether or not the relevant transaction requires a mandatory filing (noting that where there is uncertainty, investors will make a filing as the alternative is to risk being in breach of provisions that carry criminal and civil penalties); and

    (b) if a mandatory filing is required, certainty as to the process and timetable to obtain the related clearance in a timely fashion so as to not impede completion of the broader transaction.

15. In particular, the position following the 2021 changes has made it more challenging as aspects of the regime can apply even where there is no Australian subsidiary, or what would be considered a business for other regulatory regimes (eg, the Corporations Act), involved. This means that foreign investors involved in multi-jurisdictional transactions where Australia is a small component may not consider obtaining Australian law advice until much later in a transaction as it is not an intuitive screening step where a target business structure seemingly does not include an Australian company. The key feedback in this regard is that clarity of the rules would be aided if the rules were to apply only where a global transaction involves an Australian subsidiary and subject to materiality and proportionality carveouts – including providing clarity on the concepts that cause a transaction to fall outside of the existing 'de minimis' exemption.

Clarity in the FIRB process

16. Following consultation with international law firms, set out below are six key issues when applying the *Foreign Acquisition and Takeovers Act 1975* (Cth) (**FATA**) and associated legislation and regulations.

    Determining when a listed entity or fund is a 'foreign government investor'

17. The 'foreign government investor' definition, combined with tracing, applies too broadly with passive economic interests that when, properly diluted, can result in investment structures with only a minor proportion of foreign government investor involvement causing an otherwise Australian business to be treated as a foreign government investor. The rules also do not reflect the passive nature of many investors. Existing mechanisms such as the carveout to the 40% aggregate foreign government investor test assist this, as well as the passive foreign government investor exemption certificate. However, the 40% carveout does not apply to many funds which

end up still meeting the 20% test due to the effect of the tracing rules and does not assist in those scenarios where investors may only have one transaction caught by the regime such that the upfront time and cost to invest in a passive foreign government investor exemption certificate may not be warranted.

18. In addition, it is not unusual for an applicant entity to be unable to determine the ownership information of its upstream investors. This is particularly common where the applicant entity is a listed entity or an investment fund (particularly funds of funds). Fund investment and ownership information is highly confidential. It is common for funds to have confidentiality agreements with their investors that prevent them from disclosing investor identities without their express approval, or third party investor funds refuse to pass on investor information. Sometimes, the fund managers themselves are not privy to the necessary information.

19. The recent reinstatement of guidance confirming that no fines or penalties would be imposed for breaches of the FATA where reasonable inquiries were made to obtain this information is welcome. Investors would benefit though with further clarity on the scope and extent of enquiries required to fit within the current guidance – for example, in scenarios where enquiries can be made though no response is received, or the timeframe for responses to be received to make a determination as to an entity's status and ability to proceed with a transaction.

Additional clarity around statutory interpretation

20. FIRB's guidance notes assist with providing clarity in some circumstances and investors appreciate the existing guidance. There remains uncertainty around the interpretation of a number of provisions in the FATA and associated regulations which can pose challenges for clients when making commercial decisions in relation to transactions. Publication of FIRB's interpretation of the legislation would allow both FIRB and the market to operate openly on the basis of a known interpretation.

21. For example:

    (a) there are a number of terms used within the FATA and associated regulations that do not have an associated definition or the benefit of case law relating to the FATA;

    (b) the application of a number of concepts such as 'tracing' and the 'Australian land entity' rules do not apply intuitively with varying interpretations from FIRB received across matters with similar fact patterns (including the position for incremental increases above an initial direct interest or substantial interest for acquisitions made offshore of Australia).

22. With the benefit of expertise across a range of jurisdictions, international law firms have noted that other jurisdictions manage this issue by way of published opinions or an efficient informal inquiry pathway. As previously mentioned, other Australian regulators use other approaches as well – eg, ASIC class orders and ATO determinations and binding rulings.

'Reasonable inquiries' around whether a business is a 'national security business'

23. National security business, as applied in the first eight months of the rules, is very broad. This definition is again proposed to be broadened by the operation of the *Security Legislation Amendment (Critical Infrastructure) Bill 2020* (Cth). This will exacerbate the current issues with this test and feedback is generally that investors would appreciate formal materiality and proportionality thresholds in the rules.

24. Investors appreciate the existing guidance provided in the Replacement Explanatory Statement to the *Foreign Investment Reform (Protecting Australia's National Security) Regulations 2020* (Cth), which has assisted in understanding the definition of national security business in scenarios where there is clearly a national security business.

25. However, there is continued uncertainty around the standard of 'reasonable inquiries' when determining whether a business is a national security business. For example, whether target confirmation or vendor confirmation as to the facts is required when target access may not be available, or whether the applicant entity should make additional, separate investigations into the point.

26. International law firms have raised that other jurisdictions have detailed lists or a 'catalogue' of sectors that are caught by similar definitions under parallel regimes, and additional qualifiers and limitations within such a list. This provides greater certainty to investors in these jurisdictions that they are compliant with the respective regimes.

When a 'national security business' is being conducted in Australia and the target has no subsidiary in the jurisdiction

27. The 'de minimis' exemption, and the increase to the thresholds to obtain the benefit of this exemption in 2017 have greatly assisted investors for transactions where Australia is not a material component of a global transaction.

28. Expansion of the de minimis exemption to include a materiality threshold for national security businesses would alleviate the regulatory burden for some offshore transactions, with a greater focus on voluntary applications. This is in the context that, as the national security business definition is drafted broadly (and may get even broader), approval under the FATA is required for global transactions even where they have very limited and immaterial operations in Australia.

29. For example, a small business with no Australian subsidiary can fall within the national security business definition by virtue of a single contract with an Australian customer, even where that contract is delivered entirely offshore.

30. In addition, publication of examples relating to transactions that may be called in, describing features that provide a practical understanding to the market of issues of relevance, would allow investors to determine the commercial impact of making a voluntary filing or proceeding with a transaction.

Application of the 'Australian media business' test to offshore transactions

31. With a changing media landscape, investors appreciate the need for an updated definition of Australian media business. However, the combination of the expansion of this definition with the earlier concept of businesses that are wholly or partly in the media sector (or infrastructure for that sector) means that the screening rules have the potential to extend too broadly, and beyond what was envisioned as media. Again, feedback here is that more examples or categories of the media sector and Australian media business would assist, along with materiality and proportionality thresholds.

32. For example, two aspects that impact global transactions that do not have a material Australian component are:

    (a) the concept of the 'media sector' is not defined (nor are the remaining sectors, including the defence, military, communications and encryption sectors which also intersect with the national security business definition) in the 'sensitive business' test. In particular, it is not clear if the media sector is intended to refer to a broader range of businesses than the updated definition of 'Australian media business' (and indeed the other sensitive sectors and its intended overlap with the national security business concepts); and

    (b) the updated definition of 'Australian media business' operates very broadly and further clarity as to the application of this test will assist investors:

        (i) the test as it is currently drafted applies to content that "is delivered wholly or predominantly by way of programs of audio or video content". This has had the effect that some businesses have been captured within this definition seemingly inadvertently (such as education providers); and

        (ii) the daily audience threshold test does not appear to be limited to Australian viewers. This means that even where there are very few Australians accessing its content, an offshore business may still be caught within the definition of Australian media business.

Modernising the FATA for the operation of the financial services sector

33. There are a range of exemptions within the FATA first introduced in the *Foreign Acquisitions and Takeovers Regulations 1989* (Cth) that have carried through to the *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) without significant amendment to take account of the updated way in which the financial services sector presently operates.

34. This, combined with the significant updates to the FATA in 2015 and 2021, means that there appear to be unintended consequences in the application of the FATA to funds managed for and on behalf of Australians (including superannuation) where the fund manager is a foreign person. This is particularly observed in fund management structures involving interfunding, which facilitates the efficient management of funds on behalf of Australians and where the application of the FATA would result in increased costs and regulatory burden for Australian investors.

Certainty as to process and timing

35. Following the introduction of the *Foreign Acquisitions and Takeovers Amendment (Threshold Test) Regulations 2020* in March/April 2021 – that is, the COVID-19 related FIRB threshold changes, clear guidance was provided that certain circumstances would qualify particular matters to be expedited by FIRB. This guidance allowed investors was welcome for investors who understood the relative priorities, their ability to seek expedition where warranted and plan appropriately for timing for transactions otherwise.

36. Formalising processes for expedited decision-making would increase confidence in the regime, such as in circumstances where Australia is a minor part of a broader global deal. For example, other jurisdictions, such as New Zealand and France, manage this by way of a two stage process, whereby a significant number of less-sensitive transactions can be reviewed in a shorter and limited timeframe (eg, 10-15 days).

37. In addition, feedback has included a request to consider an exemption or a formal two stage process where investors are otherwise undergoing a court process – whether that involves offshore bankruptcy proceedings or other public markets transactions that are already subject of significant foreign regulatory processes (including court approvals and timetables that cannot be moved).

38. Without certainty as to timing – noting the current process involves potentially unlimited extension requests – there have been a number of transactions where Australia's relative size to the global transaction was carved out so that the global transaction could otherwise proceed. This has the result that a lack of clarity as to the rules has the seemingly counterproductive outcome that investment in Australian businesses is lost (or, anecdotally, in a worst case has resulted in Australian companies being wound-up).

Overall, investors certainly appreciate the need for Australia to appropriately screen transactions to protect Australia's national interest (including national security) and welcome any further consideration of the above issues to efficiently facilitate trade and investment flows to Australia.

Please do not hesitate to contact us if you require further information about the above.

Yours faithfully
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