13 August 2020

Manager
Policy Framework Unit
Treasury
Langton Crescent
PARKES ACT 2600

BY EMAIL – FIRBStakeholders@treasury.gov.au

Dear Sir/Madam

MAJOR REFORMS TO THE FOREIGN INVESTMENT REVIEW FRAMEWORK

Thank you for the opportunity to make submissions on the published exposure draft of the *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020*. The writer supports the measures in the Bill but believes more can and should be done.

The writer has practised in leading commercial law firms in Sydney for more than 30 years, including on foreign investment transactions and matters, big and small. The writer has previously made submissions on foreign investment law reform, including on the regulation of foreign investment in and establishing a register of interests in agricultural land and water rights.

The *Foreign Acquisitions and Takeovers Act 1975* (the **Act**), both in its present form and as it would be amended should the Bill be enacted in the form of the exposure draft, is principally concerned with ownership, direct and indirect. Except in its concern with such ownership and some arrangements in relation to land, the Act is not concerned with wider effective economic power nor returns exerted by or to be gained by foreign persons. Both economic power and returns may be exerted and gained through moneys advanced as debt, either alone or in conjunction with equity interests that may be characterised as ownership. Both debt and equity are widely used for the funding of Australian businesses, companies and concerns and both debt and equity are widely used to acquire or fund the acquisition of Australian assets, businesses, land, agricultural land and water rights. Economic power and returns can also be derived from contractual relations struck between an Australian entity and a foreign person.

It is an unfortunate element of Australia's current foreign investment review framework that debt funding can be used to side step our Foreign Investment Review Board (**FIRB**). This simple expedient is, we understand, readily and widely used. By the simple expedient of a foreign person lending moneys to an Australian company that is not itself a foreign person the Act is side stepped. The foreign person could be a foreign government, a sovereign wealth fund, a venture fund, a hedge fund or a private equity fund, junk bond holders or a trustee for them, a banker, a related body corporate, some other foreign company or entity or another form of lender.

Sovereign wealth funds, venture funds, hedge funds or private equity funds will often advance a mix of debt and equity to optimise, as best they can and as much as they are allowed, their "investment" into

a given Australian entity to give the best after-tax return. But on what justifiable basis should only the "equity piece" be subject to Australian government foreign investment review but the "debt piece" not? The "debt piece" is not unimportant to the funder and is heightened in economic importance and legal and economic strength and leverage when and if the debt funded recipient is placed in receivership, voluntary administration or liquidation: the recipient's future will in such a failing entity context be determined not by its shareholders but by its creditors – Virgin Australia, Australia's second largest airline, is a significant present case in point. Other significant cases exist and will, one would anticipate, in a stretched COVID-19 and a post COVID-19 environment. A debt funding extension to FIRB review could see with it an extension to the concepts of voting power and potential voting power in s22 of the Act.

The historic distinction between a lender to a company, such as a bank, and an owner of a company, typically a shareholder, has now long gone. Like broadcasters and internet companies, convergence is here and active now. Foreign funders of Australian entities will devise not only complex hybrid instruments but debt and equity packages to fund or "invest in" Australian entities. In doing so, foreign funders will not consider or advance the "debt piece" separately from the "equity piece" – both pieces are part of, and are assessed, advanced and managed as, one and the same investment.

Our submission is that for FIRB review there should no longer be a hard debt and equity distinction: both foreign lenders and foreign owners should be subject to FIRB review and foreign persons who are both lenders to and owners of Australian entities should be dealt with in a sensible composite way that recognises the totality of their structured "investment" package. Such structuring is not the exception; it is the rule, and often structured in a way to optimise returns to the foreign "investor" after (and minimising) Australian tax. Though some profit sharing and other arrangements in relation to land are already covered by the Act (s12(1)(a), (c), (d) and (e)), so too should contractual relationships providing returns to foreign persons be covered generally by the Act. The Commonwealth has in respect of withholding tax legislated to cover returns on debt, equity and contracts. It would seem to us sensible and achievable for the Commonwealth to legislatively cast the same net and review when it comes to FIRB review at the time the foreign person makes a debt, equity or contractual "investment" and to review the investment proposal on these fronts as a package.

Such an extension of the FIRB net will require further "major reforms" but those reforms are, in the writer's view, necessary. If FIRB review can simply be side-stepped by structuring funding as debt or a contractual return rather than equity, be it where hundreds of millions of dollars and more are involved or simply to fund an Australian to purchase residential real property, agricultural land or water entitlements, what adequate review and protection do and would we have?

Yours sincerely

Daren Armstrong
Partner
T 02 9266 3429
armstrong@bhf.com.au