Business Council of Australia

SUBMISSION

Submission to Treasury on Major reforms to the Foreign Investment Review Framework

August 2020

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ABOUT THIS SUBMISSION

The Business Council of Australia welcomes the opportunity to make a submission to the Treasury on the exposure draft of the Foreign Investment Reform (Protecting Australia's National Security) Bill 2020. This submission reflects member views on the proposed changes and broader aspects of the investment screening framework.

KEY RECOMMENDATIONS

The Business Council recognises the need to strengthen the foreign investment framework where there are risks to national security. The challenge is to achieve this while remaining globally competitive and able to attract foreign investment. It is a balancing act which is compounded by the unprecedent global downturn induced by the COVID economic shock. The Government needs to carefully consider the extent to which the system will accelerate or unintentionally constrain recovery.

Our key recommends include:

- Streamlining the Foreign Investment Review Board (FIRB) system for non-sensitive cases by introducing a registration process, rather than substantive approval process, for non-sensitive transactions, and removing some transactions from the regulatory net altogether;
- Getting the balance right between retaining the broad, discretionary scope of what transactions are caught in FIRB's net, and the imposition of harsher penalties, robust compliance, monitoring and enforcement powers;
- Including a prescribed list (what's covered) approach to 'national security' and 'national security businesses';
- Clearly defining and narrowing the scope of a 'national security concern' for the exercise of the 'call-in' power;
- Introducing improved safeguards around the 'last resort' power;
- Retaining 30-day processing times;
- Boosting FIRB resourcing, financed by a strict fee-for-service model.

OVERVIEW

The global downturn: attracting foreign investment just got harder

Foreign investment is critical to Australia's economic success and prosperity, accounting for the creation of one in ten jobs, contributing to higher GDP, higher wages and higher tax receipts. Foreign investment introduces competition, skills, innovation, new technological and supply chain capabilities to the Australian economy, all of which are vital to the national interest.

Our companies are not investing as much as in the past. Official forecasts released as part of the July Economic and Fiscal Update suggested business investment as a share of GDP could fall to levels not even seen during the early 1990s recession. This forecast is driven by a dramatic fall in non-mining business investment – almost 20 per cent in 2020-21 alone. Even before the COVID crisis, investment, especially outside the mining sector, was relatively weak.

As we look for ways to recover from the COVID crisis, the role of foreign investment will be more crucial than ever. Nevertheless, international competition to attract global capital will be much sharper in a prolonged global downturn. With global GDP expected to contract by around 5 per cent in 2020, flows of foreign direct investment globally are expected to fall by around 40 per cent[1].

The outlook for Australia is made more precarious by the fact that Australia's traditional sources of foreign investment are dominated by markets facing the greatest COVID-induced downturns. Our key foreign investment partners–the United States and the European Union – account for around two thirds of Australia's two-way investment. The IMF forecasts that these economies will contract by around 8 per cent in 2020, close to double the global average[2]. Prior to COVID, US direct investment flows into Australia had already fallen sharply in 2019, to around $600 million after averaging $15 billion per year in the previous decade.

These factors, combined with an already higher corporate tax burden, will weigh heavily on Australia's economic competitiveness and prospects for an economic rebound.

Regulatory approach: Do no harm

The Government has committed to assisting COVID economic recovery by cutting red tape, including through the Deregulation Taskforce. The early and rapid leadership of the Government at the onset of the crisis has been commendable. This has included around 80 regulatory changes to provide greater flexibility and protections to keep businesses operating, complementing major stimulus.

Nevertheless when it comes to foreign investment, regulation has been moving in the opposite direction. In March the Treasurer introduced a temporary zero-dollar threshold for all investment proposals, and extended processing times to six months. This has drawn a significant amount of routine foreign investment transactions into the regulatory net and caused significant delays to project approvals. Not only are these transactions to remain 'caught' until the proposed reforms take effect in 2021, there is a risk that such levels of

[1] UNCTAD World Investment Report June 2020

[2] IMF World Economic Outlook Update June 2020

scrutiny and regulation live on indefinitely, albeit for 'national security' triggers rather than a zero-dollar threshold.

The problem the measures seek to solve –to address national security risks and improve compliance – should be designed in a way which is proportionate to the risk and imposes the least cost on the economy. This means considering the cumulative cost burden of regulatory changes, including other national security related reforms such as the critical infrastructure policy and obligations.

While the BCA supports the policy intent underlying the draft legislation, we see serious shortcomings in key areas where the draft legislation does not fully live up to the principles of transparency, predictability, proportionality and accountability. We also identify solutions to streamline foreign investment screening for non-sensitive transactions, such as a registration / notification system, which should be introduced as matter of good regulatory practice, or at a minimum to partly offset the regulatory cost associated with key elements of the proposed measures.

We note a clear overarching policy decision in the draft legislation to embrace a regulator model over the traditional 'gatekeeper' approach of FIRB. This is evident through stronger civil and criminal penalties, monitoring and investigative powers in line with those of other regulators, including access to premises with consent or as permitted by warrant to gather information. Yet, while the consequences of breaching the rules are more severe, the reforms retain the wide, discretionary nature of a gatekeeper system. The package should better address this imbalance –preferably retaining the gatekeeper model, or alternatively providing greater certainty on what requires screening in the first instance.

Although not considered in detail here we note that the proposed changes may engage commitments made under Australia's multilateral, regional and bilateral trade agreements, as well as impact on agreements under negotiation, notably the EU and UK FTAs. It is important that changes are consistent with our trade commitments and continue to promote investment flows with our trade partners and not encourage retaliatory measures.

COMMENT AND RECOMMENDATIONS

We offer the following comments on specific areas of the draft changes:

Definition of national security:

National security is only defined in the draft legislation for the definition of 'national security business' but not when it triggers the proposed call-in power and last resort power.

We recommend:

- The definition of national security should be defined in the main legislation and extend to all references. National security should be used consistently throughout the whole legislation. It should not have one meaning in one part of the law and different meaning elsewhere.
- Adopting a prescribed list approach which identifies investments which are covered by national security. The current Foreign Acquisitions and Takeovers Act Regulations 2015 defining 'sensitive businesses' should be retained.

Mandatory notification and definition of 'national security business':

A 'national security business' could be more narrowly and more tightly defined. This term will henceforth guide the threshold issue of whether a mandatory filing is required. The consequences of an unclear or overly complex definition are significant for both investors and the government. In particular, it creates a risk that foreign investors may inadvertently fail to notify relevant actions due to confusion and uncertainty arising from the definition. This creates a disproportionate potential to resort to the use of broader, and more controversial, call-in or last resort powers.

Scope of 'critical infrastructure'

'National security business' is defined to include entities covered by the Security of Critical Infrastructure Act 2018. That legislation currently only covers a narrowly defined set of critical electricity, gas, water and port assets.

However, the Government is currently undertaking a wide-ranging review of the critical infrastructure framework to expand that legislation to cover sectors like banking & finance, communications, data/cloud, education/research/innovation, energy, food & grocery, health, space, transport. If all these sectors are included in the definition of 'national security business', a majority of businesses in Australia could become a 'national security business'. 'National security business' needs to be a workable definition and understood by investors.

- We recommend only critical infrastructure as currently defined be included as 'national security business'. Any new critical infrastructure should be reviewed before being added to the 'national security business' mandatory filing regime.

Criticality of goods, technology or services

The concept of 'critical' vs (presumably) non-critical goods, technology or services should be more narrowly and tightly defined.

- We recommend 'critical' should be comprehensively defined, rather than included as one element under each defined sub-paragraph of 10A(2).

Intent

The reference in the definition to future intentions of a business does not appear to be useful in determining what is sensitive (e.g. 10A(2)(h) "the business provides, or *intends* to provide, critical services…"). By way of example, a company might have an intention to bid for a future defence contract with no guarantee of success in the tender. However that intention, not the awarding of a contract, could impact on a FIRB decision. It should be a matter for the Department of Defence to independently decide if it wants to award the contract to that company based on its own due diligence at that time.

- We recommend removing future intentions from the test.

Starting a national security business

It may not always be clear when a company which is already operating becomes a national security business.

- We recommend providing more guidance as to when a person starts a national security business, especially where it is a growing and developing company.

Lack of information in practice

Some of the criteria in the definition of 'national security business' will be difficult to ascertain based on publicly available information (for example, whether or not a business is a carriage service provider or has access to information with a security classification) and it will not always be possible to seek information from the counterparty, for example in a hostile takeover.

- We recommend that consideration be given to a due diligence defence in the legislation or no action guidance akin to that in Guidance Note 23 for foreign government investors where it is not reasonable for the foreign person to know that the target is a 'national security business'.

'Call-in' power:

We recognise that the intention of the call-in power is to give the Treasurer additional visibility and control over those investment proposals that are most likely to pose a national security concern *without* imposing a regulatory burden on those which are less likely to pose concerns. However the legislation does not clearly identify what may constitute a national security concern that would trigger the use of the call-in power. Some threshold triggers are far too low, including for example to 'enter or terminate a significant agreement with an Australian business'.

We are concerned that the presence of the call-in power will result in foreign investors seeking to always obtain a FIRB approval when in any doubt as to whether a FIRB approval is in fact required. This will increase costs and time delays for foreign investors in making foreign investments into Australia which may be counterproductive and an unintended consequence of the introduction of a 'call-in' power.

We recommend

- Inclusion of the proposed safeguards, including the ability to obtain certainty through voluntary notification, but that the scope of the use of call-in power be narrowed.

- The time limit be short for the exercise of the 'call-in' power.

Last resort power:

The power to re-examine a previously approved transaction is a major shift in the regime. It may lead to significant investment uncertainty for acquirers and their financiers as these triggers can relate to matters that may not be within their control and reduce the incentive for comprehensive assessment during the screening process. Similarly, it cuts across the benefits of receiving an approval if such an approval can be subsequently re-visited following completion of the relevant transaction. The perception of sovereign risk - that rules can be changed after material investment decisions are made in reliance on government approval - has the potential to create a chilling effect on foreign investment into Australia.

The introduction of the last resort power is particularly problematic in the context of a long-term capital intensive project (e.g. a large CSG / LNG plant, a large transmission pipeline, a wind farm project or coal mine) which requires a long term investment horizon and certain assumptions made at the outset of the investment to justify the proponents moving to a final investment decision. If there is an ability for FIRB to revisit conditions on a FIRB approval (having already provided an approval on a long term investment), through its last resort power, this has the potential to erode investor confidence and render a foreign investment uneconomic if inappropriate conditions are retrospectively applied by FIRB (or worse still a divestment order made prior to the foreign investor making an appropriate return on its capital outlay).

This exercise of this power requires additional safeguards, including but not limited to:

• Introducing a standard of reasonableness and knowledge for directors as to what level of ongoing monitoring is required by an investor in order to identify a future national security risk.

• Providing an opportunity for the investor to consult with FIRB in the event that 'the business, structure or organisation for the person has, or the person's activities, have, materially changed' and 'the circumstances or the market relevant to the action have materially changed'.

• Providing clarity as to what remedies are available for investors if this power is used; for example, where the Treasurer makes an order for an investor to dispose of the interest.

We welcome the inclusion of a safeguard allowing investors the ability to seek review of a Treasurer's decision that a national security risk exists. However, the review appears to be restricted to reviewing the Treasurer's decision as to whether a national security risk exists, rather than on the appropriateness or merits of any orders made or new or varied conditions imposed by the Treasurer. We query whether the Administrative Appeals Tribunal (AAT) is the appropriate forum to review a decision by the Treasurer, given the substantial scale of some investments and economic consequences flowing from exercise of the last resort power.

We recommend:

- that the ability to seek review should be expanded to cover the appropriateness of those orders and conditions;
- reconsideration of the AAT as the appropriate forum for reviewing a decision by the Treasurer, or greater clarity as to the proposed review and appeals process.

Penalties, compliance and enforcement powers:

From Gatekeeper to Regulator

As noted in the introduction, the reforms would usher in much more serious consequences for investors who are found to have breached the rules (stronger civil and criminal penalties, monitoring and investigative powers in line with those of other regulators, including access to premises with consent or as permitted by warrant to gather information). At the same time, the reforms retain in the legislation the wide, discretionary nature of a gatekeeper system.

A regulator role requires a graduated enforcement toolkit to ensure proportionate responses to breaches of conditions. It remains to be seen how these legislative changes will work in practice given the old discretionary system largely continues. This will result in an undue regulatory cost on foreign investment.

We recommend:

- Consideration should be given to the most suitable institutional design to support both decision-making on foreign investment applications and, if conditions are imposed, subsequent monitoring and enforcement of compliance.
- FIRB continues to function as a gatekeeper with greater emphasis on investment facilitation noting the importance of foreign investment into Australia.
- FIRB avoid duplicating the regulator functions of other bodies such as the ACCC, ATO or ASIC. Equally, decisions by FIRB should not be delayed because of delays in other consult agencies – such outcomes effectively vest FIRB's powers in other agencies, inconsistent with Parliament's intention. Priority instead should be attached to designing consistent domestic regulations, for example in relation to critical infrastructure and data security. This helps reduce the need to use Australia's foreign investment regime to perform such regulatory functions.

We also note the non-discriminatory approach to managing national security risks in the Government's August 2020 discussion paper on Protecting Critical Infrastructure and Systems of National Significance (which as noted will have consequences for amended FATA national security definitions). That paper outlines a regulatory approach that applies to owners and operators of relevant critical infrastructure regardless of ownership arrangements. The stated intention of an ownership-neutral approach is to create an even playing field for owners and operators and to maintain Australia's existing open investment settings.[3]

Penalties

The significant increase in the maximum amount of criminal and civil penalties and the increase in maximum jail term from three years to 10 years are severe. In addition, three tiers of infringement notices are extended to business applications, so that FIRB could more easily impose penalties without going through a court process.

Given the complexity of the foreign investment regime, confusion and inadvertent breaches are common, even for diligent foreign investors. The significant penalties may also cause company directors to be more risk adverse and impact on their willingness to invest in Australia.

We recommend:

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[3] https://www.homeaffairs.gov.au/reports-and-pubs/files/protecting-critical-infrastructure-systems-consultation-paper.pdf

- Severity of penalties be reduced and made proportionate with wide scope of potential breaches, in particular:
    - Penalties for misleading statements or omissions should also be limited to circumstances where the applicant knew or could reasonably have known that those statements or omissions were misleading in the circumstances of the acquisition. This is particularly the case given the uncertain application of the national interest and national security tests. The matters that could be material to the Treasurer's consideration will often be unknown to the applicant.
    - The reforms should make clear that the misleading information or omission should relate to the statement given to the Treasurer, rather than the national interest or national security factors considered by the Treasurer.
- Material changes to the existing foreign investment regime need to be carefully messaged so as not to deter the large number of law-abiding foreign investors providing much needed investment capital into Australia.

Extension of decision-making period to 90-days:

Allowing the Treasurer to extend the statutory decision period to 90 days may undermine Australia's attractiveness to foreign investors. A period of 90 days is lengthy in the context of time-sensitive transactions: major investments usually involve merger and acquisition project teams, as well as project implementation teams, which are established and funded in advance of a FIRB application. These project teams continue to operate during the decision-making period to ensure that the implementation can commence rapidly, and begin to generate a return, upon FIRB approval. Costs incurred during a prolonged FIRB decision-making period can be considerable and delay investments that are critical to protecting Australian jobs and economic recovery. Delays may also unfairly prejudice the interests of companies participating in competitive processes.

We recommend:

- a 30 day decision statutory period, supported by an adequately resourced FIRB secretariat on a cost-recovery fee for service model.

Additional BCA proposals to help streamline regulatory process:

Should the call-in and last-resort powers be introduced, the government will have new powers to review investments once established. Under the new framework there would be a strong case to ease the level of 'front door' screening of investments by simplifying and / or removing certain transactions from the system.

Under the current system, and especially under the temporary COVID-related FIRB $0 threshold measures, many non-sensitive transactions are unnecessarily caught in the system as illustrated by the following examples from members:

Example 1: Renegotiating a lease? Need to ask FIRB

One member is in the process of relocating a warehouse. The member is concerned that due to their foreign ownership they will now need to go through FIRB approval. It is possible the landlord will take a different tenant to avoid the risk of delay.

Example 2: Australian super funds become incidental foreigners

Australian superannuation funds that channel investments through a US investment vehicle require FIRB approval, even though they are substantively Australian investments (i.e. Australian investors that are investing in Australian businesses).

Example 3: Bolt-on / Follow-on transactions

A range of low value 'bolt-on' type acquisitions require FIRB. Because of the volatile nature of the current economic environment, low value / routine transactions cannot afford to be delayed.

Example 4: Capital injections, better ask FIRB?

Members are confused as to whether notification is required for a foreign parent company to provide a capital injection into its 100% owned subsidiary for issue of further shares in the subsidiary. Members hope that FIRB would exempt such a transaction, as the purpose of capital injections is to provide working capital to Australian subsidiaries or to ease a debt burden by conversion of debt to equity.

Example 5: Corporate re-organisations, join the FIRB queue?

Members are confused as to whether notification is required for any corporate re-organisations where ultimate ownership is unchanged and where there is no foreign government investor within the structure. This goes to companies having flexibility to restructure their affairs.

Example 6: Private equity investors and leases, need to ask FIRB

Australian managed private equity firms are now getting caught because their investors are foreign investors, which means that when their portfolio companies need to renegotiate a lease due to the current downturn, FIRB approval is required.

Example 7: Establishment of new entities

The introduction of the $0 threshold has meant that the establishment by a foreign person of a wholly-owned subsidiary in Australia becomes a notifiable action. The concern is that the establishment of a wholly owned subsidiary does not result in national interest concerns and therefore, should not trigger a FIRB approval requirement.

Streamlining

These problem transactions would be resolved through a streamlining of the current system into one of the two following categories:

Registration only processes

We recommend that the Government consider introducing a registration process, rather than substantive approval, for non-sensitive transactions. This approach would not extinguish the Treasurer's powers but would avoid the need for routine upfront screening. Data acquired through a registration process would improve visibility of actual acquisitions. Registration filings for non-sensitive transactions can be made in a simpler form than the full application prepared for notifiable actions and notifiable national security actions. Such non-sensitive transactions could include, but not limited to:

- buy-backs;
- Australian entities that have no Australian assets;

- small land acquisitions that are incidental to land already approved;
- commercial property leases;
- bolt on transactions; and
- existing shareholders making creep investments within certain parameters.

Removing routine non-sensitive transactions completely

Certain non-sensitive transactions could be removed entirely from the foreign investment system. These could include:

- internal corporate restructures of foreign persons where the ultimate beneficial ownership remains unchanged. Any tax concerns arising from internal restructures for foreign entities should be regulated through the usual tax system on a non-discriminatory basis with domestic entities, rather than through the foreign investment system;
- initial or further capitalisation of wholly-owned subsidiaries by foreign persons where there is no new acquisition or new business created and the foreign person is simply contributing further working capital to an existing business owned through a wholly-owned subsidiary.

Other systemic issues to be addressed when implementing these legislative changes:

- We recommend that, should the legislation be implemented without tightly defined scope and limits, as a second-best option that:
    - the Government to provide more clarity in the legislative materials and guidance notes on how the new national security powers would be administered;
    - the Government encouraged investors to seek early advice and clarification from FIRB to determine whether their proposal requires approval on a case by case basis, whether as a mandatory or voluntary filing. Institutionalising a more formal channel for such pre-application consultation, and allocating sufficient resources to do so, would aid implementation of the new law by reducing the number of nuisance lodgements given investors are likely to take a more conservative interpretation in the absence of guidance.

We further recommend:

- improved transparency on all FIRB approvals through frequent (monthly) publication of processing times and other KPIs. Experience of foreign investors shows that, especially during the current $0 threshold period during COVID pandemic, a high degree of difficulty to plan, consider and make decisions in relation to activities which may be or are subject to FIRB approval.
- improvement of processing times through substantially increased resourcing of FIRB's secretariat as well as resourcing the agencies necessary for decision-making consultations.
- FIRB fee revenue be dedicated entirely to the proper resourcing of FIRB and consulted agencies where they impact on decisions. We note the Productivity Commission's recommendation in its June 2020 "Foreign Investment in Australia" research paper that

the Government should set application fees for foreign investment proposals at the level that recovers the costs of administration.

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