INFRASTRUCTURE TRENDS - #9: A RETURN TO HEAVY HANDED REGULATION?

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Legal Briefings – By **Matthew Bull** and **Belinda Fan**

In this series of short articles we look at the current trends affecting infrastructure investment in Australia. This article considers trend #9 – A return to heavy handed regulation?

There have been some significant infrastructure acquisition transactions in recent years, including the privatisations of the NSW electricity networks and the major East Coast and Northern Territory ports. These transactions have occurred in a relatively 'light touch' regulatory environment, with regulatory approvals from the Foreign Investment Review Board (**FIRB**) and Australian Competition and Consumer Commission (**ACCC**) being relatively straight forward in most cases.

However, there has now been a noticeable shift in regulatory approach, both during the transaction process and the subsequent operation of the relevant infrastructure asset, including:

- an increased focus on national security concerns following FIRB's high profile refusal to provide clearance to State Grid Corporation of China and Cheung Kong Infrastructure to lease the Ausgrid electricity network assets in NSW and the subsequent establishment of the Critical Infrastructure Centre (**CIC**);
- an increased willingness by FIRB to scrutinise deals more closely, require additional information and impose conditions (including requirements imposed by the Australian Tax Office); and
- increased regulatory compliance measures once a transaction has been approved, which can have implications on the management of infrastructure assets moving forward.

HEAVIER BURDEN FOR BIDDERS TO GET THEIR FOOT IN THE DOOR?

Regulators like FIRB, the ACCC and the newly formed CIC have indicated a shift towards a tougher approach and closer scrutiny of infrastructure transactions. In the case of FIRB, some transactions approved in previous years would now no longer be approved, or only approved with significant conditions.

Earlier this year, the Australian Government established the CIC. The CIC is expected to support FIRB in assessing national security issues arising from foreign involvement in critical infrastructure assets.

To facilitate this, the CIC will develop a register of approximately 100 critical infrastructure assets in the highest-risk sectors such as commercial ports, water, electricity and telecommunications. Applications to FIRB seeking clearance to invest in these critical infrastructure assets will be automatically referred to CIC for a national security risk assessment.

The infrastructure assets covered by the CIC is largely public, but the register of specific security issues will be confidential. The CIC will become influential in future significant infrastructure sales processes, including changes in upstream interests in privatised assets.

Precisely how the CIC and FIRB will interact in practice is yet to be clarified – the Attorney General is currently seeking stakeholder views on the exposure draft of the *Security of Critical Infrastructure Bill* 2017. Based on information released so far, the CIC's involvement could provide greater clarity and transparency around how security risk is assessed in respect of foreign investment in critical infrastructure, including the conditions which could be attached to FIRB approvals. On the other hand, the CIC's involvement could also result in some critical infrastructure assets being excluded from any foreign investment, or the Attorney General exercising a "last resort" veto power in respect of a particular foreign investment.

In addition to the introduction of the CIC, we have also observed FIRB increasing scrutiny in the following areas when assessing foreign investment:

- Tax arrangements – Stapling structures, related party arrangements and negative control arrangements have attracted the recent scrutiny of the ATO which, as one of FIRB's consulting partners, has significant influence on conditions to foreign investment approvals. An increasing number of FIRB approvals require foreign investors to accept bespoke tax conditions.

- Upstream ownership – FIRB has taken a firm approach to requiring disclosure of foreign government investors with 5% or more ownership in upstream funds involved in foreign

investment in Australian assets. In practice, this means sovereign investment funds and pension funds need to be prepared for information requests about even small and passive investments.

- Telecommunications and technology – FIRB often requires detailed information on the use and ownership of transmission and telecommunication technology in infrastructure, including infrastructure not traditionally considered to be telecommunication assets.

- Ownership limits – FIRB now often imposes ownership limits for various forms of investors in certain sectors, with different caps applying to strategic investors, listed companies and infrastructure or superannuation funds.

Foreign investors should to stay attuned to policy developments relevant to FIRB and the CIC, and be prepared to respond to information requests and consider the need for conditions for transactions which may raise particular national security sensitivities.

The trend towards heavier regulatory processes is also affecting the ACCC merger review process. Rod Sims, the ACCC Chairman, has publically stated that in "contentious" merger clearance processes the ACCC is likely to undertake a much more detailed examination than previously. This will involve requiring parties to provide more supporting evidence, including though the use of compulsory information gathering powers (section 155 notices) which it can use to compel parties to produce documents and answer questions under oath. Given this increased focus on obtaining documents, parties should ensure that all materials are accurate and not capable of misinterpretation.

Investors in infrastructure where there are likely to be FIRB or ACCC concerns (due to the nature of the asset or identity of the buyer) should take into account the increased scrutiny and additional requirements when seeking regulatory approvals. Appropriate strategic planning, including assessment of the relevant risks, at an early stage will be critical. Responding to more heavy handed regulatory intervention may also mean businesses need to allow additional time for regulatory approvals and be prepared to commit more management time engaging with regulators and responding to detailed information requests.

RISK OF HEAVIER REGULATORY INTERVENTION POST TRANSACTION

After successfully navigating the regulatory approvals process, owners of infrastructure assets still remain vulnerable to regulatory intervention. As noted in our previous infrastructure trends article (here), there is also a trend of increasing Government/regulator intervention in infrastructure assets, beyond what may have been expected or understood at the time of acquisition or development.

As discussed above, the CIC's involvement in assessing foreign investment in critical infrastructure will likely influence the conditions FIRB attaches to approvals. These conditions could have a substantial impact on the foreign investor's ownership and operation of the acquired assets. For example, in the recent Transgrid transaction, FIRB imposed conditions requiring ongoing Australian based management and board representation; quarantine of operational data and information within Australia; security clearance of key personnel as well as other governance restrictions.

Direct interest holders and responsible entities of critical infrastructure assets will also need to provide ongoing disclosure of commercially sensitive information to the CIC register about interest, control and operational systems and notify the CIC of any change to this information within 30 days.

Heavy handed regulatory changes can also be imposed on infrastructure post acquisition, particularly where it is a critical part of a supply chain. Buyers of such infrastructure assets need to be seen to approach the issue of access and charging in an even handed way to avoid negative perceptions from users (potentially leading to further regulation).

An example of this can be seen in the recent Federal Court decision confirming the declaration of the Port of Newcastle under the National Access Regime. Following the grant of the lease in 2014, and a subsequent increase in port user charges by the new owners, Glencore sought to have the services at the port 'declared' under the National Access Regime. Declaration requires owners to negotiate with users seeking access, with binding arbitration from the ACCC if agreement cannot be reached. As a result of the Port of Newcastle's declaration, the new owners face a more intensive regulatory profile that they probably expected on acquisition.

Amendments to the National Access Regime are likely to come into force soon. One of the amendments will shift the focus of the assessment of the competition criterion (criterion (a)) away from comparing competition with/without access (i.e. ignoring voluntary access to the service) to a comparison of competition with/without declaration (i.e. taking into account voluntary access terms and conditions).

The revised criterion (a) marks a return to the more detailed approach taken prior to the Sydney Airport Corporation case in 2006. The new criterion (a) requires a thorough, detailed review of all relevant competitive conditions surrounding the relevant infrastructure. For infrastructure owners, this means that responding to a declaration application (even if ultimately unsuccessful) is likely to involve a substantial and lengthy process, requiring significant input and attention from the business.

When dealing with conditions imposed during an acquisition, owners will need to have regard to the additional compliance burden this imposes and ensure operations are structured appropriately. Owners should also consider how third parties are likely to react in a world of heightened awareness of the availability of regulatory processes and the burdens that this can impose on infrastructure asset owners.

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