HERBERT SMITH FREEHILLS

# PRESSURE POINTS: PROPOSED CHANGES TO AUSTRALIA'S FOREIGN INVESTMENT REGIME

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Legal Briefings – By **Matthew FitzGerald**, **Philip Podzebenko**, **James Rigby** and **Alexandra Spafford**

On 5 June 2020, the Treasurer announced significant reforms to Australia's foreign investment review framework, focusing on sensitive national security-related businesses. These significant legislative changes are scheduled to commence on 1 January 2021.

To ensure a 'seamless' transition to the new framework, the Government has confirmed that the temporary changes in response to the Covid-19 pandemic will remain in place until the end of 2020.

## SUMMARY OF PROPOSED CHANGES

### NATIONAL SECURITY – A RENEWED FOCUS ON SENSITIVE FOREIGN INVESTMENT

Treasury's publication on the proposed foreign investment reforms can be found here. Set out below is a summary of the key proposed changes.

***Sensitive national security businesses***

A new enhanced national security test will be introduced for investments involving a 'sensitive national security business'. The definition of 'sensitive national security business' has not yet been settled, but it is likely to capture any business that:

a. is involved in the manufacture or supply of defence related goods, services and

technologies or can create vulnerabilities in the security of defence and national security supply chain and other core defence interests;

b. is located near defence or other national security facilities;

c. owns, collects or maintains sensitive data relating to Australian defence or national security;

d. is regulated under the *Security of Critical Infrastructure Act 2018* (Cth), including critical electricity, gas, water and ports infrastructure; or

e. is regulated under the *Telecommunications Act 1997* (Cth).

The Government has advised that the definition will not be as broad as the definition of 'sensitive businesses' under the existing regulatory framework. However, the categories listed above still mean that businesses in sectors as far reaching as energy, telecommunications, data, water and ports will be caught.

For transactions involving a sensitive national security business, a $0 financial threshold will apply to all foreign investors. This means that, if a foreign person:

a. proposes to acquire control of, or a direct interest (generally a 10% voting interest, unless the acquirer obtains additional control rights, in which case a lower threshold may apply) in, a sensitive national security business; or

b. starts to carry on a sensitive national security business,

the transaction will be subject to review by the Foreign Investment Review Board (**FIRB**) regardless of its value.

These changes will effectively extend the $0 financial threshold and direct interest tests currently applicable to foreign government investors to apply to foreign private entities that invest in sensitive national security businesses.

The moneylending exemption, ordinarily available to foreign financiers taking security over Australian assets for the purposes of their financing activities, will no longer be available in relation to sensitive national security businesses.

Foreign financiers, whether financing the initial acquisition of a sensitive national security business on a secured basis, or subsequently acquiring debt secured against the assets of a sensitive national security business, will require foreign investment approval. Although the approval requirements will not apply retrospectively, the narrowing of the moneylending exemption has the potential to affect existing secured financiers by reducing the liquidity of already-issued debt of sensitive national security businesses.

Investments above the existing monetary threshold (generally, before Covid-19, $275 million) will be assessed against the broader 'national interest' test, which includes consideration of national security matters, but also other matters, including tax, competition and the impact of the transaction on the economy and community, as well as the character of the investor.

***New 'call in' power***: A new power to 'call in' an investment (before or after it occurs) to review whether it raises national security concerns and passes the 'national security test'. There will be a time limit on the use of this power, and FIRB will issue guidance on when it may be used. Investors will be able to voluntarily notify proposed investments and will also be able to apply for exemption certificates that permit them to acquire multiple eligible investments without the hassle of case-by-case screening.

***Last resort power***: A new 'last resort' power to reassess approved foreign investments where national security risks later emerge. This will only apply to future foreign investments, and only to those that have been subject to review under the legislation. The last resort review power is expected to be similar to the last resort powers already in place in relation to critical infrastructure under the *Security of Critical Infrastructure Act 2018* (Cth), and will enable the Treasurer, in limited circumstances, to impose new conditions on approved investments or, 'as a last resort', and subject to a number of specific criteria, require divestment of the business, entity or land. Although not retrospective, the 'call in' power and consequently the 'last resort' power may apply to the commencement of new business activities by existing businesses.

## FOREIGN INVESTMENT FUNDS – RELAXATION OF AGGREGATION RULE FOR 'FOREIGN GOVERNMENT INVESTOR' DEFINITION AND SIMPLER EXEMPTIONS

Foreign investors 40% owned in aggregate by multiple foreign governments will no longer be considered 'foreign government investors' (**FGIs**) (unless there is influence or control).

Foreign investors 20% owned by a single foreign government will still be considered FGIs, however will be able to apply for exemption certificates for particular time periods, where they can demonstrate the absence of influence or control.  The Government gives the example of a private equity limited partnership with foreign government pension funds invested, where the real control is in the hands of the general partner. This is clearly a positive development for private equity investors who play an increasingly important role in M&A in the Australian market.

## REQUIRING FIRB APPROVAL FOR INCREASES IN FOREIGN HOLDINGS IN COMPANIES

FIRB approval will be required for increases above 20% in proportional holdings above what has been previously approved, including as a result of 'creep' acquisitions, share buybacks or selective capital reductions. This is to cover off potential 'gaps' in the existing regime.

### INCREASED ENFORCEMENT AND PENALTIES

Treasury will be given monitoring and investigative powers in line with other business regulators, and the power to give directions to or require enforceable undertakings of investors to address suspected breaches of conditions or foreign investment laws.

Civil and criminal penalties will be increased and a lower tier of penalty by infringement notices will be introduced to respond to minor breaches.

### INTEGRITY MEASURES

There will be new penalties, and powers to add conditions or require divestment, where investors have obtained FIRB approval or an exemption certificate based on applications that make incorrect statements or which omit material information.

Tracing rules will be extended to include unincorporated limited partnerships, in addition to corporations and trusts. This will ensure all offshore acquisitions that involved downstream Australian businesses will be captured where subject to the ordinary thresholds.

### FEES AND TIMING FOR FIRB APPLICATIONS

A 'fairer and simpler' framework will be adopted for charging fees. Importantly, the review of fees will take into account the increased roles and responsibilities of FIRB, and increasing costs of the review process. This indicates that there may be fee increases (noting that the existing fees are already material).

FIRB will be given new powers to extend the 30-day decision deadline by up to 90 days for complex or sensitive applications, rather than an extension being required to be requested by an applicant.

## TIMELINE: NEW LAWS FROM 1 JANUARY 2021

The Government will release exposure draft legislation in July 2020 followed by a six week consultation period.

The proposed reforms are scheduled to commence on 1 January 2021, at which time the temporary Covid-19 related changes will be unwound.

## POTENTIAL IMPACT

The proposed reforms are significant as they create new and potentially broad categories of investment that may require FIRB approval. The reforms shift the focus of the foreign investment framework towards a qualitative assessment of the nature of the investors and their investments. Parties to a transaction will need to further consider the proposed structure for their investment and submit comprehensive FIRB applications to ensure compliance with a more sharply-toothed regime and watchdog. This will likely minimise extensive delays in the FIRB approval process, where sensitive businesses are involved.

The proposals ultimately reflect a shift in political mindset that has been occurring over the last half decade, and will call for a change in business mindset. As foreign investment remains an important part of Australia's globally-integrated economy, the foreign investment regime will no longer only be a major consideration during M&A processes. Rather, proactive compliance with ubiquitous FIRB approval conditions will become the norm, and FIRB will begin to look more like the other regulators such as the ACCC and ASIC, conducting its own investigations and taking enforcement actions.

Although the headline changes grant the Treasurer significant new powers, the application of these is unlikely to result in dramatic changes to Australia's welcoming attitude to foreign investment. In 2018-19, FIRB reviewed nearly 10,000 applications, and only one was rejected. As such, despite the Government's understandable concern for national security, it is not expected that this welcoming approach will materially change.

In practical terms, although the current temporary Covid-19 measures and the implementation of the new regime may result in delay of FIRB approvals, as well as an increase in application fees, it seems unlikely that it will result in significantly more rejections. However, closer scrutiny on FIRB applications can be expected as well as more onerous conditions attaching to FIRB approvals.

# KEY CONTACTS

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


**MATTHEW FITZGERALD**
PARTNER, BRISBANE

**ANDREW RICH**
PARTNER, SYDNEY

+61 2 9225 5707
andrew.rich@hsf.com

**PHILIP PODZEBENKO**
PARTNER, SYDNEY

+61 7 3258 6439
Matthew.FitzGerald@hsf.com

+61 2 9225 5381
philip.podzebenko@hsf.com

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