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ECONOMICS REFERENCES COMMITTEE

Reference: Foreign investment by state owned entities

MONDAY, 22 JUNE 2009

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**SENATE ECONOMICS
REFERENCES COMMITTEE**

Monday, 22 June 2009

Members: Senator Eggleston (*Chair*), Senator Hurley (*Deputy Chair*), Senators Bushby, Joyce, Pratt and Xenophon

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Mark Bishop, Joyce, Eggleston, Hurley, Pratt and Xenophon

Terms of reference for the inquiry:

To inquire into and report on:

- a. the international experience of sovereign wealth funds and state-owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact and outcomes of such acquisitions on business growth and competition; and
- b. the Australian experience of foreign investment by sovereign wealth funds and state-owned companies in the context of Australia's foreign investment arrangements.

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Committee met at 8.25 pm

CHAIR (Senator Eggleston)—I declare open this public hearing of the Senate Standing Committee on Economics for its inquiry into foreign investment by state owned entities. On 18 March 2009, the Senate referred this matter to the committee to report by 17 June 2009. The Senate has since extended the reporting date for the inquiry until 17 September 2009.

The reference seeks to explore: (a) the international experience of sovereign wealth funds and state owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact and outcomes of such acquisitions on business growth and competition; and (b) the Australian experience of foreign investment by sovereign wealth funds and state owned companies in the context of Australia's foreign investment arrangements.

These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind the witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness should state the ground upon which the objection is taken, and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may also be made at any other time.

I remind members of the committee that the Senate has resolved that departmental officers shall not be asked to give opinions on matters of policy, and shall be given reasonable opportunity to refer questions to superior officers or to a minister. This resolution prohibits only asking for opinions on matters of policy, and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[8.28 pm]

COLMER, Mr Patrick, General Manager, Foreign Investment and Trade Policy Division, Treasury

ROSSER, Mr Michael John, Manager, Investment Review Unit, Foreign Investment and Trade Policy Division, Treasury

CHAIR—I welcome officers from the Department of the Treasury and the Foreign Investment Review Board. Do you wish to make an opening statement?

Mr Colmer—No, I do not wish to make an opening statement. I am more than happy to deal with questions that you may have.

CHAIR—Thank you. I will ask you an opening question. Can you tell us something about the scale of foreign investment in Australia—where it comes from, who the largest investors are, who the smallest investors are and what the spectrum is?

Mr Colmer—I can tell you something about that, but before I do I would like to just sound a couple of notes of caution. The information that we have from the foreign investment system is data on proposed investment, and in that sense it is very different from the formal data on actual investment which comes from the ABS. I cannot emphasise that too strongly, because it looks very different. The reason for that is, as I said, first of all, that it is proposed investment and often it does not proceed after we have approved it. It may be that the deals fail at a commercial level. It may be that we have approved—I should not use that word because we do not approve; we ‘do not object’ rather than ‘approve’—or rather it may be that we have dealt with competing cases for the same target. That is quite a common occurrence.

The other thing I would say is that when we compile our data we do not actually disaggregate what might be a proportion of investment coming into Australia when the target is a multinational enterprise. I guess the classic case of that would be the Chinalco investment into Rio Tinto at the start of the year—which we counted as \$19 billion although in reality most of that actually went to the UK arm of Rio rather than the Australian part. So there are some issues around what we count and how we count it.

Having said that, we pulled out some figures for you which are for the current financial year—so they are incomplete figures. Again, they have not been validated because we will not do that process until the end of the year so they are I guess illustrative figures rather than definitive figures. For the current financial year as at today, we have had a total so far of \$259 billion worth of proposed investments. Of that, \$23 billion or so is in the real estate sector. So that comes out to something in the order of \$230 billion of proposed investment in industry.

The No. 1 investor, as I think pretty much always it has been in recent times, is the United States—followed by the United Kingdom. This year, for the first time, China comes in at No. 3. Last financial year China was at No. 6 in the overall total. We should just be careful with using those figures because they are only illustrative at this stage.

CHAIR—That is interesting. So China's level of investment is, say, greater than that of Japan, the Netherlands, Germany, France and Singapore?

Mr Rosser—There are a couple of caveats on that. In relation to China that includes the Rio Tinto acquisition—

CHAIR—Which has not happened?

Mr Rosser—No, this was the original one in August. So obviously that is a one-off large investment lump. A number of other ones in the figures that Mr Colmer cited have a particular relevance probably only to this year, because the global financial crisis has resulted in a number of financial institutions having injections of capital by their home government and each of those, as it comes to us, is treated as a foreign investment application. Therefore the relevant amount of investment, as in the Australian acquisition, if you like, is captured in our figures. So we probably have a large one-off figure which will be unwound over future years as the governments exit those investments.

CHAIR—Over the years we have had a lot of foreign investment in Australia, particularly, as we have heard, in the minerals industry. I suppose the biggest investors in the early part of the last century were certainly the British and the Americans. In the sixties, seventies and eighties there was a lot of Japanese and Korean investment in Australia. Now there is an increased incidence of Chinese investment. Would you make any comparisons between the Japanese investment of the sixties, seventies and eighties and the Chinese investment which is occurring today? Are there any differences or any similarities?

Mr Colmer—I guess the similarity is that both the Chinese and the Japanese and Koreans were looking for resource security. I think that is an undeniable similarity. I think probably the major difference is the structure of the Chinese economy and the Chinese state. That is certainly a very big difference, but at different times some of those other national economies have had less formal means of organising their industry that may have produced not dissimilar results—so, for example, the Japanese system through the seventies and eighties was not the formal state control that we see in China but some of the results may not have been that different.

The other point I would make is that the policy has changed since the early nineties, which was after most of the major Japanese investment came into the country. Up until 1993 there was a rule that required 50 per cent Australian equity in resource projects unless it could be demonstrated that that was not available. That rule no longer holds. So we are seeing more Chinese proposals to take stakes which are larger than 50 per cent—and at times 100 per cent stakes.

CHAIR—Wasn't foreign investment in Japan covered by the ministry which was concerned with foreign investment? Was it MIMI?

Mr Colmer—That is before my time in the field.

CHAIR—It is before my time too, but I have read about it.

Mr Rosser—I think it was MITI.

Mr Colmer—Yes, I think it was MITI.

CHAIR—In other words, what I am trying to suggest is that Japanese investment to some degree was influenced by the Japanese government—even though this was from private enterprise companies. Is that a possible comparison to draw?

Mr Colmer—I think that is true up to a point. I guess they are two very interesting sides of the one coin. The Japanese system was less formal than the Chinese system but the outcomes may not be dissimilar. While there is a much greater formal link between a Chinese company and the Chinese government, what we see, by and large, is a fair degree of overt commercial behaviour on the part of the Chinese companies seeking to invest in Australia. They certainly believe that they are very competitive with each other. We certainly see that they are trying to understand western business processes and they do have a strong commercial orientation.

CHAIR—Back in the sixties, seventies and eighties though, because of the rule about the percentage of foreign ownership, the Japanese companies could not have had a controlling interest in a resource company in Australia—was that the case?

Mr Colmer—Most of the Japanese investments were less than 50 per cent holdings. But that rule tended to crumble away as Australian equity became harder to come by with the greater expansion, I think, of the sector as much as anything else. The situation that we find ourselves in now is that there are very high levels of foreign ownership across the board in the resources industry. Indeed BHP under our laws is a foreign corporation—as is Rio Tinto. Both of those companies have fairly high levels of foreign ownership. I think in the case of Rio Tinto it is probably around the 80 per cent mark, and in BHP it is somewhere between 50 and 60 per cent I believe.

CHAIR—I have an article here from the *Financial Review* of 15 May this year which suggests that it should be noted that BHP's share register is more than three-quarters foreign owned. That is a big percentage. Do you think foreign investment has been driven by the fact that there was not a great deal of Australian capital available for this sort of investment—domestic capital?

Mr Colmer—I think foreign investment generally is driven by a lack of domestic capital. I think though that the resources sector is a bit different from that. Australia has some first-class international resources that certainly are attractive as resource projects. On top of that, Australia is generally considered to be a good destination for foreign investment because we have such a strong legal system, investors' rights are protected and we have good political stability and good infrastructure. So the risk for a foreign investment into Australia is much less than it is in many other parts of the world.

Senator PRATT—One of the issues that strikes me from what the chair has asked is the kinds of investments that national governments might have an interest which both China and Japan might have in common—that is, strategic resources and energy assets versus I suppose the other kinds of foreign investments that have a much greater diversity but that might not have the same national strategic importance. Is that too much of a generalist statement or are there some elements of truth to it?

Mr Colmer—We have seen a lot of government related investment in Australia. As Mr Rosser said just before we have seen an awful lot more in the last 12 months as a result of foreign governments taking control of their financial institutions.

Senator PRATT—It is a very common practice these days.

Mr Colmer—As someone said to me recently—and I do not know whether this is true but it very well could be—the biggest state owned enterprise in the world now is General Motors. I suspect it is true. I have not actually tested that. Major banks are now owned by their home governments. We have seen a variety of other investments in Australia and while resources are probably the major ones for the Chinese, they are not the only ones. The Chinese have made some other investments into the financial sector and some of the chemical industries. We have seen, for example, Canadian investments into the media sector where there is a sovereign wealth fund interest there. We have seen a number, recently, of French related interests in the public transport area. We have seen French interests in defence industries. So there are a variety of foreign governments with a variety of interests in different Australian industries.

Senator PRATT—I actually have a list of questions I would like to ask, but I am required in the chamber to go and give a speech. I might reflect on the *Hansard* and ask you specifically what the trends are around foreign investment by sovereign wealth funds and state owned enterprises internationally generally.

Senator JOYCE—Chair, on an ETS I can run down and give the speech for her, if you like?

Senator PRATT—I do not think so, Barnaby. Not tonight.

CHAIR—I think that is a very kind offer, Senator Pratt.

Senator PRATT—It is a very kind offer, but I think we have rather different positions on this.

CHAIR—Senator Pratt, this is a question of some debate. Do you want to put those questions on notice? This session will not last for too much longer.

Senator PRATT—No, I am comfortable if that is the case.

Senator JOYCE—I want to go through a few things. First of all, in the Foreign Investment Review Board, what do you see as your goal for Australia? In the deliberations and the representations you give to the Treasurer what is the paradigm for what you see is good for Australia? How do you define that?

Mr Colmer—I think we start off by saying that foreign investment is good for Australia. Foreign investment has been a major component of the Australian economy for many years, probably since first settlement. The way that the legislation is set up is that the default position is that the investment is allowed to proceed. The legislation is set up so that it is clearly the exception rather than the rule to intervene in an investment case. What the legislation does is provide an opportunity for the Treasurer, as the responsible minister, to raise objections if a proposal is considered to be against the national interest.

Senator JOYCE—When is a foreign investment bad for Australia?

Mr Colmer—That is a question which I think varies over time. If you look back at the cases that we have rejected, you can see that we have not rejected outright very many at all. In fact our best information is that 16 cases have been rejected since 1990. That is out of something in the order of, on average, about 500 business cases a year. We have had a different pattern in real estate but I have not actually been talking about that. The predominant reason for rejecting those cases has been to do with various forms of criminality on the part of the proposer. There is also the Shell-Woodside case where the decision was taken back in 2001 that Shell was not going to develop that resource; and the decision was taken at the time that the national interest was best served by developing that resource much more quickly than Shell was expected to do it.

Senator JOYCE—Just briefly, was that Woodside decision a decision of rejection by the Treasurer?

Mr Colmer—That is right.

Senator JOYCE—What do you see as the national interest?

Mr Colmer—As I said, the national interest is first and foremost to get an orderly foreign investment system. But if you look at what elements might make up a national interest concern, then I think you cannot do better than to go back to the Treasurer's statement of February last year where he announced the principles for foreign government investments. As I am sure you are aware, there were six principles that were laid out there—only one of which is specifically relevant to state owned enterprises. The other five are considerations that we take into account on any proposal. They are things like competition impacts, the taxation implications, national security considerations, the impact on other Australian businesses and how well a company can be expected to operate within the Australian system.

Senator JOYCE—Referring back to my previous life, in tax we have the related entity test. If something is substantially controlled or owned by another entity then it is deemed to be the one entity for assessment under the tax act, to stop people sneaking around. Do you take into account the related entity test?

Mr Colmer—We have an associate provision in the legislation which allows us to take into account those sorts of issues, yes.

Senator JOYCE—So you would have to see such things as sovereign wealth funds and state owned entities of China as all one, as far as the tax act and the test you apply to them are concerned, because the Chinese government is strongly interrelated with them. Interrelationship, ownership—they all seem to tick off, suggesting they are related entities.

Mr Colmer—I cannot comment about the tax act definitions, but they are not considered as all one related entity in the terms of the Foreign Acquisitions and Takeovers Act.

Senator JOYCE—What is your definition of real estate? With foreign entities and the purchase of real estate, there is a certain limit and they have to go to you for assessment.

Mr Colmer—We have not spoken about real estate at all so far tonight. The basic legislation sets out a requirement for all foreign acquisitions of residential real estate to be notified. However, over the 20 or so years that that system has been in place, there have been a number of exemptions provided from that. The latest lot were done earlier this year, and new regulations were brought in in about April, I think. In terms of residential real estate, though, we expect all nonresidents acquiring residential real estate to notify. Under the foreign investment policy, nonresidents are generally prohibited from buying established real estate and can only buy new real estate.

Senator JOYCE—Why is rural land outside this?

Mr Colmer—The actual act specifically exempts primary production land from being classified as real estate under the act. It is exempted and has been, I assume, since the late eighties, when the real estate provisions were brought in.

Mr Rosser—The act applies to land that is not being currently used for a primary production purpose. So what is called ‘urban land’ in the legislation is in fact all land in Australia that is not actively being farmed, apart from exemptions for specific types.

Senator JOYCE—One of the things that is cast towards us over and over again—and I think you have already touched on it—is that the conditions under which the Japanese could invest back in the seventies are the same as the conditions now and that we had no complaints then, so we should not have any complaints now. But that is not actually the case, is it? There is a difference between the conditions that the Japanese were assessed under and the conditions now.

Mr Colmer—The major change was the 50 per cent equity rule for resource projects, which was removed in 1993.

Senator JOYCE—You were saying you look to criminality in the assessment of foreign corporate interests. Does that get complicated if there is a sense of what we would deem to be criminality in the actions of a government?

Mr Colmer—We do make a distinction between the entity and the government, as a general rule. There may be the very occasional case where a government itself is making a direct investment, but that would be very rare. I do not think I can recall any. What typically happens is that government related investments are made through a separate entity.

Senator JOYCE—If, for instance, Zimbabwe wanted to buy—and they could not—a mine in Queensland, would the actions of the Zimbabwean government have anything to do with the assessment of the process?

Mr Colmer—Off the top of my head, I am not entirely clear on our sanctions regime against Zimbabwe, but I do not think that is what you are asking about. We do have a regime of sanctions against Zimbabwe and members of the Zimbabwean government. I take it that is not what you were going to; you were trying to ask a hypothetical question of how we would differentiate between an entity and a government.

Senator JOYCE—Yes. Let us make up a name for a place: Zimrwandantarctica. Zimrwandantarctica has done something that is quite obviously criminal or is an action that fair-minded people across the world say is beyond the pale. Does that become one of the instruments of assessment for the Foreign Investment Review Board or do they have to put that aside and say, ‘That is irrelevant for the purposes of assessment’?

Mr Colmer—It would only be relevant for the purposes of the assessment, I think, if that government—I will just say the ‘antarctican’ government; I cannot remember what the rest of it was—

Senator JOYCE—Zimrwandantarctica.

Mr Colmer—You must use that other in other circumstances! If the ‘antarctican’ government was a separate entity from the ‘antarctica mining company’, we would have to look at that and then try and make a judgment based on what was the actual relationship between the government and the company. I guess, though, that when you talk about the actions of government and criminality you are getting into—

Senator JOYCE—Diplomatic area.

Mr Colmer—You are getting into a diplomatic area but you are also potentially getting into a highly political area. For example, there are people who have taken very different positions about some of the major conflicts in the world. Some of them would say that some governments have acted criminally in Vietnam, Iraq or whatever; other people would say no. So it is not a clear-cut case, I do not think, if you are trying to go to the issue of criminality in governments.

Senator JOYCE—It is very sensitive. You would have to say it would make life very difficult for Australia because all of a sudden how you deal with it becomes extremely sensitive. Would that be correct? As opposed to a corporate entity, where you just say—

Mr Colmer—As opposed to a corporate entity, there are going to be a whole lot of different considerations.

Senator JOYCE—Sensitivities.

Mr Colmer—But I think it is probably largely something that we are not going to see because, as I said, we see very few—in fact, outside of real estate I cannot think of any cases where I have ever seen a direct investment by a government without some separate entity interposed.

Senator JOYCE—Do you take into account the reality of court structures, the transparency of government and how the judicial principle operates in the country that is the source of the investment to be invested here, or do we just say that also something that is not for consideration under FIRB guidelines?

Mr Colmer—I think it is fair to say that our major concern is any information that sheds light on how we can expect an investor to operate in this country. It is important to recognise that an investor in this country will be subject to the industrial law, to the environmental law, to the

health and safety law. All the Australian laws apply equally to a foreign investor once they are established in the country as they do to any other company operating in this country. As I said, our major concern would be anything that sheds light onto whether or not we can reasonably expect problems with the way they would behave inside Australia, so we would be looking very closely at any evidence that they had acted outside of the law elsewhere.

Senator JOYCE—So, if they acted badly elsewhere, that would be an element of consideration in how they might possibly work inside Australia?

Mr Colmer—It may be, yes. That is the sort of thing that we would be looking to try and understand.

Senator JOYCE—What about the issue of reciprocity? Do you say, ‘Okay, we’re going to give this country an avenue to generate wealth in our country, therefore we should be allowed the same or approximate avenue of generating wealth in their country; and, therefore, if they don’t let us buy that, we shouldn’t let them buy this, because otherwise it becomes a one-way street’?

Mr Colmer—No, we do not.

Senator JOYCE—If it is good for Australia to allow unencumbered investment, why would other countries think differently?

Mr Colmer—Most other countries do not think that way. Most other countries do not base their investment policies on reciprocity. Most countries base their investment policies on what they see as a good result for their country. In investment, certainly, in the OECD, reciprocity is not considered to be a useful way to go. I think, though, that if you look more generally, for example, if you look at Australia’s history with tariff reform over the last 20 or so years, that was all done on a unilateral basis. There is a lot of evidence to suggest that reciprocity does not really do much apart from make the system much more complicated and probably does not actually provide good results.

Senator JOYCE—If you have got a vertically integrated entity, how do you discern when they are not acting in Australia’s interests, through mechanisms such as transfer pricing—if they just say, ‘Well, if you’ve got a problem with us, deal with it via our ambassador’?

Mr Colmer—If you are talking about transfer pricing—that was the example—that is fundamentally a matter for the tax office, and I do not think anybody would dream of expecting a tax officer to deal with an ambassador. They would deal with the company direct. The reality of having an entity making an investment in Australia means that that entity is subject to Australian law, and Australian law does not say, ‘Go see the ambassador.’

Senator JOYCE—But we referred earlier on to the sensitivities that were obviously in place in the assessment process and how we deal with them and the actions of countries overseas. Surely, this just becomes another extension of those sensitivities? People do not become less sensitive on another issue. Ultimately, people work to their commercial advantage, and if they can push the envelope they will, and one of the items they would consider would be ‘I’m stronger than you are, so don’t push me too hard’.

Mr Colmer—Well, possibly. We have no evidence to suggest that that is happening. If you have any evidence to suggest that that is actually happening, we would be more than interested in seeing it.

Senator JOYCE—Are there boards equivalent to the Foreign Investment Review Board in other countries, such as India, China or the United States?

Mr Colmer—Yes and no. The United States has a system called the Committee on Foreign Investment in the United States, generally referred to as CFIUS, and that is similar to the foreign investment process that we run. I would say, though, that our system is much more interventionist than the United States system, and in the OECD in this area we are ranked 35 out of 41, as being the 35th least restrictive—get your head around that! It is difficult; I don't know which way to count on that—

Senator JOYCE—Who is the most restrictive?

Mr Colmer—The most restrictive is either China, India or Russia, but I am not sure which one.

Senator JOYCE—China, India or Russia—they are all up the top there somewhere?

Mr Colmer—They are down at 41. We are at the bottom.

Senator JOYCE—I know, but the most restrictive on investment are China, India and Russia?

Mr Colmer—Yes, I think that is right, from memory. And the least restrictive are typically the European countries. I think maybe Iceland might be No. 1, but I have not looked at the ranking for a while. The UK is up in the top five.

Senator JOYCE—The problem at the moment, of course, is that Iceland is broke, Ireland is broke and Britain is making its very best attempt at going broke. Would these be good indicators of how you should operate?

Mr Colmer—I am not sure whether or not you can relate their economic situation totally to their investment regime. I think there are probably a wide range of other factors that are in play.

Senator HURLEY—You are just relying on the last 18 months out of many decades of prosperity.

Senator JOYCE—What are the great sensitivities of Russia? In what section of its economy has it got immense sensitivity about where people invest?

Mr Colmer—I am not terribly familiar with the Russian investment system, except that I do know that it is one of the more restrictive ones. We are probably better compared to places like Canada, New Zealand and the US, who all have—in a very general sense—a similar system to ours. There are quite different arrangements at the detailed level, but they are generally similar types of systems.

Senator JOYCE—With the OZ Minerals-Minmetals approval, they now have the capacity of 100 per cent ownership of what was formerly Century Zinc and every other mine except Prominent Hill. That is correct, isn't it?

Mr Colmer—There were a few other little bits that were kept out of the deals.

Senator JOYCE—There was one in Indonesia, which is really nothing to us.

Mr Colmer—OZ Minerals have a few exploring-type assets as well as Prominent Hill, I think. I am not sure of that.

Senator JOYCE—Does it create problems for us that we have created a situation where 100 per cent ownership by a foreign state-owned entity is okay? Does that create a precedent which is a problem if we ever want to reject anybody who wants less than 100 per cent ownership?

Mr Colmer—I do not believe it does. I think we have taken great pains to explain to foreign investors that we do look at cases on an individual case-by-case basis. We have also taken considerable efforts to explain our preference for small stakes in large producers and various partnership and joint venture-type arrangements—in the order of 50 per cent in smaller players. But we do look at things on a case-by-case basis.

Senator JOYCE—In the assessment of the Rio-Chinalco deal, they talked about 18 per cent, but in some instances that was 50 per cent of some strategic assets. Was that the case?

Mr Colmer—That is right.

Senator JOYCE—Say there is a manipulation of the process and they had—hypothetically, because it is not going forward there, so we can talk about it—cut their ownership down to 15 per cent but still had 50 per cent ownership of certain strategic assets. Would they have been exempt from the Foreign Investment Review Board guidelines?

Mr Colmer—That is a very difficult question to answer without actually seeing the detail of a transaction that is proposed. At the end of the day, whether the act applies is a question of law and it does depend on a whole range of issues. I think that, if you look back at the Qantas arrangement, you can see that that was a situation where there were problems in the application of the act and it seemed to be explicitly structured to avoid the operations of the act. Just as with tax law, it is possible to structure arrangements so that the act does not apply.

Senator JOYCE—The Qantas one is interesting because Allco was in play there and Allco went broke. We would not have an airline now if the deal had gone forward. Do people will take into account the proportion of ownership? Even though you might have only a 15 per cent interest, you may be, through structuring, by far and away the most influential shareholder in an organisation. You might have the capacity to influence, not explicitly but implicitly, the other directors on the board and the directions of the board because of your strategic share ownership.

Mr Colmer—The way that the legislation is written says that a 15 per cent interest in either the issued shares or the voting power of the company is the trigger. That is the way that the law is written. That is the way it has been since 1975. Yes, it is possible to construct a proposal that

may not trigger that. It is one of the reasons why the government announced that we would be looking at a legislative fix on that.

Mr Rosser—The act also applies to arrangements that go to the governance of the company. So if there are arrangements or agreements in place that would give somebody control, notwithstanding that they might not have 15 per cent of the voting rights or the shares, then the act potentially has the capacity to deal with that as well.

Senator JOYCE—So you can look into it and say, ‘This person has the capacity to influence people in a way that might be not explicit but implicit. They have the capacity to influence where everything is going.’ As we all know, there are a lot of people who control companies who never own 50 per cent of them.

Mr Rosser—It also has the ability to look at separate entities that have a degree of association or are acting in a concerted way, so two people owning 14.9 per cent could be considered to be able to exercise control. The act also applies to entities where the ownership of the company is at 40 per cent. So, where a new foreign person becomes one of the 40 per cent holders, the act can apply to that as well.

Senator JOYCE—Is there any belief in a limit to foreign ownership in Australia before it actually works to the detriment of Australia? Take, for instance, mineral wealth. If it were 90 per cent owned by foreign entities, would that be to the detriment of Australia or is there no concern about that? Could it be 100 per cent owned by foreign interests without the consent of the Foreign Investment Review Board? Is there any tipping point of ownership which rings bells?

Mr Colmer—I do not think that is in any way a simple question. Before you could possibly contemplate an answer to it, you would have to ask a whole series of questions about the rest of our legal framework, such as the taxation system, the royalty system, environmental management and similar sorts of things, before you could even come to any conclusion as to whether or not there was a point and what it might be.

Mr Rosser—There is another element too. The resources in question might not be developed or at least not developed as quickly without foreign investment. So you could have a situation where a particular resource is being developed and that is contributing to the nation but at that particular time it is owned by foreigners.

Senator JOYCE—So the benefit to us is purely royalties.

Mr Rosser—Royalties, taxation, employment, jobs—all of those things.

Mr Colmer—Regional development.

Mr Rosser—It is hard to analyse it without thinking about what would happen if the investment were not present.

Senator JOYCE—Thank you.

CHAIR—We thank you for appearing, and thank you for your briefing.

Mr Colmer—Thank you.

[9.14 pm]

GRIMWADE, Mr Tim, Executive General Manager, Mergers and Acquisitions Group, Australian Competition and Consumer Commission

BORDIGNON, Mr Stephen, Assistant Director, Transport and General Price Oversight, Australian Competition and Consumer Commission

CHAIR—I welcome our next witnesses, from the ACCC. Thank you very much for appearing here tonight. Do you wish to make an opening statement and perhaps outline the ACCC's role in foreign investment, if any?

Mr Grimwade—I had not planned to make an opening statement, unless you would like me to make a statement to that effect.

CHAIR—It might be helpful if you did, I think—just to outline the ACCC's role.

Mr Grimwade—Okay. We do not have any role at all in relation to the Foreign Acquisitions and Takeovers Act. Our role in relation to acquisitions is restricted to purely competition assessment under section 50 of the Trade Practices Act, which prohibits, in effect, anticompetitive mergers.

CHAIR—Thank you very much. Have you at times been invited to review a proposal for foreign investment in, say, a minerals or other business in Australia?

Mr Grimwade—Yes. We review a large number of acquisitions by foreign acquirers of Australian or other interests. Of the, say, 400 mergers that we review each year, a fair number are actually referred to us by the Foreign Investment Review Board, and we will often conduct assessments in relation to those. Separate to those, where there are particularly major transactions that involve a foreign acquirer, we are directly notified, or clearance is sought from us. So it is not uncommon at all. Of interest to this inquiry is the fact that we have looked at at least three major Chinese acquisitions of mining interests in the last six to 12 months, and there have been a much larger number of smaller acquisitions that we have been notified of by the Foreign Investment Review Board where we have conducted some form of assessment.

CHAIR—Given your interest is in competition and preserving competition, what dimension of an investment in a mining venture triggers your attention? Could you explain that. Is it because you think competition might be lessened between Australian miners? What is it exactly?

Mr Grimwade—For acquisitions in the mining sector, there are two particular theories of competitive harm that we will examine when we are looking at a merger in terms of our assessment of whether or not there is a breach of section 50 of the Trade Practices Act. We are looking at the likely effect on competition, and there are several different types of theory of competitive harm that we will explore to see whether there is an anticompetitive effect.

On the one hand, we will look at any horizontal aggregation of interests that the acquirer might already hold in addition to its acquisitions. For instance, if an acquirer already has some interests in Australia that compete with the target that it is intending to acquire, then we will look at the extent to which there might be some chilling or a diminution of competition in the market as a result of that acquisition. Separately—and this was an issue we explored particularly in the mooted Chinalco acquisition of Rio Tinto—we look at the vertical relationship as well, where you have an acquirer who does not necessarily have an interest that competes with its target head-to-head but it is a purchaser or has a related entity that is a purchaser of the product—the ore, for example—that is being produced by the target it is acquiring. The theory of harm we will examine there is the extent to which there can be any foreclosure of competitors through the vertical integration that might result or ensue from that acquisition. So they are two different anticompetitive effects that we will examine when we are looking at mergers generally and some of the acquisitions of mining interests in particular.

CHAIR—Thank you. Senator Joyce or Senator Hurley?

Senator HURLEY—I just want to go on to sovereign wealth funds. My understanding is that usually they invest in companies in Australia or if they invest in foreign companies that they do not necessarily form part of the management of the company. Is that right? And can you comment on the role of sovereign wealth funds in Australia in the context of your considerations of mergers and acquisitions?

Mr Grimwade—I cannot really provide any general comment. I am better answering questions that relate to particular transactions that we have examined. I will do my best. We will have regard to the interrelationship between the various interests that the sovereign wealth fund might have in competing entities and those of the target that it is going to acquire. We have not had to address the issue head-on yet, particularly in relation to Chinese acquisitions, but it is something that we have given a bit of thought to. Indeed, in relation to the Chinalco-Rio matter, if there was going to be a problem a number of conditions had to be met. One of them would have been that there was some relationship, say, between the Chinese steel mills and the entity that was proposing to purchase Rio, which was going to supply the ore to those Chinese steel mills. Ideally we will have regard to the sorts of relationships that do exist between companies. That might go to the level of ownership, control or influence that they might hold over each other.

Senator HURLEY—Last year, I think it was, I went to a briefing by a US sovereign wealth fund manager. They were talking about the range of investments they had in Australia but they were not necessarily 100 per cent owners or even a substantial owner of some of those businesses. When you are looking at mergers or acquisitions, how far down do you take the ownership? If a sovereign wealth fund or another investor entity were investing in, say, an area of property, would any alarm bells ring once they went to a certain percentage of ownership of that company?

Mr Grimwade—There is no bright red line, really. In fact, the provision that prohibits anticompetitive mergers does not require an element of control or ownership to be assessed in reaching a view of whether or not there is an anticompetitive effect. What we focus on is the effect on competition. To get to that point, to determine whether or not there is an effect on competition, you have to have regard, essentially, to incentives. There are a whole lot of factors

that might come into play to determine whether or not the incentives will change after an acquisition. The level of ownership might be one of those factors, but there might be factors like board representation or other mechanisms of influence.

It might be that there are particular assets of a target. Senator Joyce raised this point before with the previous witness: in Chinalco-Rio there was a proposal to move from nine to 18 per cent of the shareholding of the Rio entity. As part of that acquisition there were other assets that were being acquired with a much greater degree of ownership. There were various committees where there was a greater representation by Chinalco to govern the management of that particular asset. So there are a lot of complicating factors in reaching a conclusion as to whether or not competition might be affected. There is interplay of a whole degree of different factors.

Senator HURLEY—I have not been here to listen the whole time, but it seems as though there has been a lot of discussion about Chinese investment. My understanding is that there have been waves of investment by all kinds of countries, by sovereign wealth funds and other large companies. Have you ever seen a particular country creating a particular problem?

Mr Grimwade—We do not really focus on the nationality of the acquirer, except to the extent that there might be some impact on competition. We are focusing more now on Chinese acquisitions because there is a trend and there are a large number of acquisitions in a particular sector. But it is fair to say that there are a large number of acquisitions in different sectors by companies that are based in countries all around the world and some of those companies have other interests here. Often they are a new entrant and raise no competition issues at all.

Senator HURLEY—That competition issue is clearly important to you. Often investment or a company coming in creates more competition. Sometimes it enables Australian companies or Australian originating companies to reach a critical size so that they can go out and work in other countries or create more competition by going interstate. That is a factor that you consider when you are looking at mergers and acquisitions, I presume ?

Mr Grimwade—Yes. Often we are confronted with sale processes where there are a number of competing bidders. Often there will be several bidders who are foreign companies who do not have a presence here. Often they will be the acquirers that pose the least competitive problems for us under section 50, particularly in oligopolistic markets, of which there are quite a few in Australia, where there are very few players.

Senator HURLEY—I worked in the investment banking industry in the mid-eighties. There were a lot of mergers between foreign banks going on there later on in the period. I guess at that time that played a role in keeping the sector alive, because they were experiencing difficulties and it might have collapsed altogether otherwise, even following the deregulation of the banking sector. Is that sort of injection of a stimulus into a struggling industry also something you take into account?

Mr Grimwade—In a way, yes. It might influence our thinking if you are comparing that acquirer with another acquirer that is not going to engender such a procompetitive outcome. But it is interesting to note that, at least in the banking industry, where there were quite a few international entrants, like HBOS with BankWest, there has been a departure of some of those interests from our shores.

Senator HURLEY—Thanks.

Senator JOYCE—Do you have a working knowledge of the Foreign Investment Review Board guidelines?

Mr Grimwade—I am not sure I would say it is a working knowledge.

Senator JOYCE—Do you have any knowledge of it?

Mr Grimwade—I have a little bit of knowledge. It is a different decision-making process.

Senator JOYCE—We used the analogy of a fictitious place, similar to Antarctica, to say if there was an issue with that country, would it concern you. I want to run through a couple of situations. Would the ACCC have any concerns if Iran in its current form under Ahmadinejad were to make substantial investments in Australia?

Mr Grimwade—Our focus in looking at an acquisition is on whether or not it is going to have an effect on competition. Whether or not there are national interest issues and implications is the role of the FIRB to advise the Treasurer on under the FATA. We would not have regard to the political dimensions of the country.

Senator JOYCE—Do you have any knowledge whether the Foreign Investment Review Board gives any consideration to the political dimensions of the country that is investing?

Mr Grimwade—That is a question that you should put to the FIRB.

Senator JOYCE—How do you deal with the issue of shelling out? Let's say that you have a company that is now the owner of the resource in Australia and the purchaser of the resource overseas. The logical thing is that it will buy from itself and affect all the companies around it trying to also supply that sector. Take the example of uranium. If you have one major purchaser of uranium that is also one of the major owners of uranium in the ground in Australia—I am not saying this has happened but if it did—surely that would affect all the other uranium mines which are trying to supply the same market. Would that be the case?

Mr Grimwade—In a hypothetical scenario, if you have one buyer of the product and it integrates with one of a number of competing suppliers then that transaction would enable foreclosure of those competing suppliers.

Senator JOYCE—If it was a substantial buyer of a resource and it was also a substantial owner of a resource in Australia would that also have effects?

Mr Grimwade—It may. You have to remember the prohibition on anticompetitive mergers is an acquisition that is likely to have a substantial lessening of competition in a market in Australia. If the market is overseas and there is no market in Australia, it may well not be anticompetitive.

Senator JOYCE—My favourite area is the substantial lessening of competition test! Can you please for the purpose of the *Hansard* tell us the section of the Trade Practices Act which

pertains to the substantial lessening of competition test then give the briefest description of how it works.

Mr Grimwade—Section 50 of the Trade Practices Act proscribes acquisitions that would have the effect or would be likely to have the effect of substantially lessening competition in a market.

Senator JOYCE—What is the test for that?

Mr Grimwade—Other provisions explain what a market is. Under section 50(3) the commission must have regard to a number of factors in assessing whether or not there is a breach of section 50. In that subsection the commission must have regard to things like import competition, concentration, barriers to entry, the likelihood of the removal of a vigorous and effective competitor, degree of substitutability and a few others.

Senator JOYCE—What is the general test? For me to get the keys to the court, to wander in the door, under section 50, the substantial lessening of competition test, what do I need to actually prove? Can I just prove that it is a big player in the market or do I have to prove more than that?

Mr Grimwade—You have to prove more than that.

Senator JOYCE—A lot more than that?

Mr Grimwade—I do not want to focus solely on concentration. That is one of the factors which the court must have regard to.

Senator JOYCE—I think the substantial lessening of competition test is a complete and utter furphy that is impossible to prove. I will cut to the point. I am going to try to clarify that point because I really have to prove that that person has almost a complete domination of a market before I can really get anywhere. To prove that point I will ask you this question: what was the last company that you succeeded in proving the substantial lessening of competition test on?

Mr Grimwade—As I mentioned this morning I think in response to a question you posed to the commission in Senate estimates, we have opposed at least 10 mergers this year. None of those have been challenged in court, so we have not had to go to court to establish—

Senator JOYCE—From your long history in the ACCC, your knowledge since you have been in that culture and your knowledge of everything to do with the substantial lessening of competition test, tell me a case where they said, ‘We took that one to court and they failed the substantial lessening of competition test’?

Mr Grimwade—In my time in Mergers, in the last five years, there has not been one, except for AGL-Loy Yang and that preceded me. In that case we were not successful.

Senator JOYCE—In all seriousness, would the Rio-Chinalco deal have failed the substantial lessening of competition test?

Mr Grimwade—No, it would not have failed the competition test. In fact we cleared that transaction.

Senator JOYCE—How much ownership of the iron ore or coal market would Rio and Chinalco have to have held, do you believe, before they would have a chance of failing the substantial lessening of competition test?

Mr Grimwade—In our view that was a clear-cut case of not a breach of section 50. If we look at, for instance, the iron ore market, Chinalco did not have a presence in iron ore and so the theory of competitive harm was one purely of a vertical nature. So our inquiries focused on the extent to which Chinalco, through its ownership of 18 per cent and its other interests in Rio, would have had the ability and incentive to influence the pricing and supply by Rio of its iron ore to Chinese steel mills.

For us to establish an SLC in such a circumstance, there were a number of conditions that would have to have been met. One we decided to conduct a working assumption of—namely, that the Chinese steel mills and Chinalco were related. Two, there would have to have been an establishment of the proposition that Chinalco would have been able to control Rio and influence Rio in making a decision to actually increase the supply of iron ore so as to lower the price of iron ore to the Chinese steel mills. Thirdly, we had to establish that Rio would have had the ability and incentive to actually increase supply and lower the price of iron ore. That third condition was simply not met, because the only way that competitive harm could have resulted from a vertical nature was if Rio was to oversupply iron ore and lower the price of iron ore to the Chinese steel mills to the detriment of others.

Senator JOYCE—And there was no way you were going to be able to prove that. How would you ascertain these facts? You would have to have a thorough knowledge of the workings of the market in China and that knowledge is precluded from you because you are dealing over there with state owned enterprises and they are just not going to let you know how their pricing mechanism or their costing mechanism works. That information is just not available to you.

Mr Grimwade—I think that question is pertinent to the first condition I mentioned, which was the extent to which different Chinese owned entities compete with each other. But, no, that is not relevant to the key issue for us, which was the ability and incentive of Rio to influence the pricing that Chinese steel mills would have paid for iron ore. We did not need to delve into the workings of the Chinese corporate mind because Rio would not have been able to exercise that ability and it would not have had the incentive. We established to our satisfaction that should Rio have increased its supply—that is, it brought forward its various production programs—then the reaction of its competitors would have been to hold off their production programs and minimise or reduce their supply so that there could not have been a change to the international pricing of iron ore in that transaction. So there was no ability or incentive for Rio to engage in the sort of competitive harm that we would have needed to establish for it to breach section 50.

Senator JOYCE—There are two issues here. Look at all oil, for instance. Oil comes out of the ground and can be converted into diesel, so it can arrive on the streets of Iraq at a cost of about 7c or 8c. It is not very much. By the time it gets over to Australia, the terminal gate price for it is about \$1.10. That is 38.186c in excise and the rest is transport. But the rest is just what they call control of the market. That is how they manage to make a quantum of money. Surely

that is going to work in the other direction to the detriment of Australia when the ownership is in such places as China and there are miners in Australia and we are relying on the transfer pricing on the way through. Since all these entities are related, because they are all owned by the Chinese government, their primary source and their preferred source will be from the entity they own and control in Australia. Then we just have to rely on some sort of honesty and transparency in what becomes a completely and utterly different transaction—that is, a transaction to themselves.

Mr Grimwade—We did not consider that that level of concern arose in the Chinalco-Rio transaction because Rio simply would not have been able to act in a way that advantaged the Chinese customer over any other customer of Rio for iron ore. We did not even need to get to the point where of establishing that Chinalco would have had some degree of strong influence over Rio's pricing decisions.

Senator JOYCE—Let us say, Mr Grimwade, that the ACCC, despite your best efforts and with the greatest sense of diligence and honesty in the way you acted, got it wrong. Can you please refer me to the divestiture powers that you would use to break the arrangement up?

Mr Grimwade—There is a divestiture power for acquisitions. I think it is under section 81.

Senator JOYCE—There is a very temporary one after mergers and acquisitions, but it has no longevity in it.

Mr Grimwade—Three years after the date of the acquisition, the commission—only the commission, not a private party—has the power to seek divestiture in court.

Senator JOYCE—So after three years you are sort of stuck, aren't you? There is no power. You would have to introduce a bill to get the divestiture power beyond that date. Even then, divestiture powers in Australia are extremely limited in their operation in comparison to those of other countries. You would have to say that, wouldn't you?

Mr Grimwade—I am not that familiar with other countries' divestiture powers. There are certainly some jurisdictions that would have a broader divestiture power that extends to monopolisation. Our divestiture power is restricted to acquisitions.

Senator JOYCE—Mergers and acquisitions, in a temporary form after the event. How would you deal with the problem if you found out later on it had all gone pear-shaped? Say an entity, by reason of its vertical integration, was shelling out the marketplace? How are you going to deal with it?

Mr Grimwade—The divestiture power is rarely used. I think it might have been used once years ago.

Senator JOYCE—That is interesting. When was the last time divestiture power was used?

Mr Grimwade—It might have been in the Australia Meat Holdings case, which was in the nineties, I think.

Senator JOYCE—Who owned Australia Meat Holdings at that stage?

Mr Grimwade—Not Swift.

Senator JOYCE—Was it ConAgra?

Mr Grimwade—I cannot remember.

Senator JOYCE—I will just declare for the record that I was an accountant for Australia Meat Holdings.

Mr Grimwade—Okay. Hopefully not at the time we took action against them.

Senator JOYCE—I am going to inform you that the trick is to rip you off.

Mr Grimwade—Just going back to your question, one of the complications in convincing a court to grant the remedy of divestiture in a merger case is that we would have to establish that the acquisition was the cause of the competitive harm. The longer you wait after an acquisition, the murkier it is gets as to what might be the actual cause of any anticompetitive effect, because there might be changes in the marketplace. There might be another acquisition. There might be some other change that has been somewhat responsible for the anticompetitive effect that might result. It is not an issue that we have faced in recent times, I should say.

Senator JOYCE—So really we are looking at the fact that the substantial lessening of competition test under section 50 has not got a history—if you actually look at the court history of it, it is extremely limited and almost non-apparent. If you look at the divestiture powers, it virtually is non-apparent. Does this not give us a concern about what happens if things go wrong? And what do you think your capacity is in the ACCC to haul into court a foreign entity which—to be completely frank—is far more powerful than Australia?

Mr Grimwade—Can I just address the first part of your question because I do not agree with you. I think the substantial lessening of competition test is quite satisfactory. You seem to be judging its effect on the basis of the lack of court actions that have been taken. I would say that the great success of the substantial lessening of competition test is that we have engendered at the commission and through the informal clearance process a great degree of compliance with section 50. There are often companies that I will speak to that say, ‘We thought about this transaction, but we are not going through with it because we know that we could not get it past you or we know it would breach section 50’.

As I mentioned before, there are a number of transactions that we will oppose each year and the companies are sufficiently satisfied with our analysis and that we have reached the correct result that they are not going to challenge us in court. They can go ahead with the merger and then we have to prove our case in court. They chose not to because, invariably we consider that we have a strong case under section 50. In addition to those mergers that we oppose under section 50, there is a lot of engagement that we have confidentially with firms that come in with proposals. They will walk away before we even reach a final view.

Senator JOYCE—What percentage of mergers go through?

Mr Grimwade—90 to 95 per cent of the mergers that we would review we would clear.

Senator JOYCE—There is more than that, though, isn't there? So there are 90 to 95 per cent that go through and then there are a few more with conditions.

Mr Grimwade—There are those that we would have opposed otherwise.

Senator JOYCE—How many are actually opposed and do not go through?

Mr Grimwade—I would say we opposed 10 this financial year.

Senator JOYCE—As a percentage?

Mr Grimwade—That is three or four per cent.

Senator JOYCE—That is what I thought—97 per cent ultimately end up going through. If I had a 97 per cent strike rate in darts, I would be the king of every pub in town.

Mr Grimwade—You have to look at it in context. I could reduce the number of mergers that we look at in the commission by a couple of hundred and increase our strike rate—double it.

Senator JOYCE—I am not saying you should reject. I am just saying that from an outsider looking in it looks like you are really doing something crazy if you get rejected. Internally in Australia, I suppose we can handle the problem domestically. We have got real problems when the jurisdiction goes outside our borders because it makes it twice as difficult when you are dealing with an organisation in which there are diplomatic issues and a whole range of issues that are pertinent to that issue.

Mr Grimwade—If the acquisition by a foreign acquirer is going to give us competition concerns, invariably that acquirer is going to be carrying out some business in Australia, so there will be an entity that we will be able to enforce a finding against. There is a section of the act, section 50A, which has never been used—do not asked me to cite it, because I do not think I could—which essentially deals with acquisitions that occur overseas and have some effect in Australia.

Senator JOYCE—Which is a form of quid pro quo. China is now looking at that with Rio and BHP—or a type of act similar to 50A. There would be a Chinese version looking at those.

Mr Grimwade—Something like that.

CHAIR—Senator Joyce, we are a little bit beyond time. I do not know what other questions you have.

Senator JOYCE—I understand. It gives us something to go on. Thank you very much, gentlemen.

CHAIR—With that, I thank the witnesses for appearing tonight. I thank the secretariat and Hansard.

Senator JOYCE—I just have one question. Stephen, what are you doing here tonight?

Mr Bordignon—Moral support, I think!

Senator JOYCE—You did a very good job of moral support; you were very moral and very supportive.

Mr Bordignon—Thank you, Senator.

CHAIR—Thank you for being here.

Committee adjourned at 9.50 pm