Business Council of Australia

SUBMISSION

Submission to the Senate Economics Legislation Committee on the Foreign Investment Reform Bill 2020

November 2020

ABOUT THIS SUBMISSION

The Business Council of Australia welcomes the opportunity to make a submission to the Senate Economics Legislation Committee on the Foreign Investment Reform (Protecting Australia's National Security) Bill 2020 and Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2020 [Provisions]. 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-19 economic shock. Parliament needs to carefully consider the extent to which the system manages risks without unintentionally constraining growth and jobs.

Our key recommendations include:

- Better targeting the regime to areas of highest risk where the imposition of harsher penalties and enforcement powers are proportionate to the problem. Providing a broad discretion for the Treasurer to apply these powers across the economy will come at a high cost and could ultimately be self-defeating as Foreign Investment Review Board (FIRB) processes become clogged with routine transactions;
- Clearly defining risk through a prescribed list approach to ‘national security’ list (i.e. what’s covered) approach, allowing for this to be updated over time;
- Vastly expanding the streamlining measures 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;
- Limiting the time available for the Treasurer’s exercise of the ‘call-in power’ to three years 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;
- A restructure of fees so they are proportionate to the cost of administering the regulatory system.

OVERVIEW

The global downturn: attracting foreign investment will be harder

As we look for ways to recover from COVID-19 induced global economic disruption, the role of foreign investment will be as crucial as ever.

Foreign investment has traditionally underpinned much of 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. Our ability to attract foreign investment has translated into healthy competition, skills, innovation, and new technological and supply chain capabilities in the Australian economy, all of which are vital to the national interest.

As a result of the global economic downturn however, competition to attract capital is becoming tougher. According to UNCTAD's Investment Trends Monitor for October 2020, global foreign direct investment flows in the first half of 2020 were down 49 per cent compared to 2019. Australia's record is not faring much better – inward foreign direct investment flows fell sharply in the first half of 2020 by 40 per cent (in comparison, Canada fell by 32 per cent).

This coincides with what were already low business investment levels in Australia prior to COVID-19. Official forecasts released as part of the 2020-21 Budget now suggest 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 – around 15 per cent in 2020-21 alone.

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

Regulatory principles that enable foreign investment

The Business Council believes it is vitally important that the government defend against risks to Australia's national interest, especially risks associated with national security. As a result of a confluence of developments — including rapid technological change and changes in the international security environment – there is greater degree of uncertainty and risks are changing. Our governance and regulatory systems need to sensibly adapt to a changed environment.

We must, as a starting point, recognise that Australia's system of government, institutions, rule of law, and existing regulators provide a firm basis to address potential risks flowing from foreign investment. The FIRB regime has historically sought to complement these regulatory structures by providing a gatekeeper mechanism to consider the broader national interest implications of incoming investment.

The proposed FIRB changes

The traditional 'gatekeeper' approach of FIRB is increasingly giving way to a more formal regulator approach. 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 regime retains the wide, discretionary nature of a gatekeeper system with expanded and loosely defined trigger points which could catch any number of investors. If the Parliament is to adopt a more 'hard

line' regulatory approach it must provide greater certainty to investors about the activities that will be subject to these powers.

Being clearer about the activities that may be of greatest concern not only reduces unintended consequences across the economy, but is more likely to mean the regime succeeds in addressing national security concerns. A FIRB system clogged with minor routine cases is not only bad for business and for economic recovery, but also waters down the ability of the FIRB to focus on the more important risks.

We recommend limiting the national security businesses covered under the changes to identifiable assets, including electricity, gas, water, ports, telecommunications and defence assets. Adding or removing assets to take account of changing risks or emerging technologies should be carried out through a considered policy process and in consultation with industry and other relevant stakeholders.

When introducing new regulation we should always look at what regulation can be removed. The proposed changes would benefit from offsetting measures to streamline investment screening for non-sensitive transactions, such as a registration / notification system, which should be introduced as a matter of good regulatory practice.

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.

SPECIFIC COMMENT AND RECOMMENDATIONS

We address in this submission the defining features of the Bill and offer some suggestions on how they can be improved. For a detailed examination of other specific changes we refer the committee to earlier submissions by the Business Council to Treasury as well as the other contributions from a range of industry bodies and market participants.

The scope of transactions covered: defining 'national security business'

Much of the way the future system operates hinges on the definition of 'national security business'. The Bill does not provide a definition – it is instead in the draft regulations issued by Treasury.

That definition encompasses several limbs.

To the extent that some of those limbs are tangible and conceptually clear, this helps investors to understand what a national security business is, and hence, whether they need to notify FIRB. For example investors will more readily understand the meaning of businesses which supply critical products, technologies and services for Australian defence and intelligence activities, as well as personnel businesses that are carriers or carriage service providers under the Telecommunications Act. Although there is room for drafting improvements to increase precision of these limbs, they are at least conceptually tangible.

However, the scope of the definition in other respects is vague and fuzzy. In particular, it cross-references an expanded Security of Critical Infrastructure (SOCI) Act, meaning the scope of FIRB's coverage is automatically and arbitrarily tied to the outcome of a different package of reforms. This is not fit for purpose regulation making.

The sectors that would be covered are listed in the exposure Draft of the Security Legislation Amendment (Critical Infrastructure) Bill 2020 (the critical infrastructure bill). A 'national security business' could include businesses active in the following sectors:

- Financial services and markets
- Communications;
- Data storage and processing ;
- Defence industry;
- Higher education and research;
- Energy;
- Food and grocery;
- Healthcare and medical;
- Space technology;
- Transport; and
- Water and sewerage.

These potential sectors are extraordinarily broad. For example under food and grocery the bill's explanatory memorandum notes "… if a supermarket … were to subcontract out the trucking of groceries from a warehouse to a supermarket, then the trucking portion of the food and grocery network would still be considered a critical food and grocery asset, even though it would not be directly operated by a critical retailer or wholesaler as prescribed by the rules".

This means a trucking company that is at least partially foreign owned would have to go through a FIRB approval process to transport groceries from a warehouse to a supermarket, regardless of the value of the groceries being transported.

Similarly, FIRB approval would be needed for entities involved in the higher education and research sector. This sector broadly defined as "defined as the sector of the economy that involves being a higher education provider as defined in the Tertiary Education Quality and Standards Agency Act 2011, or undertaking a research program that has received investment, funding or a grant from the Commonwealth, or is relevant to one or more critical infrastructure sectors".

This means FIRB approval could be needed where a transaction involves entities engaged in certain research activities, including for example the 'research activities relevant to the space or health sector'.

The unintended consequences of a poorly defined criteria are significant. Investors will invariably seek to avoid uncertainty which could result in:

a) a permanent increase in FIRB notifications to avoid uncertainty in the definition, with resulting strains on the screening process and longer processing blow-outs;

b) risks 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;

c) ultimately a disincentive to invest in Australia.

<u>We recommend:</u>

- The definition of national security business as it regards critical infrastructure assets clearly spell-out the current definition in the SOCI Act – i.e. '*responsible entity*' and / or '*a business is an entity that is a direct interest holder in relation to a critical infrastructure asset*'.
    - For greater certainty, those definitions cover electricity, gas, water and port assets (note telecommunications assets would be covered by cross-referencing in the definition a business which is a carrier or carriage service provider to which the Telecommunications Act 1997 applies).
- No 'automatic update' by reference to a revised SOCI Act. Revisions to the national security business definition should made in consideration of foreign investment policy and in consultation with industry.

Regulatory offsets: taking transactions out of FIRB's net

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.

Low-risk transactions getting caught

Under the current system, and especially under the temporary COVID-related FIRB $0 threshold measures, many non-sensitive low-risk transactions are unnecessarily caught in the system. This has dramatically slowed down processing of FIRB cases. Under the proposed changes, the number of transactions potentially caught by FIRB may not subside given the wide scope of 'national security business' coverage.

The following examples, drawn from evidence compiled by members, illustrate FIRB bottlenecks and the unintended negative economic consequences:

- An investor operating in Australia for 60 years has required FIRB approval to secure a long term lease on a car park in order to simply install solar panels in the car park and lease it back.
- An investor in the process of relocating a warehouse 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.
- An Australian fund manager's transaction was unable to proceed due to the length of time needed for the FIRB review. After three months passed with the application still under review by FIRB, the vendor decided it was unwilling to extend the deal 'sunset date' for the fund manager. The business to be acquired was a 'bolt-on' and hence very similar to those already in the fund's portfolio. Had it not been for the COVID-19 temporary measures, the transaction would not have been subject to screening.
- Numerous foreign businesses have been considering shutting down Australian operations where they account for a small component of a global business network, in order for global transactions to proceed without FIRB delay. This is occurring where there are between 5 to 25 employees in Australia, and the businesses would have otherwise fit within the 'de minimis' rules previously available under the FIRB regulations.
- The 'streamlined' exemption certificates on offer have not been processed in time for meaningful use by investors, despite applicants paying the fee for a full exemption certificate. For example, an applicant needing a certificate for their retail footprint (including land technically characterised as vacant due to hardstand car parking associated with those retail sites) was informed that such land could not be included in a streamlined review process after two months of engagement with FIRB.
- An investor who was otherwise exempt prior to the COVID-19 rules is required to comply with an open and transparent sales process in relation to landlocked parcels of land. The vendor is, in practice, limited to selling to the proposed buyer but must go through the costly process of publicly advertising the land for sale.
- The executive of a major foreign investor in Australia recently commented "*When you have a board in another country looking at where to deploy capital, it is a negative having to highlight the need for FIRB, as well as including the best estimates of delays to transaction closing due to FIRB"* .

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.

'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 also concerned that the existence of an option for the Treasurer to exercise the call-in power for a full 10 years (as defined in Treasury's draft regulations) 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.

A 10 year call-in power will not provide that certainty and may well result in the unintended consequence of strongly encouraging foreign persons to voluntarily notify FIRB in circumstances when it is not strictly required. This will increase costs and time delays for foreign investors in making foreign investments into Australia.

The existence of a 10-year call-in power, when taken together with the new proposed last resort power, creates a sovereign risk issue: the rules can be changed after material investment decisions, which may discourage foreign investment into Australia.

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 through the issuance of Guidance Note on what constitutes a 'national security concern'
- The time limit for the exercise of the 'call-in' power be 3 years.

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 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 unviable 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 recommend:

- The review by the Administrative Appeals Tribunal (AAT) should extend to the appropriateness and reasonableness of the orders that the Treasurer makes to address the national security risk, and rejection of a proposal on national security grounds.
- Additional safeguards be introduced for the exercise of the last resort power, including a requirement that the Treasurer consults with the Prime Minister, the Minister for Foreign Affairs, the Minister for Trade, the Minister for Home Affairs and other relevant ministers from the Commonwealth, States or Territories, as well as the foreign person impacted.

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:

- 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.

Fees

The Business Council is concerned that the new fee structure will not only be out of proportion with the cost of delivering the investment screening regime, some fees will be so prohibitively expensive – up to $500,000 per transaction - they will deter investment in vital sectors of the economy, particularly agriculture.

The Productivity Commission already noted in its June 'Foreign Investment in Australia' that in 2017-18 the government collected $114 million in fee revenue while the operational costs of FIRB and its secretariats in the Treasury and the ATO totalled only $14.7 million.

While the Business Council accepts that increased resources come at a cost, the new fee structure will pale in comparison to the imbalance the Productivity Commission has already identified. The reality is that the fees will be an inefficient 'stamp duty' tax on foreign investment.

We note in particular:

- Despite the hike in fees proposed, statutory processing times are planned to be extended from 30 to 90 days under the new (non-temporary) rules;
- There is a high risk that changes result in entrenching an effective default fee of $13,200 for foreign investments, and increasing from there up depending on transaction;
- Effectively the same fee applies to non-national security related transactions as it does to a national security related transactions.

We recommend:

- wholesale restructure of fees so they are proportionate to the cost of administering the regulatory system, accounting for increased resourcing of FIRB / consulted agencies;
- The fee structure should align with the need to screen for national security risks, with particular attention to setting appropriate fees for transactions in the agricultural sector;
- Greater consideration given to refunds of FIRB application fees being provided to prospective purchasers that ultimately do not enter into binding legal documentation with an Australian vendor on a transaction in relation to which a FIRB application has been submitted.

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