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Protecting Australia's National Security

Proposed Changes to Australia's Foreign Investment Approval Regime Incoming From 1 January 2021

Asia Pacific – 16 September 2020

As announced on 5 June 2020 by the Federal Treasurer (the Treasurer), the Australian government is introducing major reforms to Australia's existing foreign investment review and approval framework in the interests of reinforcing national security.

The Treasury has recently published proposed legislative amendments to the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA or the Act) in the form of an "exposure draft", subject to public review and comment (the Exposure Draft). While the Exposure Draft is subject to potential amendment following rounds of stakeholder engagement (submissions regarding the proposed changes closed on 31 August 2020), it sets out the government's preferred reforms and is unlikely to be substantively altered prior to implementation.

The Exposure Draft of the *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020* (Cth) intends to "strike a balance between the benefits foreign investment into Australia bring and emerging national security concerns", by introducing a series of substantive amendments, including:

- A third limb of regulated acquisitions – "notifiable national security actions" (in addition to pre-existing "notifiable actions" and "significant actions")
- A new "call-in" power, allowing the Treasurer to "call-in" acquisitions for review on national security grounds
- A "last-resort" power, allowing the Treasurer to impose new conditions, vary existing conditions or even force the divestment of any completed investment that was subject to review under the FATA, including transactions previously approved, where national security concerns are later identified

The potential impact of this reform was not apparent when initially announced on 5 June 2020 due to the ambiguity of what the Australian government would consider to impact national security or exactly how the Treasurer's new powers would operate. In light of the Exposure Draft, the future of foreign investment into Australia is now clearer. A high-level summary of the proposed key changes is set out below.

Notifiable National Security Actions

From 1 January 2021, foreign persons investing into Australia will need to notify proposed transactions to the Foreign Investment Review Board (FIRB) and seek approval of the Treasurer where the acquisition constitutes a "notifiable national security action". Critically, there is no monetary threshold applicable to a "notifiable national security action", meaning all proposed transactions that meet the definition, regardless of total value, will be notifiable.

A "notifiable national security action" is defined in full in the Exposure Draft, but can effectively be broken down to two general types. In summary, an action, or proposed action, will be considered a "notifiable national security action" if it is undertaken by a foreign person and proposes, or results in, the acquisition of:

a. a direct interest in, or the commencement of, a national security business; or

b. an interest in Australian land that is national security land.[1]

A national security business is a business that, if disrupted or carried out in a particular way, could create a national security risk. What constitutes a national security business will be prescribed by the FATA's regulations, and is currently proposed to include businesses that:

- Hold "critical infrastructure" regulated under the *Security of Critical Infrastructure Act 2018* (Cth)
- Are carrier or carriage service providers subject to the *Telecommunications Act 1997* (Cth)
- Are involved in defence supply chains including the development, manufacturing or supply of critical goods and technology used for military end use or the provision of critical services to prescribed defence and intelligence personnel
- Store or have access to classified data, or the personal information of Australian defence and intelligence personnel, in prescribed circumstances

A foreign person proposing to start a business of this kind, or acquiring a "direct interest" (being 10% or more of an interest in an entity or acquiring influence or control over an entity) in a business of this kind, will require approval of the Treasurer under these proposed amendments.

1 Please note, "national security land" is not a defined term in the Exposure Draft and is being used here for succinctness.

Australian land considered to be national security land is land that is:

- A "defence premises" within the meaning of section 71A of the *Defence Act 1903* (Cth), which includes land owned by Australia's defence industry
- Land in which an agency in the national intelligence community has, or will have, an interest (but only where the foreign person could reasonably be expected to be aware of the agency's interest)
- Land prescribed by legislative instrument to be of national security significance
- Acquiring an interest in Australian land that is national security land will require approval of the Treasurer under these proposed amendments.

An action that is a notifiable national security action but does not constitute a "notifiable action" or a "significant action" (for example because it does not meet the applicable monetary threshold) will only be assessed by the Treasurer against national security considerations. However, where an action is both a "notifiable action" and/or a "significant action" and is also a notifiable national security action, it will be assessed against the broader national interest test (which includes considerations as to national security and which remains unchanged as a result of this reform).

The New "Call-In" Power

The Exposure Draft proposes that the Treasurer be given a new "call-in" power. Under the existing foreign investment framework, the Treasurer has no power to review transactions generally, merely those submitted to FIRB in accordance with the FATA. This restriction, combined with a unique quirk in the FATA whereby some "significant actions" may not be "notifiable transactions" and, therefore, not subject to mandatory notification, means that there are a number of potentially significant foreign investments or acquisitions that are not currently subject to the Treasurer's purview.

In order to address this, and further address national security concerns, it is now proposed that the Treasurer may "call-in" any transaction that is:

a. a reviewable national security action; or

b. a significant action that is not otherwise a notifiable action or a notifiable national security action,[2]

where the Treasurer considers that it is an action that may pose a national security concern.

A reviewable national security action is defined broadly and includes the acquisition of a direct interest in an Australian business, the acquisition of an interest in Australian land, the issue of securities, the entrance into or termination of a significant agreement with an Australian business, the entrance into an agreement or amendment to constituent documents giving a foreign person control or substantial influence over the affairs of an entity or starting an Australian business.

These proposed "call-in" powers allow the Treasurer to request further information from applicable parties, effectively requiring them to submit a FIRB application along the lines of those that would be submitted if the acquisition was a notifiable action. From there, the Treasurer will review the proposed transaction and may make orders prohibiting the transaction, requiring the disposal of the interest (if the transaction has already occurred), or impose conditions on the transaction if the Treasurer is satisfied that the action would be contrary to national security.

The broad scope of the proposed "call-in" power has the capacity to put transactions at risk of being "called-in" at any time prior to completion of the deal or for a limited time afterward (such time period is yet to be finalised). In order to avoid this uncertainty, it will be open for interested parties to self-notify the Treasurer of potential reviewable national security actions and seek confirmation that the Treasurer has no objection. Once an order is made with respect to a transaction, or the Treasurer was notified of a transaction and failed to respond within the statutory time period, the "call-in" power will no longer be available to the Treasurer.

The "Last-Resort" Power

Australia's current foreign investment framework does not give the Treasurer capacity to wind-back transactions that have previously been granted approval by FIRB. Under the proposed reform, the Treasurer will be given a "last-resort" power, allowing it to impose new approval conditions, vary existing conditions or, as a last resort, force the divestment of a realised investment in the event national security concerns are subsequently identified.

The "last-resort" power can only be used where a number of conditions are met, which include:

a. that the Treasurer is satisfied that a materially false or misleading statement or omission was made in connection with the FIRB approval previously received, that the business, structure or organisation of the person have materially changed since FIRB approval was received or that the circumstances or market relevant to the transaction have materially changed;

b. that the Treasurer has undertaken a re-review of the relevant transaction (which requires the Treasurer to be satisfied that one of those pre-conditions set out in paragraph (a) above apply); and

c. that the Treasurer considers the relevant transaction poses a national security risk, with respect to which the Treasurer must have regard to advice provided by applicable national intelligence agencies.

Notice of any review by the Treasurer must be provided to the interested party, unless it would prejudice Australia's national interest to do so.

2 What constitutes a "significant action" is not being amended under the proposed reform and will continue to operate as the FATA currently provides.

Before making an order under the "last-resort" power, the Treasurer is required to:

- take reasonable steps to negotiate in good faith to eliminate or reduce the national security risk; and
- be satisfied that the use of all other regulatory systems of Australia would not adequately eliminate or reduce the national security risk.

The Treasurer may only impose a "last-resort" order if it is reasonably necessary to do so in order to reduce or eliminate the national security risk.

Other Changes

In addition, the Exposure Draft proposes the imposition of stricter penalties (including penalties linked to the quantum of investment or acquisition), additional compliance and enforcement powers, and new information gathering and sharing powers, along with general amendments to the FATA to streamline the Act, improve its readability and address pre-existing inconsistencies within. The Exposure Draft also flags amendments to FIRB's fee schedule, which are expected to increase in 2021 and beyond.

One further change of particular note is the new exemption given to "passive" foreign government investors. Following this change, certain privately controlled investment funds with foreign government participants will no longer be considered "foreign government investors" if the foreign government entity (or entities) does not, or could not be perceived to, have influence or control over the investment or operational decisions of the entity or any of its underlying investments. These changes are designed to cut red tape and allow international investment funds to only comply with the same standards applicable to private investors.

This reform is proposed to be available in two tiers:

- First, entities that have more than 40% foreign government ownership in aggregate but less than 20% from any single foreign government and in which no foreign government has influence or control will no longer be deemed to be a "foreign government investor" for the purposes of the FATA's regulations
- Second, entities that have one or more foreign governments with more than a 20% interest and yet are still not subject to foreign government influence or control will still be considered to be a "foreign government investor" but will be able to apply for an exemption certificate on a case-by-case basis

Private equity funds with foreign government investors that meet these new standards will be subject to screening at the monetary thresholds applicable to private investors, likely streamlining a number of international private equity investments in the future.

Final Comments

The changes proposed by the Exposure Draft will introduce substantial uncertainty into Australia's foreign investment sphere. The lack of clarity around the terms "national security concern" and "national security risk" (applicable with respect to the "call-in" and "last-resort" powers respectively), combined with the Treasurer's new powers to "call-in" transactions it has not reviewed or re-review those that it previously has reviewed, introduces substantial risk to international mergers and acquisitions. In light of these changes, acquirers and financiers will need to take on additional risk, including post-completion risk, where the transaction potentially impacts Australia's national security.

However, the "last-resort" power's high thresholds, requiring the Treasurer to have identified material false or misleading statements or omissions, mean that this power is likely only able to be exercised in extreme circumstances.

Likewise, the ability to self-notify the Treasurer of a transaction and avoid the uncertainty of being subject to a "call-in" means the transaction risks identified above can be mitigated to an extent, albeit at the cost of a FIRB application. Given this, we would advocate foreign investors take care in understanding the businesses they are looking to acquire and, where any grey area exists as to whether the business has national security concerns, look to self-notify in order to reduce uncertainty.

While this legislation does pose new risks to foreign entities looking to invest in Australia, entities and their advisers can stay ahead of the pack by increasing due diligence, understanding what they are buying and determining when they need to engage FIRB, and, by doing so, mitigate these new risks and ensure that they can continue to invest in Australia.

These changes are expected to come into effect from 1 January 2021 and will apply to transactions notified to FIRB prior to, or which occurred after, 1 January 2021.

Australia's foreign policy, and how it impacts foreign acquisitions and interests in Australia, is a constantly evolving landscape, as evidenced by Australia's recently announced review powers over deals between foreign governments and Australian state, territory and local governments and public universities.

We will continue to consider these proposed reforms in the event they are amended following public consultation, and when they are formally passed into law. If you have any questions regarding these changes, or if you would like to discuss an upcoming transaction, please contact us.

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