Law Council
OF AUSTRALIA

Business Law Section

Foreign Investment Reforms: Submissions on Tranche 2 (Foreign Investment Reform (Protecting Australia’s National Security) Regulations 2020 and Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020)

Manager
Policy Framework Unit
Treasury
Langton Cres
Parkes ACT 2600
FIRBStakeholders@treasury.gov.au

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About the Business Law Section of the Law Council of Australia

The Business Law Section was established in August 1980 by the Law Council of Australia with jurisdiction in all matters pertaining to business law. It is governed by a set of by-laws adopted by the Law Council and the members of the Section. The Business Law Section conducts itself as a section of the Law Council of Australia Limited.

The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, as well as enhance their professional skills.

The Law Council of Australia Limited itself is a representative body with its members being:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Operating as a section of the Law Council, the Business Law Section is often called upon to make or assist in making submissions for the Law Council in areas of business law applicable on a national basis.

Currently the Business Law Section has approximately 900 members. It currently has 15 specialist committees and working groups:

- Competition & Consumer Law Committee
- Construction & Infrastructure Law Committee
- Corporations Law Committee
- Customs & International Transactions Committee
- Digital Commerce Committee
- Financial Services Committee
- Foreign Corrupt Practices Working Group
- Foreign Investment Committee
- Insolvency & Restructuring Law Committee
- Intellectual Property Committee
- Media & Communications Committee
- Privacy Law Committee
- SME Business Law Committee
- Taxation Law Committee

- Technology in Mergers & Acquisitions Working Group

As different or newer areas of business law develop, the Business Law Section evolves to meet the needs or objectives of its members in emerging areas by establishing new working groups or committees, depending on how it may better achieve its objectives.

The Section has an Executive Committee of 11 members drawn from different states and territories and fields of practice. The Executive Committees meet quarterly to set objectives, policy and priorities for the Section.

Current members of the Executive are:

- Mr Greg Rodgers, Chair
- Mr Mark Friezer, Deputy Chair
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- Mr Adrian Varrasso

The Section's administration team serves the Section nationally and is based in the Law Council's offices in Canberra.

For Further Information

This submission has been prepared by the Foreign Investment Committee (**Committee**) of the Business Law Section of the Law Council of Australia.

The committee would be pleased to discuss any aspect of this submission.

Any queries can be directed to the chair of the Committee Malcolm Brennan at malcolm.brennan@au.kwm.com or 0417 290 705 or the deputy chair of the Committee Wendy Rae at wendy.rae@allens.com.au or 0411 646 774.

With compliments

Greg Rodgers
Chair, Business Law Section

Introduction

1. This document contains our submissions on the 'Tranche 2 Regulations', which comprise

   - the *Foreign Investment Reform (Protecting Australia's National Security) Regulations 2020* which will amend the *Foreign Acquisitions and Takeovers Regulation 2015* (**FATR**); and
   - the *Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020* which will set out a new FIRB fee regime.

2. The overwhelming consensus from members of the committee, based on their own views and those of various of their foreign investor clients, is that the Tranche 2 Regulations will give rise to uncertainty and be unreasonably onerous for foreign investors.

3. As mentioned in our Tranche 1 submissions, we accept the Commonwealth Government's objectives of addressing national security risks and strengthening compliance. We do not in any way dispute the Government's prerogative to reflect its policy priorities in the foreign investment regime and, to be clear, we fully support a foreign investment regime which is designed to and will protect Australia's national interest.

4. At the same time, however, the foreign investment regime needs to have clear and objective rules and remain workable for the vast majority of foreign investments which do not pose a national security concern. The rules should not impede or create uncertainty for low-risk foreign investment proposals.

Call-in Power

Scope of the call-in power

5. There are concerns held by us, as well as by investors and their financiers, about the material risks that would be imposed by the call-in and last resort powers, and the potential impact of these risks on investment flows and the cost of capital. These powers introduce an additional layer of 'sovereign risk'.

6. The proposed extended period of 10 years – following a reviewable national security action or significant action for which FIRB approval was not sought - for the Treasurer to exercise the call in power exacerbates these risks because the length of this period creates uncertainty for investors as it encompasses the potential for multiple changes of Government and re-setting of priorities and sensitivities (for example, a change to what is considered to be a national security matter). It may complicate the process for any refinancing of an asset as those sensitivities emerge.

7. The current drafting of the call in power, together with the associated 10 year period, means that it is not clear how parties transacting in relation to a target business can allocate risk:

   a. Can a call in be initiated for a transaction that occurred 9 years ago if the relevant target business has since been sold?

   b. Does the sale of the business 'restart the clock' on the 10 year limitation period or does it continue on for the new owners of the target business? Presumably two rights to review should not overlap.

   c. Does the Treasurer's call in power cease to apply if the target business is sold to a buyer that is not a foreign person? Presumably it should cease given that there should no longer be a national security concern arising from foreign ownership, but these things are not clear in the current package. It is not an acceptable answer to financiers in particular that "the Treasurer wouldn't exercise a power in that way". We suggest that this be clarified through the drafting.

8. Given the breadth of the concepts associated with the call in power, the need for certainty to provide confidence to investors, and as the Government is the party best placed to identify any national security risks, we submit that a period of 2 years is more appropriate.

9. The Treasurer's right to review an action ("A") should be de-activated if there is a subsequent action ("B") which cleanses the earlier action "A" or makes it irrelevant. For example, if a buyer of an asset (first acquisition "A") sells it after 5 years (being action "B") the review power should not continue to apply to action "A". It may apply, on its terms, to the subsequent action "B" but the buyer of the asset under "B" should not be exposed to an order made because of action "A"; that is, if action "B" was the subject of a notice of no objection or was undertaken by an Australian person but there is an ability to unwind the sequence through exercising a residual power arising from action "A". We suggest that this be clarified through the drafting.

10. A combination of these factors will mean that the current high volume of FIRB applications will remain as parties and their financiers are unwilling to take any residual risk even if notification is not required (or even increase as the call in power applies to a wider range of transactions than even the temporary $0 thresholds). Parties will also face heightened administrative burdens as financiers will require an assessment of even theoretical risks and a long-running call in right may lead to an increased cost of finance.

11. We note that there is no specific limitation on the time that may be taken in a "review" process. One should be introduced – we suggest in-line with the approximate 4 month period commonly assumed (pre-COVID) for sensitive actions.

Recommendations:

We recommend that the call-in power cease to be exercisable:

12. Within 2 years, rather than 10 years, after the occurrence of a reviewable national security action or significant action for which FIRB approval was not sought; and

13. Upon the occurrence of an action which cleanses an earlier action which was a reviewable national security action or significant action for which FIRB approval was not sought, eg. where the purchaser of an asset has sold it the call-in power should cease to be exercisable in respect of the initial purchase.

Reviewable national security actions

14. We welcome the Government's proposal to extend the various notifiable action and significant action exemptions under the current regime to the new notifiable national security action concept.

15. However, we are concerned with the proposal not to extend various exemptions to the reviewable national security action concept, including the exemptions for rights issues, dividend reinvestment plans and acquisitions of passive minority interests in land entities (s41 of the FATR). (Making an investor that already holds 100% of an entity seek approval to acquire shares and remain at 100% is of no utility to any party. The same point goes to investors whose proportionate interest does not change.) The experience of the COVID crisis leading to urgent capital raising has shown the importance of the rights issue exemption.

16. The passive minority interests in land entities exemption is also more aligned with the direct interest trigger for a reviewable national security action relating to an acquisition of interest in a non-land rich entity or an Australian business. Clear policy explanation should be provided why a 10% passive interest in a non-land rich entity is non-reviewable but a 5% passive interest in a land entity is reviewable (and this should not be taken to be an invitation to lower the review threshold for an acquisition of interest in a non-land rich entity).

17. This will create significant uncertainty and, as previously mentioned, will result in more foreign investors voluntarily seeking FIRB approval to obtain upfront certainty that the call-in power will not be exercised post-transaction. The ability to seek FIRB approval to remove the risk of call-in is not a reasonable solution, because it will inevitably impact the timing and feasibility of proposed transactions.

18. We are also concerned with the inclusion of the issuance by a foreign person of securities in an entity (proposed s37B(1)(a)(iii) of *the Foreign Acquisitions and Takeovers Act 1975* (**FATA**)) as a reviewable national security action. As a conceptual matter, an issuer of securities should never be subject to the call-in power. The objective of the FATA is to regulate acquisitions by foreign persons, and the FATA (both currently and under the proposed new regime) extensively regulates acquisitions of securities, including as a result of issuance. We note also that there is no percentage threshold associated with the issuance of securities, whereas there are direct interest and substantial interest thresholds associated with the acquisition of securities. and under section 40 of the current FATA a change of control must result from an issue of securities in order for it to be a significant action.

National security exemption certificates

19. We note that two new types of exemption certificates have been introduced – certificates to undertake a program of actions or kinds of actions that would otherwise meet the definition of: (i) a notifiable national security action; and (ii) a reviewable national security action. Whilst they appear potentially useful introductions to the regime, there is concern that applicants will be required to obtain several exemption certificates to conduct routine business – a land and business exemption certificate as well as the 2 national security exemption certificates. This will be confusing and will require clear guidance.

20. We make the following requests for clarification in respect of the proposed exemption certificates:

    a. the categories of businesses or types of land that fall within the definition of a “national security business” or “national security land”, in respect of which FIRB would consider issuing an exemption certificate;

    b. the categories of national security businesses or types of national security land where foreign investment is considered high risk and hence applications for exemption certificates will not be considered or issued by FIRB in any event;

    c. the preferred types of investment vehicles/structures, investor control rights or the level of board representation which would not exacerbate national security concerns, and safe harbour thresholds with respect to the ownership stake held by an investor (including type of investor) that would ease or alleviate concerns around national security risk such that an exemption certificate would in all likelihood be granted to an applicant;

    d. The length of time for which the exemption certificates issued will be valid. (Consistent with the current exemption certificates, the validity period of the national security certificates should also be for periods of up to 3 years.); and

    e. fees should be adjusted and refunds available as discussed below.

Recommendations:

We recommend that:

21. The Government reconsider its proposal not to extend the existing exceptions to the reviewable national security action concept. Ideally the existing exceptions should apply to the reviewable national security action but, if they do not, then certain modifications should be made to mitigate the adverse consequences for transactions, such as:

    a. the rights issue and DRP exemptions should also operate as exceptions to the reviewable national security action other than in circumstances where the relevant person's percentage interest in the securities issuer materially increases as a result of participation in the rights issue or dividend reinvestment plan;

    b. allowing a would-be issuer of securities under a rights issue to confidentially apply for a fast track exemption certificate covering all existing investors who are foreign persons, so that foreign investors can participate with certainty without themselves needing to seek FIRB approval.

22. The issuance by a foreign person of securities in proposed section 37B(1)(a)(iii) should be deleted as that does not involve an acquisition by the issuer and acquisitions of issued securities by foreign persons are regulated elsewhere.

23. The exemption for the acquisitions of passive minority interests in land entities should not be a reviewable national security action given that such investors have no influence or governance rights so it is very difficult to see how any national security risks can arise from such investments.

24. There should be a new exception to the notifiable action, significant action, notifiable national security action and reviewable national security action concepts which is available where a foreign person acquires interests in securities but without that resulting in any increase in that person's percentage interest in the issuer entity. No national security concerns can arise in this context as the status quo remains.

25. Clear criteria and guidance should be set out for the proposed new national security exemption certificates.

Foreign government investors (FGIs)

26. We agree with the position in the Treasury's "Summary Paper" that FIRB screening of investments by institutional investors that are privately controlled but caught as foreign government investors (and therefore subject to a zero dollar screening threshold) creates unnecessary barriers to investment. These investments typically do not give rise to national interest concerns and discourage investment. However, having regard to the passivity principles articulated in the explanatory statement accompanying the exposure draft legislation, proposed regulation 17(2) will not in practice exempt any market-standard private equity fund.

27. We understand the proposed exclusion to the definition of foreign government investor is intended to exempt investment funds, where the general partner / trustee is deemed to be a foreign government investor as a result of meeting the aggregate 40% test in paragraphs 17(1)(b)(ii), (c)(ii) or (d)(ii) of the definition of foreign government investor, where such investors are genuinely passive investors. This new exclusion will currently only operate if:

    a. the investors in the fund are not able to influence any individual investment decisions, or the management of any individual investments, of the corporation, trustee or general partner under the scheme; and

b. the foreign government investor in question does not have access to any sensitive information about investments under the scheme, other than financial information.

28. The explanatory statement describes Treasury's approach to passivity. Specifically, it distinguishes between investors' influence in relation to decisions relating to specific investments, versus influence in relation to general strategy, and also expresses a view that all non-financial information is "sensitive information" to which passive investors should not have access.

29. The Institutional Limited Partner Association (**ILPA**) is an industry association which represents institutional investors globally.[1] ILPA asserts that effective private equity partnerships depend on alignment of interests, governance and transparency, and through extensive industry consultation over a number of years has issued successive sets of principles (**ILPA principles**)[2]. The ILPA principles address key private equity fund commercial terms and put forward "best practice" approaches to achieve the aims of alignment, governance and transparency. Many private equity funds are required to benchmark their funds against the ILPA principles when prospective investors conduct due diligence on their funds, and as a result the ILPA principles heavily influence the terms of private equity funds around the world.

30. The ILPA principles contain specific principles which are at odds with Treasury's narrow approach to passivity, as expressed in the explanatory statement accompanying the exposure draft regulations.

Individual investment decisions

31. The explanatory statement attempts to distinguish between investors that are able to influence individual investment decisions (for example, the purchase or sale of particular shares or property) on the one hand and investors that have some influence over the broad investment strategy on the other hand. The explanatory statement specifically notes that having an investor representative serve on an advisory committee can fall into the latter category as long as the advisory committee members are not involved in individual decisions for particular investments.

32. In respect of LPACs (limited partner advisory committees), the ILPA principles recommend that the mandate for the advisory committee should be specifically set out in the fund documents and should generally include matters specific to evaluating conflicts of interest as presented by the general partner, and other matters that would require a change to or interpretation of certain provisions within the fund documents, including:

    a. conflicts of interest such as cross-fund investments and general partner investment in portfolio companies outside of the fund's interest or that violates the stated exclusions policy;

    b. matters concerning tests of investment strategy, geographic, allocation or concentration limitations; and

    c. affiliated transactions.

33. Accordingly, most advisory committees are able to make decisions on (among other things) the following matters:

[1] Its membership base is approximately 60% US-based; and 40% from Europe, Canada and throughout the rest of the world. Limited partner type is represented by public pension funds, endowments and foundations, private pension funds, family offices, insurance companies and other institutional investors.
[2] A copy of the current version of the ILPA principles can be found here: https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf.

a. Making an investment outside the diversification, prudential, geographic or investment parameters set out in the fund documents.

b. Making an investment where the fund sponsor has a conflict of interest (such as where investments are made by two or more funds managed by the same fund sponsor).

34. These restrictions can generally be overridden by the advisory committee, which by definition means the advisory committee members will (as a collective) be able influence individual investment decisions as the issue will only ever come to the advisory committee when there is a specific investment that the fund sponsor wishes to make.

Access to information

35. As a general matter, the explanatory statement distinguishes between financial information and "non-public, non-financial information about investments that may affect the financial metrics (for example, knowledge of trial outcomes, resignations of key personnel, intellectual property, legal actions)", which should not be available to investors.

36. The explanatory statement appears to imply that such non-public information will be strategic information. This is not necessarily the case. Therefore, the reference to "non-public, non-financial information about…" should be replaced by a reference to "non-public, non-financial information of a strategic nature about…".

37. More specifically, the explanatory statement suggests that resignation of key persons would be a kind of "sensitive information". The current version of the ILPA principles states, "The investment team is a critical consideration in making a commitment to a fund. Accordingly, any significant change in that team should allow limited partners to reconsider their decision to commit, through the operation of the key person provisions". The ILPA principles go on to recommend the following in respect of key person resignations:

a. the resignation should trigger a suspension of the investment period;

b. the suspension should become permanent after 180 days unless a defined majority of limited partners affirmatively vote to reinstate the investment period (which typically involves either approving a replacement key person or being comfortable that no replacement is required).

38. Of necessity, information about key person resignations would have to be provided in order for these provisions to operate.

39. Further, the explanatory statement suggests that information about the outcome of litigation would be "sensitive information".

40. The ILPA principles include a recommended agenda for advisory committee meetings, which includes litigation updates, as well as other non-financial information.

41. In summary, the overwhelming majority of fund documents include variations of the provisions described in paragraphs (a) and (b). Accordingly, the current passivity requirements, as interpreted by the explanatory statement, render the exclusion in proposed regulation 17(2) completely meaningless.

42. These kinds of protections are designed to protect the legitimate financial interests of limited partners and do not give rise to the kinds of concerns that the Government has expressed in relation to foreign government investors. Funds that in general terms give limited partners the kind of oversight recommended by the ILPA principles should properly be considered to be passive investment funds, and therefore excluded from the definition of foreign government investor by the operation of proposed regulation 17(2).

43. We consider that this is consistent with the approach taken by other regulators, including in the United States.

Recommendations:

44. We recommend that:

    a. the proposed Guidance Note on the new definition of FGIs should recognise that the investor protections recommended by the ILPA principles and other customary minority protection rights would not constitute influence for the purposes of proposed reg 17(2)(b)(iii);

    b. the proposed Guidance Note on the new definition of FGIs should recognise that not all non-financial information is sensitive information; and

    c. the following statement should be deleted from the explanatory statement (page 10): "However, non-public, non-financial information about investments that may affect the financial metrics (for example, knowledge of trial outcomes, resignations of key personnel, intellectual property, legal actions) should not be available to investors".

Investor specific exemption certificate

45. Treasury had flagged in its summary paper that "entities which have a single foreign government with at least 20 per cent ownership (without influence or control) will still be deemed FGIs, however they will be able to apply for a broad exemption certificate on a case by case basis."

46. We reiterate the statements made above about Treasury's unrealistic assessment of passivity, which would apply equally to these investor specific exemption certificates.

47. Further, we understand that while the proposed changes do not provide for a specific exemption certificate of this type, it is Treasury/FIRB's intention to issue a Guidance Note to give effect to this regime using its powers to grant exemption certificates under the legislation. However, the current process for obtaining exemption certificates (in particular timeframes and conditions and particularly business exemption certificates to facilitate "roll-up' acquisitions of businesses) has been frustrating. The business exemption certificate proposed by FIRB, after an extensive and time consuming process, has often not met the needs of the investor. The concern is that, if the current experience with business exemption certificates is any indication of the process involved with obtaining an investor specific exemption certificate for the 20% test for FGIs, this proposal is unlikely to be effective. This is unless the process is streamlined and made more transparent.

Recommendations:

48. We recommend that the proposed Guidance Note for the investor specific exemption certificate be circulated in advance and subject to consultation and that it is clear in respect of conditions and timeframes for processing.

49. As a drafting issue, it would be helpful for the Guidance Note to clarify that a corporation itself could be the scheme that is being operated for the purposes of the new section 17(2)(b) of the FATR. Investment funds could take the form of a corporation, in addition to a trust or a limited partnership.

Money lenders

50. The proposed exclusion from the moneylending exemption in section 27(1)(c) of the FATR means that transactions involving security taken over national security land (and exploration tenements in respect of national security land) or assets of a national security business will not be exempt from the operation of FATA. We note as follows:

Availability of exemption

51. The moneylending exemption should continue to operate as there is no conflict between the Government's interests in protecting national security, and the routine and low risk nature of moneylending transactions. We understand that Treasury is concerned that the exemption could be abused as a back-door method of gaining control of a national security business. However, to be eligible for the exemption the security interest must be granted "in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business (a moneylending business) of lending money," must be held solely by way of security for a moneylending agreement (s27(1)(a)(i)) and must not deal with "any matter unrelated to the carrying on of that business". So the exemption is tightly constrained and protected by its own anti-avoidance provisions.

Recommendations:

52. There are several potentially less disruptive approaches than removing the moneylending exemption altogether including:

    a. It may be that Treasury's concern derives from the second limb of the moneylending exemption, s27(1)(a)(ii), being an interest "acquired by way of enforcement of a security held solely for the purposes of a moneylending agreement". In fact this limb is little used as on enforcement a receiver or administrator is appointed by a security trustee on instructions from the financiers with a view to sale to a third party. It would greatly alleviate the dire consequences of revoking the moneylending exemption under the new s27(1)(c) if that new provision could be limited in its effect to the second limb of the exemption (ie s27(1)(a)(ii)).

    b. However, the exemption should be allowed to continue to apply in an enforcement scenario:

        i. in an active enforcement situation if a controller is appointed; or

        ii. if the secured creditor adopts a passive position in an insolvency by allowing the administrator or liquidator to remain in control of the debtor's business during insolvency (e.g. as per Virgin).

    In each case, an experienced insolvency practitioner (meeting the criteria specified in the Corporations Act and licensed by ASIC) is in possession, or has control, of the collateral or the debtor. To achieve this, rather than adding the new section 27(1)(c), section 27(1) can be drafted to be subject to a new section 27(4) which sets out this condition. Given that the person in control of the national security business or national security land would be a licensed insolvency practitioner with a specific statutorily defined role, the government's national security concerns should be alleviated and provide a workable solution for the vast majority of lenders who are not interested in taking over the business and rely on professional insolvency practitioners to recover their loans.

    The formulation above does not lessen the national security protection, because mandatory notification would still be required in other enforcement circumstances where an insolvency practitioner is not appointed, e.g. if a foreign lender wishes to:

i. adopt a loan-to-own strategy; or

ii. implement a debt to equity swap; or

iii. take direct possession through an agent (sometimes happens on mortgagee sales, but otherwise very rare); or

iv. require foreclosure (very rare also); or

v. exercise step-in rights.

The appointment of an insolvency practitioner as described above should provide sufficient comfort. But if additional safeguards are required, e.g. in the case of a foreign government investor lender, then there could be additional conditions that:

i. the foreign banks do not control the vote on security enforcement (usually 2/3rd of the vote); and/or

ii. the foreign banks were disenfranchised (i.e. their votes don't count) on certain enforcement decisions.

The above should allow foreign banks to participate in a syndicate where they only hold a minority participation interest and have minimal influence.

c. A less disruptive approach would be to mirror the approach taken to residential land security. That is, amend section 27(2) of FATR to insert "national security land or a national security business" after "residential land". This would allow ADIs or otherwise licenced financial institutions to benefit from the exemption but require other parties to seek approval. In this way, acceptable parties have the benefit of the exemption.

d. Another less disruptive approach would be to mirror the approach taken with moneylenders that are deemed to be foreign government investors, limiting the period of enforcement to 6 months. Section 27(3) of the FATR could be amended to include enforcement in respect of insert "national security land or a national security business". In this way, the interest if enforced is required to be sold or an approval obtained and the Government therefore has the oversight it is looking for.

Fees

53. The proposed exclusion from the moneylending exemption is likely to result in moneylenders having to seek approval for the same transaction that the acquirer is seeking approval for, meaning two separate FIRB applications and two sets of fees. Borrowers will effectively be required to bear both sets of fees, since lenders can be expected to pass these costs onto borrowers.

54. In addition, it is unclear how application fees will be assessed, given application fees are normally assessed based on consideration and there is no consideration per se in moneylending transactions.

Recommendations:

55. We suggest that in circumstances where the main transaction also requires FIRB approval, any application fees associated with a lender's or security trustee's application should be eligible for a complete or partial waiver, given some of the work in relation to the application (assessing the target) will be common to both applications.

56. We would suggest a flat fee, rather than a scaled fee, given the routine nature of these transactions and the very low possibility that a lender will ever end up actually acquiring the assets in question (as opposed to selling them, which is also rare), given lenders are not in the business of operating these kinds of assets.

After-acquired property

57. It is unclear how the moneylending exemption is meant to work in respect of after-acquired assets. The way security is typically granted in secured money lending transactions is under a general security deed (which grants a security interest over all present and after-acquired property of the security grantors). This means that it is likely that any asset which is acquired by the grantor under such general security deed will automatically become subject to a lender's / security trustee's security interest. That could mean that a grantor could acquire an asset which is of the kind referred to in proposed section 27(1)(c) of the FATR without the consent or approval of, or even notice to, a lender or security trustee, such that the lender or security trustee may not be able to prevent the grantor acquiring, or even be aware that the grantor has acquired, such an interest – in those cases, the lender or security trustee could be breaching FATA without even knowing it (or in situations outside its control).

58. Note this would affect lenders and security trustees in not only "new" secured moneylending transactions (ie, after the new FATA regime takes effect), but also in existing secured money lending transactions entered into before the new FATA regime takes effect (as the general security held by the lenders / security trustees in those transactions would likely cover all present and after acquired property of the grantor.

Recommendations:

We suggest the following:

59. At a minimum, any security granted before the new FATA regime comes into effect should be grandfathered so that changes in the nature of the assets would not cause the lender / security trustee to be in breach of FATA.

60. For security granted after the new FATA regime comes into effect, ideally the legislation would operate so that the lender's / security trustee's obligation in relation to FATA is measured at the time the security is first granted and in relation to what they know or ought reasonably to have known in respect of the assets over which security is being granted. If that is not acceptable, then at a minimum guidance should be provided to the effect that enforcement powers will not be used against lenders who have taken reasonable precautions (such as by including covenants in the financing documents) to ensure that they do not end up with security over assets of the kind referred to in proposed regulation 27(1)(c) before they have had the chance to obtain FIRB approval.

Transitional arrangements for existing security arrangements

61. It is unclear how the changes would impact security agreements entered into before the changes come into effect. Presumably these would continue to be governed by the existing laws and enforcement actions taken in accordance with a security agreement entered into before the changes would not be subject to the new law.

Recommendations:

We suggest the following:

62. The impact on existing security arrangements be clarified in the guidance note.

Australian media business

63. We have a number of concerns with the proposed definition of 'Australian media business".

64. Under the proposed legislation, an 'Australian media business' would be defined as:

> *"an Australian business of doing one or more of the following:*
>
> *(a) publishing daily newspapers in Australia;*
>
> *(b) broadcasting television or radio in Australia;*
>
> *(c) operating an electronic service (including a service provided through the internet) accessible to persons in Australia that delivers, or allows access to, content that:*
>
> *(i) is in the form of data, text, sounds, images or in any other form; and*
>
> *(ii) is similar to a newspaper or radio or television broadcast;*
>
> *(d) producing content described in paragraph (c), to be delivered, or made accessible, through a service described in paragraph (c)."*

Paragraph (c) – operating an electronic service

65. This part of the definition is too broad as it could apply to almost any electronic service that shares information.

66. In order for the definition to work as intended, we submit that the framework for the definition should specify precisely the type of content which would need to be shared by the electronic service to trigger the definition. For example, if the intention is that the definition of "Australian media business" captures electronic services which provide news content, then that should be specified.[3] Alternatively, FIRB will need to issue very clear guidance as to precisely what content is similar to a newspaper or radio or television broadcast.

Recommendations:

67. Amend paragraph (c) of the proposed new definition of Australian media business to specify precisely the content which the electronic service provides or issue very clear guidance as to this content.

Paragraph (d) – producing content as described in paragraph (c), to be delivered, or made accessible, through a service described in paragraph (c)

68. The reference to “producing content” would pick up a range of ancillary businesses such as advertising production companies, subtitling services, CGI animators, copywriting

[3] See definition of "News" and "Journalism" at page 282 - ACCC Digital Platforms Inquiry Final Report, June 2019, https://www.accc.gov.au/system/files/Digital%20platforms%20inquiry%20-%20final%20report.pdf, page 299

agencies, music production companies and possibly even non-media businesses that produce media content in-house. Query whether this level of reach is necessary.

69. There is no policy basis for extending the definition of these businesses to capture producers of content. It is submitted that the rationale for media regulation is its reach, and hence its ability to influence. The producers of content have neither of these characteristics.

Recommendations:

70. Delete paragraph (d) of the proposed new definition of Australian media business".

Wholly offshore internet business

Recommendations:

71. Provide further guidance whether a wholly offshore internet business the service of which can be accessed by persons in Australia would be considered as an Australian media business.

Fees

72. We are concerned by the material increases in fees proposed, which involves a fivefold increase in maximum fee amounts (moving from $107,100 to a new upper limit of $500,000).

73. Whilst the specific impact on money lenders has been noted above, this change will also impact a wide cross-section of investors given the increased reach of the proposed FIRB regime and the potential impacts of the possible changes to the *Security of Critical Infrastructure Act 2018* to substantially expand the definition of 'critical infrastructure asset' to capture numerous sectors not typically associated with the term 'critical infrastructure'.

74. A great deal of anecdotal evidence suggests that offshore investors are concerned about the increasing fee burden (which is coupled with the increasing uncertainty stemming from expanded call-in and last resort powers). This new fee framework will act as a disincentive to invest in Australian businesses and will have flow on effects across the Australian market:

    a. Substantial fees will act as a major deterrent in the participation of projects that feature a tender process (or other equivalent). It will not make sense for investors to pay such fees when it is still unclear what the likelihood is of securing that investment.

    b. Lower levels of competition and demand shifts market forces that benefit from a wider pool of potential investors. Local investors will inevitably be faced with higher prices as a result.

75. In the midst of COVID-19 and a global recession, Australia's access to a strong, diverse pool of investors will be critical for its economic and social recovery. Foreign investors are already more likely to retreat inwards to seek their own domestic investments in the face of economic uncertainty, and with Australia's proposed FIRB fee regime set to impose a higher fee burden than its international equivalents, we respectfully submit that the proposed fee regime will only serve to hasten this process.

76. Fees payable by foreign investors under the FIRB regime should be commensurate to the cost of administering the FIRB framework and process, and should not operate as an additional form of tax on foreign investors. In that context, we note the view of the Productivity Commission around even the current fees being 'out of proportion to the actual costs involved with administering the scheme'. [4]

77. We note that the Explanatory Statement to the draft Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020 states that the new fee regime "is intended to establish a fairer and simpler framework for foreign investment fees". With respect, we cannot see that intention reflected in the draft regulations.

    a. A fairer framework would involve the imposition of fees on a cost-recovery basis, whereas under the current regime the total fee revenue exceeds FIRB's operational expenses (see earlier point).

    b. A fairer framework would also involve differing fee amounts depending on whether or not a proposed transaction is sensitive, as a sensitive transaction (such as where the target is a national security business or national security land) utilises more Government resources as part of the assessment process than a non-sensitive one (such as commercial and retail leases).

    a. We consider the proposed new fee regime to be as complex as, if not more complex than, the current regime.

78. As the fees will be so large, to assist with the adverse impact we suggest that a refund mechanism (or at least a partial refund mechanism) be implemented for applications that are made early (as encouraged by FIRB) but where the bid is not successful or otherwise the transaction does not proceed.

79. We also note that in a competitive bid/tender process, the general expectation is that there will be more than one foreign bidder or participant. Most of the work that will need to be undertaken by FIRB and the consultation agencies will feature an assessment of the asset and / or target and this analysis would in most scenarios be transferrable and able to be utilised for each foreign applicant involved in the competitive bid process. Multiple fees will have been paid for what is the same workload in this regard, so it would make sense for at least partial refunds to be provided to unsuccessful bidders. We also note in competitive bid processes, the FIRB filing fees are a sunk cost for unsuccessful bidders and the prospect of a refund, regardless of the work undertaken by FIRB, encourages investment as well as more timely applications. This is particularly important in the current context where the Treasurer has flagged that such investment will be a cornerstone of economic growth over the medium to longer term.

80. In addition to our general comments above, we have suggested some specific changes which we believe are necessary to ameliorate the impacts of the proposed changes, set out below.

Agricultural land

81. Whilst we do recognise that there are sensitivities with respect to agricultural land investments, we do not think that there is any policy rationale for distinguishing between the maximum fees attaching to agricultural land investments and those that would apply to other sensitive classes of commercial land (indeed section 52(6) of the FATR sets out many classes of low threshold commercial land and none of those classes attract differential fees).

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[4] *Foreign Investment in Australia – Commission Research Paper*, June 2020, Productivity Commission

82. Any concerns regarding agricultural land investments should be addressed as part of the national interest and national security assessments and not dealt with by way of applying a prohibitive fee.

83. The change to the calculation of the fee for agricultural land from highest value title to the consideration for the proposal is a second massive increase in the fee outcome. For example, a $20 million property on 11 titles currently attracts a $2,100 fee but under the proposed new rules the fee would be $118,800. That is disproportionate and a clear disincentive to invest.

84. As agricultural land is generally operating or able to be operated as a business, the fees for business should apply. We note that despite the focus on national security and increased scrutiny, there is no differentiation in the fee structure for such proposals.

Recommendations:

85. We recommend that the 'fee constant' for agricultural land be increased from $2 million to $50 million to bring it in line with commercial land.

Solar and wind farms

86. It will be important to ensure that the *Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020* framework accounts for standard practice in the renewables space and it should be made clear to investors that investments in land interests associated with solar and wind farm projects will not attract FIRB application fees that would otherwise apply to interests in agricultural land.

87. As land will be classified as agricultural land if it can be reasonably used for a primary production business, this leaves open an ambiguity in the classification of land where that land is to be used for a solar or wind power station. Through its subsequent amendments to the FATR, FIRB has in the past recognised the commercial nature of renewables projects and how this should impact land classification. Section 44 of the FATR sets out that land is no longer considered to be agricultural land if the land is wholly or predominantly used for the renewable power station located on the land. Section 40(2A) of the FATR also sets out that the purchaser of land that has a wind or solar power station that is already located on the land can disregard the fact that the land is agricultural land for the purposes of sections 52(2) and (3) of the FATA.

88. However, due to the references to 'predominant use' in section 44 of the FATR and the lack of further guidance, it remains unclear whether the agricultural land definition and related carve outs focus on the use of the land (for example, taking into account the space required for any peripheral activities such as sheep grazing that may continue to some extent on the land) or output, revenue or the productivity that is derived from the land (which would capture the existence of any wind or solar farm infrastructure). We submit that consistent with section 40(2A) and the intentions evidenced by the below Explanatory Statement, land that is used for a wind or solar power station or otherwise falls within the carve outs in section 44(7) of the FATR should not be treated as agricultural land for the purposes of calculating FIRB application fees just because some primary production activities are continuing on the land (such as sheep grazing).

89. We refer to the Explanatory Statement of the *Foreign Acquisitions and Takeovers Amendment (Exemptions and Other Measures) Regulations 2017* which implemented these changes and note the specific recognition of this issue,

Currently, the foreign investment framework does provide clear or consistent treatment for wind and solar farm operators or those acquiring such businesses. ***In practice, established wind and solar farms are commercial uses of land****, but because the infrastructure (for example, wind turbine) does not* *always fall within the meaning of a fixture or building, where the land is not being used (or could not reasonably be used) for a primary production business it is treated as vacant commercial land. Furthermore, depending on the nature of the solar or wind farm, it is possible that land used for this purpose can also still be used for primary production which means that it will still be treated as agricultural land despite the fact the foreign person's use of the land is for wind or solar farm operation.*

90. The current ambiguity around land classification for renewables projects will be further exacerbated by the proposed fee regime.

Recommendation:

91. We recommend that FIRB clarify the intended treatment of land to be used for renewables projects, which we would expect should be consistent with the approach outlined above.

Exemption certificates

92. Under the proposed fee framework, fees for exemption certificates will amount to 75% of the fee that would be paid for an investment of a value equal to the monetary limit set under that exemption certificate. We believe that this will in many cases unwind the benefits that exemption certificates are intended to provide, requiring significant fees to be incurred by an investor before an investment is even made (or potentially identified).

93. From a practical perspective, the workload required from FIRB should be the same irrespective of whether an exemption certificate is granted for $100 million or for $1,000 million, given that the higher investment amount does not mean that FIRB will need to consider a higher number of different targets. Given this, in line with fees being commensurate with the work required, FIRB should be able to apply a flat fee to any exemption certificate application.

94. Unforeseen circumstances or risks (which include sovereign risks) may mean that the investments ultimately acquired under an exemption certificate are much lower than the monetary limit originally posed under that exemption certificate. We expect that the proposed changes to the fee regime for exemption certificates will deter investors from seeking exemption certificates, which will ultimately have the effect of removing foreign investors from competitive bids due to not being able to quickly take up opportunities and add additional workload to FIRB with more matters requiring separate approval. The intent of the exemption certificates (or prior annual programmes) is to deal with high volume low sensitivity matters quickly and efficiently. This allows applicants to get on with investment and frees up FIRB resources to focus on matters of greater sensitivity. The approach to the fees is self-defeating for Treasury, applicants and the economy.

Recommendation:

95. As many investors do not use the full extent of the expenditure cap, we recommend that a straightforward mechanism be put in place for partial fee refunds on exemption certificates where the total consideration cap in a certificate is not fully utilised, or could be applied towards the next exemption certificate.

Single fee payable under one agreement

96. Under the current FIRB fee regime, where more than one action (other than in relation to residential land) occurs under a single agreement, the fee payable is the highest of the fees that would otherwise be payable on each separate action (section 9 of *Foreign Acquisitions and Takeovers Fees Imposition Act 2015*).

97. It is of concern that this 'higher fee rule' is not brought across to the proposed *Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020*. In fact, it is not clear whether the draft Regulations even deal with a situation where actions of different kinds are covered under the one agreement. Proposed section 44 is headed "Fee to the extent that

the actions are all of the same kind" but the provision itself does not expressly say that the actions need to be of the same kind. It is implicit in subsection (2) which requires that the fee be ascertained on the basis of the aggregate consideration for all actions – which only makes sense if all actions are of the same kind. This is distinctly different to the higher fee rule where there is no such aggregation.

98. It is also unclear what the fee outcome is where more than one foreign person is taking an action under the same agreement. Is there a single fee payable for all actions undertaken by all foreign persons, or does each foreign person need to pay a separate fee for their own actions? The former is fairer and in line with the current higher fee rule.

Recommendations:

99. We recommend that the proposed *Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020:*

    a. deal with a situation where two or more actions of different kinds occur under the one agreement;

    b. bring across the higher fee rule under the current FIRB fee regime; and

    c. specify how to determine the fee payable where more than one person is taking an action under the same agreement.

100. Straightforward refund mechanisms be put in place for proposals that have been lodged early with FIRB but are not successful and where exemption certificate expenditure caps are not fully utilised.

101. The fees for agricultural land be tied to the business fees.

102. The calculation of fees for agricultural land be on the highest value title approach.

Schedule 3—Reinstating Monetary Thresholds

Student accommodation

103. The exemption in section 38(5) of the FATR is to be reinstated in order to again extend the monetary thresholds applicable to non-vacant commercial land to certain residential land, including land used for student accommodation premises.

104. Consistent with the pre-COVID-19 approach, to qualify for the monetary thresholds applicable to non-vacant commercial land, the premises must provide accommodation to students *in connection with an education institution that is not a school*.

105. Traditionally, student accommodation facilities were connected to specific education institutions. However, it is now common for many student accommodation facilities to cater to students generally rather than in connection with a specific university or other education institution. This is particularly the case with for-profit student accommodation facilities within the inner-city suburbs of our major capital cities. The developers of these facilities locate them within close proximity to a number of universities, TAFE colleges and private colleges and/or major public transportation hubs that provide connections to education institutions that may be further away. In most cases, the facility is independent of the education institutions whose students they accommodate.

106. We do not think there is a policy basis to distinguish between student accommodation facilities that are connected with a particular education institution and those that seek to cater to students generally.

Recommendation:

We recommend that proposed section 38(4)(5)(iii) of the FATR read as follows:

premises that provide accommodation facilities to students other than in connection with a school;

107. If the Government is concerned that the absence of a connection to an education institution will open up the potential for exploitation of the exemption in respect of premises, this can be addressed by requiring that the premises to have:

   a. been specifically developed or redeveloped to accommodate students; and/or

   b. the capacity to accommodate a minimum number of students.

Public infrastructure

108. Section 52(6) of the FATR is to be reinstated in order to again determine non-vacant commercial land that is to be the subject of a lower threshold (previously $60 million), commonly referred to as “low-threshold commercial land”.

109. Consistent with the pre-COVID-19 approach, one of the criteria for classification as low threshold commercial land is that “public infrastructure will be located on the land” (section 52(6)((c)(x) of the FATR). “Public infrastructure” is defined in section 5 of the FATR to include a system or facility that is used to provide certain services to the public – these include “the generation, transmission, distribution or supply of electricity” and “the supply of gas”.

110. In the case of both electricity and gas supply, some of the electrical wiring or gas piping on private land is owned by the relevant utility and forms part of the utility’s system for the supply of electricity or gas to the public (including the relevant occupiers of the private land). As a consequence, it is arguable that all non-vacant commercial land with electricity or gas connections will be classified as low-threshold commercial land.

111. In the case of electricity, if a grid-connected solar power system is installed on an office or other commercial building then it is arguable that the land on which the building is constructed will be classified as low threshold commercial land because the solar power system will at times be used to generate electricity for the public via a feed-in to the electricity grid. This may operate as a disincentive to the installation of solar power systems on commercial premises. In addition to solar power systems, this issue can also arise with commercial premises that accommodate bioenergy plants.

Recommendation:

112. We recommend that that proposed section 52(6)((c)(x) of the FATR be amended to exclude public infrastructure comprising:

   a. small-scale electricity generation plants (e.g. with an installed capacity of less than 5MW); and

   b. any part of a system or facility that is used to supply electricity or gas to occupiers of the relevant land or other land under common ownership, or from small-scale electricity generation plants on the land or other land under common ownership.

We note that this will be consistent with the approach to telecommunications network units which in 52(6)(viii) references services not being provided on other land.

Timing of reinstatement of pre-COVID monetary thresholds

Recommendation:

113. We encourage the Government to commit to the reinstatement of the pre-COVID monetary thresholds by 1 January 2021, consistently with the previous messaging that the Government intent is to have a smooth cross-over between the new laws and the reinstatement of the pre-COVID monetary thresholds. Investment decisions could already have been made in reliance on the previous messaging.

Schedule 5—Technical amendments

Devolution

114. It is proposed that section 29 of the FATR be amended to remove the exemption for "an acquisition of an interest in securities, assets, a trust or Australian land that is acquired by will". However, the current exemption for an acquisition by "devolution by operation of law" is to be retained.

115. We are concerned to ensure that the removal of the exemption for acquisitions by will is not interpreted as excluding the personal administrators of deceased estates (particularly executors named in wills) from being able to rely on the exemption for acquisitions by devolution by operation of law.

116. State and Territorial succession laws take different approaches to the vesting of property interests with a mix of statutory and common law applied. However, all provide for the vesting of the property interests comprising a deceased estate to its personal administrators, either on death or the grant of probate or letters of administration. Only some of the laws describe this vesting as a "devolution"[5].

117. Some Commonwealth legislation[6] uses the phrase "devolution by will or by operation of law", which could suggest that the use of the phrase "devolution by operation of law" alone would not cover devolution to executors named in wills.

118. In *O'Brien v Komesaroff*[7], the High Court of Australia considered the meaning of devolution by operation of law in the context of determining whether copyright could be said to have devolved by operation of partnership law. The Court held that it did not based on the following reasoning.

> The word "devolution" therefore contemplates a legal consequence flowing from an involuntary act. Is there any relevant difference between the passing of property upon an intestacy or a bankruptcy and the passing of property from a sole owner into partnership? There is an obvious distinction between death or bankruptcy and entry into a partnership.

119. We believe that there are strong public policy reasons for exempting acquisitions of interests in the property of a deceased estate by personal representatives (in that capacity) from the operation of the FATA. In particular:

   a. where succession laws provide for the passing of interests in property to executors immediately upon death[8], death may result in a breach of compulsory notification requirements under the FATA;

   b. in other cases, the need for FIRB clearance may delay the grant of probate or letters of administration; and

[5] *Succession Act 1981* (Qld), s 45, *Administration and Probate Act 1958* (Vic), Division 3 (heading only), *Administration and Probate Act 1935* (Tas), s 4.

[6] *Corporations Act 2001* (Cth), s 1070A, and s 1 of Sch. 4, and *Designs Act 2003* (Cth), s 10(2).

[7] (1982) 150 CLR 310.

[8] For example, in Queensland pursuant to the *Succession Act 1981* (Qld), s 45.

c. a personal administrator (in that capacity) does not have a beneficial interest in the property of a deceased estate and his or her control of such property is temporary.

Recommendation:

120. To avoid any potential uncertainty as to whether the exemption for acquisitions of interests by devolution by operation law extends to personal representatives, we recommend that the Explanatory Material include an appropriate clarification that the exemption is intended to include the vesting of interests in the property of a deceased estate upon its personal representatives.

Aquaculture land

121. There is an anomaly in the interaction between the FATA and the FATR, the result of which is that land used exclusively for an aquaculture business, and that cannot be used for any other type of primary production business, is neither agricultural land nor commercial land. Therefore, unless it can be characterised as residential land, the land is not Australian land.

122. This is because "Australian land" is defined as "agricultural land, commercial land, residential land or a mining or production tenement" under the FATA. Land that it used exclusively for an aquaculture business will not be:

   a. agricultural land, if the land could not reasonably be used for any other primary production business (s 44(13) of the FATR); or

   b. commercial land, based on the definition of commercial land excluding land "used wholly or exclusively for a primary production business" (s 4 of the FATA).

As a result, unless such land can be classified as residential land, the acquisition by a foreign person of the land would not be a significant action and notifiable action under the FATA.

Recommendation:

123. To resolve this anomaly, we recommend that the FATR be amended to provide that paragraph (a) of the definition of commercial land in section 4 of the FATA does not apply in relation to any action involving the acquisition of an interest in land that:

(a) is not residential land; and

(b) would be agricultural land but for the operation of section 44(13) of the FATR.

Section 37(1)(b) of the FATA permits the making of a regulation to this effect.