

NEW CRITICAL INFRASTRUCTURE CENTRE TO ADVISE FIRB: WHAT IS IT AND WILL IT HELP?

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Legal Briefings - By **David Ryan, Partner** and **Matthew Fitzgerald, Partner**

A new Critical Infrastructure Centre within the Attorney-General's Department of the Australian government has been announced to pre-emptively assess national security risks for critical infrastructure, assisting the Foreign Investment Review Board (**FIRB**) to know earlier if those risks are at play in future deals.

Following last year's late and unexpected decision to block the takeover of electricity network Ausgrid, and the security concerns raised following the long-term lease of the Port of Darwin to a Chinese investor in 2015, the Treasurer Scott Morrison MP and Attorney-General Senator George Brandis QC announced the creation the Centre which will streamline engagement with FIRB and provide more certainty to vendors and bidders at the start of sale processes. The Treasurer's announcement indicated that this may include a physical evaluation of some assets.

WHAT DOES THIS MEAN FOR THE FOREIGN INVESTMENT PROCESS?

The introduction of the Critical Infrastructure Centre does not represent a change in the law governing foreign investment in Australia. Rather, it is a change to streamline the FIRB process by creating a pre-emptive register of national security risks relating to critical infrastructure, so that when the national security question is asked in a transaction, the government has already developed an answer.

We understand that the register of critical infrastructure will remain confidential given it will concern national security matters. As a result, it will not be available to potential vendors and bidders prior to a sale process. However, preliminary engagement with FIRB should be more reliable as potential national security issues with individual critical infrastructure assets should have already been identified. This should in turn allow FIRB and vendors/bidders to consider and develop acceptable mitigation strategies for the national security risks identified. The register of critical infrastructure may also see vendors undertaking greater preliminary engagement with FIRB prior to commencing a sale process.

Despite the 2016 decisions to block foreign investment in Ausgrid and agricultural group S. Kidman & Co Limited, it is worth reiterating that there have only been a handful of prohibitions of major foreign investment proposals since 2000.

However, it is possible that the new resources to be developed by the Critical Infrastructure Centre will result in a continued increase in the conditions attached to FIRB approval for major transactions, as FIRB will have more precise information on the specific risks in each sector and for each piece of infrastructure. While this approach is to be preferred to blocking deals outright, it will require special consideration and expert local advice when putting transactions and bids together and in submitting applications for FIRB approval.

WILL THE CRITICAL INFRASTRUCTURE CENTRE HELP?

Foreign investors might soon get a hint of any changes to FIRB's approach once it reaches a decision on the Cheung Kong Infrastructure consortium's takeover of the DUET Group, which owns gas and electricity distribution networks in Victoria and Western Australia. Given the DUET board recommendation of the takeover we would expect some level of confidence coming from FIRB, but DUET may still shape up as the first real test for the new approach.

If FIRB approval is given for the acquisition of this gas and electricity network, this may also help build confidence in Australia as an investment destination after the Ausgrid decision.

The future scope of the Critical Infrastructure Centre will also be interesting. Restricting analysis of national security risks for critical infrastructure to instances of acquisition by foreign investors seems to be only a small part of the issue. National security risks for critical infrastructure need to be understood for assets owned by Australian investors (including governments) and for assets already under foreign ownership. Further, exposure to national security risks for critical infrastructure necessarily linked to the ownership of the relevant asset. These assets are also exposed to risks such as cyber-security, terrorism and extreme weather events.

It appears that the launch of the Critical Infrastructure Centre in the context of FIRB approvals is only an initial step and a direct response to the perceived process failings of the Ausgrid and Port of Darwin processes. In the longer term we expect to see the Critical Infrastructure Centre take a broader role to assessing all national security risks for critical infrastructure. This role may be similar to the US Department of Homeland Security's policies regarding critical infrastructure security and resilience (see <https://www.dhs.gov/critical-infrastructure-sectors>). Those policies apply to 16 different critical infrastructure sectors, which may again signal the future scope and direction of the Critical Infrastructure Centre.

Infrastructure owners, operators and potential bidders will be watching closely as the Critical Infrastructure Centre takes shape. The limited details provided in the announcement are to be expanded upon in an upcoming discussion paper, which will seek feedback on the challenges faced in this area, and give investors a better idea of future directions for Australia's foreign investment framework and for the assessment of national security risks for critical infrastructure more generally.

BACKGROUND

National security concerns have continued to emerge as a crucial issue for Australia's foreign investment approval framework, and have remained a focus of the Commonwealth Government since the long-term lease of the Port of Darwin.

That lease was exempt from FIRB approval as it was conducted by the Northern Territory Government, but drew criticism particularly since the United States has defence interests in nearby facilities. Following this, the foreign investment rules were tightened to require FIRB approval for all acquisitions of critical infrastructure by foreign persons, including for transactions by State and Territory governments.

The issue came to the fore again when the Treasurer blocked the proposed acquisition of a 50.4% interest in Ausgrid, the New South Wales electricity transmission and distribution business, by investors from mainland China and Hong Kong, in August 2016. The sale was blocked on national security grounds (with specific details not released due to security clearance issues). To the dismay of both the State of New South Wales and the bidders, these national security grounds appear to have only been identified very late in the Ausgrid bid process. The Ausgrid decision was made more even difficult because the specific national security issues were not disclosed and are not immediately evident from the nature of the asset.

The Treasurer noted that the issues were inherent to the asset itself, rather than the identity of the acquirers. However, notwithstanding this the Chinese Ministry of Commerce issued a statement raising concerns about a chilling effect on investment in Australia if the foreign investment criteria for future sales processes are not clear from the outset.

This problem, of only discovering crucial national security concerns once the process is already underway, appears to be the target of this week's announcement.

Important details of the announcement include:

- The Centre will be within the Attorney-General's Department (rather than within FIRB), meaning its focus will be firmly on gathering information on national security matters, especially from the Department of Defence and Australia's intelligence agencies.
- The Centre will develop and maintain a register of critical infrastructure and risk assessments.
- The Centre's first task is releasing a discussion paper to outline the challenges it faces and seek feedback from State governments, infrastructure owners and operators and bidders.

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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