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MAJOR FOREIGN INVESTMENT REFORMS IN AUSTRALIA – WHAT YOU NEED TO KNOW

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Legal Briefings – By **Matthew FitzGerald, Malika Chandrasegaran, Philip Podzebenko and Henry Meehan**

Significant amendments to Australia's foreign investment regime commenced on 1 January 2021. Nearly three months after their commencement, we are beginning to see evidence of a more cautious approach by applicants seeking foreign investment approval. However, 2021 has also brought some positive movement towards business as usual in the foreign investment approval process following the disruption caused by the COVID-19 pandemic in 2020.

NEW RULES TO PROTECT AUSTRALIA'S NATIONAL SECURITY

The headline amendments to the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (the **Act**) and the *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) (the **Regulation**) provide for enhanced scrutiny of investments impacting upon Australia's national security.

Under the new "national security test":

- proposed investments concerning a "national security business" or "national security land" are subject to mandatory notification to the Foreign Investment Review Board (**FIRB**);
- investments not notified to FIRB may be "called in" for review by the Treasurer on national security grounds; and

- in exceptional circumstances, the Treasurer may exercise "last resort" powers to impose conditions, vary existing conditions, or require divestment of approved investments where national security risks emerge.

NOTIFIABLE NATIONAL SECURITY ACTIONS

Under the existing regime, a proposed action *must* be notified to FIRB if it is a "notifiable action" under the Act.

From 1 January 2021, FIRB approval will also be mandatory for a new category of "notifiable national security actions". The following actions, when taken by a foreign person, are "notifiable national security actions":

- starting a "national security business";
- acquiring a "direct interest" (generally 10% or more) in a "national security business";
- acquiring an interest in "national security land"; or
- acquiring an interest in an exploration tenement in respect of "national security land".

A *nil monetary threshold* applies to any actions by foreign persons that are "notifiable national security actions".

A "national security business" is one carried on wholly or partly in Australia that concerns critical infrastructure; telecommunications; or goods, services, or information for military or intelligence use. Critical infrastructure for the purposes of the Act derives its meaning from the *Security of Critical Infrastructure Act 2018* (Cth) (**SOCI Act**). There is currently a draft bill amending the SOCI Act which proposes to substantially broaden the categories of critical infrastructure to include new classes of assets in 11 industry sectors (including data storage and processing, financial services, food and grocery, transport and communications sectors) – this could have significant implications for what would constitute a national security business under the Act. In order to satisfy the definition of national security business, it must be publicly known or could reasonably be known that the business concerns these matters. Although this "reasonable knowledge" test curtails the scope of a "national security business", foreign investors will need to be wary of the breadth of potential businesses and sectors captured by this new provision.

"National security land" includes defence premises and land in which a national intelligence agency has an interest (provided that the interest is publicly known or could reasonably be known).

REVIEWABLE NATIONAL SECURITY ACTIONS

Under the existing regime, a proposed action *may* be notified to FIRB if it is a "significant action" under the Act.

From 1 January 2021, a new category of "reviewable national security actions" may also be voluntarily notified to FIRB. "Reviewable national security actions" are broader than all other types of actions, comprising certain actions (including acquiring any interest in an entity, Australian business, or Australian land) which have a defined result (including that a foreign person acquires a "direct interest" (generally 10% or more) in an entity or business, or any interest in Australian land). Entities captured by these provisions may include holding entities of or foreign entities carrying on an Australian business.

THE TREASURER'S "CALL IN" POWER

Under the new reforms, the Treasurer has the power to review "significant actions" or "reviewable national security actions" that the Treasurer considers may pose a national security concern. This power can be exercised for up to 10 years following the action having been taken, and may lead to a no objections notification, the imposition of conditions, prohibition of the action, or even requiring divestment.

However, the Treasurer cannot review actions that have already been approved by FIRB (whether through a no objections notification or exemption certificate). In practice, the existence of the "call in" power (and its ability to be exercised up to 10 years following the action being taken) is likely to encourage foreign persons to voluntarily lodge FIRB applications in order to avoid the possibility of the power being exercised. We are already seeing such circumstances and consider voluntary notification to be an increasingly prudent option where the transaction may give rise to national security concerns now or in the future.

THE TREASURER'S "LAST RESORT" POWER

One of the more challenging reforms for foreign investors is the introduction of the Treasurer's "last resort" power to review actions on national security grounds, even where FIRB approval has already been obtained. There is no time limit on the exercise of this power and the consequences are potentially serious (up to and including an order for divestment).

Controls over "last resort" power

Nevertheless, strict controls on the exercise of this power have been included in the Act, giving some comfort that it will be used only as a genuine last resort.

- **First**, there must be a false or misleading statement or omission by the foreign person, a material change to their activities, or a material change of circumstances or market.
- **Secondly**, there must be a national security risk relating to the action.

- **Thirdly**, the Treasurer must obtain advice from national intelligence agencies, negotiate with the foreign person to reduce the risk, and be satisfied that existing systems are inadequate to address the risk.

On this basis, and having regard to the significant sovereign risk issues that may emerge should this power be used extensively, we envision that it will be exercised sparingly and only when strictly necessary.

REINSTATEMENT OF PREVIOUS MONETARY THRESHOLDS FOR FIRB APPROVAL

Another significant change in the new reforms is the reinstatement of monetary thresholds for FIRB approval, which were temporarily removed in 2020 in response to the COVID-19 pandemic. These have been reinstated at their previous levels, although foreign investors should note that a nil monetary threshold is in place for "notifiable national security actions". This is a positive change for foreign investors that we expect to significantly improve application processing times, which were frequently extended during the COVID-19 pandemic, due to a higher volume of FIRB applications in circumstances where the approval threshold was $nil.

KEY CHANGES TO DEFINITIONS AND EXEMPTIONS

PASSIVE FOREIGN GOVERNMENT INVESTORS

Historically, many private funds and similar entities were treated as "foreign government investors" (and subjected to stricter regulation) due to governments, sovereign wealth funds or government-established pension funds holding minority interests in them. This could give rise to unintended consequences where FIRB approval was required for many actions taken by such private funds due to their classification as a foreign government investor.

In positive news for these investors, the new reforms include amendments to tighten the definition of a "foreign government investor" where foreign government investors are not involved in management or control of the relevant fund. In these circumstances, provided that no individual foreign government investor (or various foreign government investors from the same country) holds a "substantial interest" i.e. an interest of at least 20%, the entity will not be a foreign government investor under the new regime, which has the practical effect of reducing the circumstances in which such investors need to obtain FIRB approval.

MONEYLENDING EXEMPTION

One of the key exemptions relied upon by foreign financiers, the so-called "moneylending exemption", provides that the acquisition and enforcement of security interests will not constitute "notifiable actions" or "significant actions". After consultation on the new reforms, this exemption has been extended to "notifiable national security actions" with one key change.

The moneylending exemption *does not apply* to acquisitions by enforcement of security interests in "national security businesses" or "national security land", unless the enforcement is undertaken by a receiver (i.e. it will not apply in the generally rare situation where a lender forecloses or directly acquires the secured property). Given that receivers are already commonly used for this purpose, we expect that the exemption will continue to be available in the significant majority of circumstances.

PASSIVE INCREASES IN PERCENTAGE HOLDING

Under the new reforms, certain passive increases of percentage holding in an entity (for example, an increase in percentage holding as a result of not participating in a share buy-back) can constitute a "significant action", a "notifiable action", "a notifiable national security action" or "reviewable national security action" if the other conditions for such actions are met. If the passive increase constitutes a notifiable action or notifiable national security action, the foreign investor will have 30 days after the action is taken to notify FIRB of the action.

SIGNIFICANT CHANGES TO FIRB APPLICATION FEES AND PENALTIES

SUBSTANTIAL INCREASES FOR FIRB APPLICATION FEES

The new reforms have implemented substantial changes to the FIRB application fee regime. Fees are now calculated based on the value of consideration for the notified action and, in many cases, will result in significant increases to the fees payable.

The maximum fee cap for a FIRB application now stands at $500,000, which is a substantial increase from the previous fee regime (where the maximum FIRB application fee was approximately $105,000).

"Reviewable national security actions" attract a fee of 25% of the notional fee, while general exemption certificates attract a 75% notional fee in place of the fixed fee charged under the previous regime. Unfortunately, this change to fees for exemption certificates will generally represent a substantial increase on the previous regime, rendering exemption certificates a less economical option for foreign investors going forward.

PENALTIES FOR NON-COMPLIANCE

The new reforms also bring substantial increases in penalties for non-compliance with the Act and Regulation. These include maximum criminal penalties of up to 10 years' imprisonment or $3.3 million for individuals and $33 million for corporations. The maximum civil penalty has been increased to up to $555 million.

NEW COMPLIANCE AND ENFORCEMENT MECHANISMS

FIRB has historically had limited compliance and enforcement powers in comparison with other regulators such as ASIC and the ACCC. The new reforms would appear to suggest a change in philosophy. FIRB has been given a suite of new enforcement mechanisms, including the ability to:

- issue infringement notices for all actions taken under the Act;
- exercise monitoring and investigative powers, including access to premises;
- accept enforceable undertakings;
- give compliance directions, with penalties for failing to follow these;
- revoke approvals where false or misleading information was given by the applicant; and
- require applicants to notify FIRB where they take the actions specified under a no objections notice.

Viewed holistically, the substantial increases to FIRB application fees and penalties for non-compliance (with associated increased audit rights) suggest that FIRB may be taking on a greater watchdog role akin to the approach of the ACCC and ASIC.

TRANSITIONAL ARRANGEMENTS

Active foreign investors should be aware of the potential impact that transition to the new regime may have on actions recently notified to FIRB. Transitional arrangements can apply to:

- foreign persons with a no objection notification or whose application for one is still being considered;
- foreign persons with an exemption certificate or whose application for one is still being considered; or
- foreign persons who have given notice of a notifiable action prior to 2021.

The transitional arrangements are not intended to disrupt approved actions that have already been taken prior to 1 January 2021. However, where an action has been approved but not taken, or where approval is pending, further action may be required. For example:

- if a foreign person has obtained a no objection notification or exemption certificate in 2020 but not yet taken the relevant action, further notifications may be deemed or may be required; or
- if a foreign person has given notice of a notifiable action prior to 2021, and that action is also a notifiable national security action under the new regime, further notifications may be required.

CONCLUSION

The nil monetary threshold for actions taken in relation to the broadly-defined category of "national security businesses" is likely to have significant implications for M&A in critical infrastructure, telecommunications, defence and adjacent sensitive sectors. Given FIRB's increased scrutiny of these sectors, proposed transactions with potential national security concerns should be carefully considered for voluntary FIRB notification as protection against the Treasurer's use of the "call in" power.

The Treasurer's broad new powers, including the "call-in" and "last resort" powers, have the potential to create sovereign risk concerns and appear to signal increased government intervention in foreign investment. However, given FIRB's continued positive rhetoric about the fundamental importance of foreign investment to Australia, we consider it likely that these powers will be used only in exceptional cases.

Substantial increases to FIRB application fees and penalties for non-compliance (with associated increased audit, investigation and enforcement rights) suggest a change in philosophy with FIRB taking on a greater watchdog role akin to the approach of the ACCC and ASIC. Proactive and open engagement with FIRB will continue to be of increasing importance to foreign investors throughout the lifespan of a transaction.

The Government's changes to the foreign investment regime are substantial and wide-reaching. The key reforms highlighted in this article are just some of the many amendments applicable from 1 January 2021. In this environment, we encourage foreign investors to make the pragmatic assumption that FIRB approval will be required unless proven otherwise. Nevertheless, the new reforms provide much-needed certainty after a tumultuous period of temporary regulation. With the new regulatory boundaries drawn, and Australia having been highly successful in responding to the COVID-19 pandemic, Australia continues to be an attractive destination for foreign investment.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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