EABER
EAST ASIAN BUREAU OF ECONOMIC RESEARCH

EABER WORKING PAPER SERIES

PAPER NO. 112

AUSTRALIA'S FOREIGN INVESTMENT APPROVAL REGIME: A PRACTITIONER'S POINT OF VIEW

ANDREW LUMSDEN AND LIZZIE KNIGHT
CORRS CHAMBERS WESTGARTH

EABER SECRETARIAT
CRAWFORD SCHOOL OF ECONOMICS AND GOVERNMENT
ANU COLLEGE OF ASIA AND THE PACIFIC
THE AUSTRALIAN NATIONAL UNIVERSITY
CANBERRA ACT 0200 AUSTRALIA

Abstract

Australia's national interest is well served by having a foreign investment regime that has the right balance between flexibility and certainty. One highly successful aspect of that policy has been the ability to use conditional approvals to ensure that applicants behave in a manner that is consistent with the national interest.

In the context of Treasury's attempt to modernise the 40 year old foreign investment rules we consider the existing conditional approval regime be improved to reflect best regulatory practices and support ongoing investment.

Keywords: Australia; foreign investment regime; policy reform

Biographical notes: Andrew Lumsden is a Partner at Corrs Chambers Westgarth, specilising in M&A, securities transactions and corporate governance. Lizzie Knight is a Partner at Corrs Chambers Westgarth, specialising in cross-border mergers and acquisitions, with a focus on foreign inbound investment by companies in Australia,

1 Introduction

In an explicit recognition of the many benefits foreign direct investment (FDI) has and will continue to provide to this economy, Australia's foreign investment framework presents a welcoming and permissive approach to foreign investment.

As the Prime Minister has recognised, Australia has been importing capital since the first fleet sailed into Sydney Harbour. It is foreign investment that has allowed Australia to develop into the great nation we see today (Abbott 2012).

The simple fact is that given our small domestic population Australia simply cannot generate sufficient savings domestically to fund all the required investment necessary to allow economic growth, so the shortfall has to come from offshore.

Australia's foreign investment framework seeks to satisfy two competing objectives: the need to attract and retain FDI to Australia; and Australia having a regime that imposes sufficient safeguards to ensure continued community support for FDI.

Managing these two objectives requires flexibility as well as plenty of political skill and judgment.

When Australia first formalised its foreign investment framework in 1975, it was applied in a much more restrictive manner than today. This reflects the community's growing comfort with FDI and the scope of international trade, which has in turn resulted in an ongoing liberalisation of Australia's trade and investment regimes. It has also been because successive state and federal governments have been prepared to spend the time to bring the community with them about the importance of FDI to the nation's collective prosperity. As the Treasurer has said:

"It is an absolute statement of fact that Australians would experience a much lower standard of living if there was no foreign investment, or even reduced levels of foreign investment" (Foreign Acquisitions and Takeovers Act 1975).

The following practitioners note will provide support for reform of Australia's foreign investment framework. The note will initially analyse the scope of the reform currently being discussed in Australia; it will then introduce the concept of conditionality and enforcement; next it will discuss the issues relevant to investment abroad by state-owned enterprises (SOE) and how to manage issues relevant to foreign SOE capital flows in host countries.

2 Reform

In recognition of the importance of foreign investment and concern about community disquiet about residential real estate, the Treasurer issued a consultation paper on strengthening Australia's foreign investment framework,

which included a number of proposals relating to residential, commercial land, agricultural land and agricultural businesses as well as proposed application fees for acquisitions of shares and business (Australian Treasury 2015b). This consultation paper was followed on 18 May 2015 with an options paper for modernising the foreign investment framework (Australian Treasury 2015a).

From a practitioner's perspective, we have in the past worried that we have not given the foreign investment rules a serious 'tune up' in a very long time. Indeed since the inception of the Foreign Acquisitions and Takeovers Act (Cth) (FATA) in 1975, the legislation has only been substantively amended three times.

As we have previously argued, ensuring Australia remains vigilant in continuing to assess how its foreign investment framework accommodates developments in the global economy and capital markets is paramount to our ability to continue to attract FDI.

For these reasons, we support the proposals for reform and consider them significant in the context of the modernisation and simplification of Australia's foreign investment framework. In addition, we support reforms in the area of conditional approvals.

2.1 Conditional approvals

The FATA and Australia's Foreign Investment Policy (Policy) provides the Australian Treasurer with the right to make an order prohibiting a foreign investment proposal from proceeding or limiting it if he or she is 'satisfied' that allowing it to go ahead would be contrary to the 'national interest' (FATA 1975).

Under FATA, the Treasurer may permit foreign investment on the basis of conditions which the Treasurer considers necessary to ensure that the proposal, if carried out, will not be contrary to the national interest (FATA 1975) .

The use of conditions has been prevalent, indeed since 2006 the median percentage of applications approved with conditions was 56%.

Outcome	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Total considered	7025	8548	5821	4703	10865	11420	13,322	25,005
Total approved	6157	7841	5352	4401	10293	10703	12731	24102
Approved unconditionally	1520	1656	2266	2672	4606	4900	5535	12307
Approved with conditions	**4637**	**6185**	**3086**	**1729**	**5687**	**5803**	**7196**	**11795**
Percentage approved with conditions	**75%**	**79%**	**58%**	**39%**	**55%**	**54%**	**57%**	**49%**

Source: Applications considered (number of proposals) Foreign Investment Review Board Annual Report 2013-14

While not all decisions of the Treasurer (including those which are made subject to conditions) are made publicly available, the media releases from the Treasurer in relation to more controversial decisions indicate that conditions

provide the Treasurer with considerable flexibility. Based on publicly available decisions, it is possible to discern some common conditions imposed by the Treasurer.

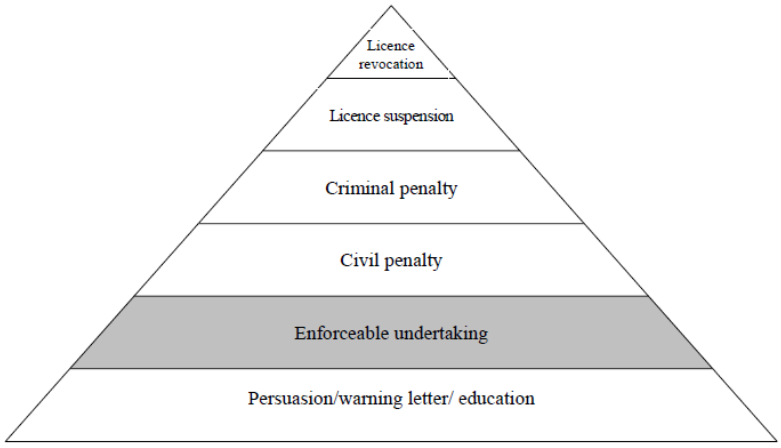
Common conditions which have previously been imposed on foreign investors across a number of sectors include [5]:	**Examples**
Business to remain headquartered in Australia	China Minmetals acquisition of OZ Minerals Yanzhou Coal acquisition of Felix Resources Red Earth increase of interest in PBL Media Brambles merger with GKN plc (dual listed companies)
Key management to be Australian based	China Minmetals acquisition of OZ Minerals Yanzhou Coal acquisition of Felix Resources Red Earth increase of interest in PBL Media CanWest acquisition of majority stake in Ten Network Holdings Brambles merger with GKN plc (dual listed companies)
Assets to be operated according to commercial objectives	JBS acquisition of Primo China Minmetals acquisition of OZ Minerals Yanzhou Coal acquisition of Felix Resources
Public reporting / transparency	JBS acquisition of Primo China Minmetals acquisition of OZ Minerals Yanzhou Coal acquisition of Felix Resources
Compliance with Australian law	China Minmetals acquisition of OZ Minerals BHP Billiton's acquisition of WMC Resources
National security	Thales acquisition of remaining 50% interest in ADI Limited China Minmetals acquisition of OZ Minerals
Asset-specific conditions	JBS acquisition Wilmar International's acquisition of Sucrogen from CSR China Minmetals acquisition of OZ Minerals Anshan Iron and Steel acquisition of additional share in Gindalbie Metals Airline Partners Australia seeking to takeover Qantas

The ability to impose conditions provides the Treasurer with an option for foreign investment which enables approval of foreign investment in a manner which limits or reverses any potential national interest concerns in contrast to outright prohibition.

As it stands today if an investor breached a condition, then the Treasurer would have to treat the acquisition as having been made in breach of FATA because the condition was breached. In essence this provides the Government with only a 'nuclear' option, which involves the imposition of a criminal penalty and divestiture [6 ss 25(1B) and (1C)].

The position for conditions imposed as part of an approval, is likely to be improved by the proposed new civil penalty and infringement notice regime and provide a less blunt response to a failure to comply with the conditions. In our view though, an explicit enforceable undertaking regime might further enhance the enforcement of FATA and the Policy.

This would provide the Government with a range of options within Braithwaite's enforcement pyramid (Ayres & Braithwaite 1992).



This model allows the regulator to differentiate its process to systemically treat entities differently based on the regulator's assessment of the risks of the entity's non-compliance.

2.2 Enforceable undertakings

Enforceable undertakings are an Australian invention and the product of two inquiries into legislative control of mergers and acquisition which followed the 1980s takeovers boom and were ultimately introduced into the Trade Practices Act 1974 (Cth) in 1992 (Robertson 2014).

In broad terms, the enforceable undertakings framework (which have not been amended since their introduction in 1992 and replicated in the Competition and Consumer Act 2010 (Cth) (CCA)) gives the Australian Competition and Consumer Commission (ACCC) the ability to accept written undertakings in the exercise of its powers under the CCA and for the enforcement of such undertakings in the Federal Court of Australia. Under the regime, parties that give such undertakings may subsequently withdraw or vary them with the consent of the ACCC.

The success of an enforceable undertaking model (albeit focused more on enforcement associated with breach of law, rather than as a preventative tool to manage the potential effects of proposed conduct, for example the detriment to competition in the case of a merger), has resulted in the adoption of the regime by a number of Australian regulators. In 1998, the Australian Securities and Investments Commission (ASIC) was given powers similar to those in the CCA under section 93AA the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act).

In the early to mid-2000s a number of other regulators were given the power to accept enforceable undertakings (along the lines of section 87B of the CCA and section 93AA of the ASIC Act) including the Australian Prudential Regulation Authority, Takeovers Panel and the Australian Communications and Media Authority (Robertson 2014).

In addition to regulators, legislative frameworks have adopted the enforceable undertaking model with a Federal Minister granted the power to accept enforceable undertakings. While providing power to the Federal Minister, these regimes work in a manner similar to the ACCC and ASIC models.

For example, if the Environment Minister considers that an action taken by a person has contravened a civil penalty provision of Part 3 of the Environment Protection and Biodiversity Conservation Act 1999 (Cth), the Minister may make certain administrative penalty decisions, including and accepting an enforceable undertaking pursuant to section 486DA of the Act.

Based on models such as that adopted under the Environment Protection and Biodiversity Conservation Act 1999 (Cth), the lack of a 'regulator' for FATA would not prevent the adoption of the enforceable undertaking model with the Treasurer being granted the power to accept and enforce the undertakings. The now ubiquitous nature of enforceable undertaking models in Australia and the similarity between the models adopted, particularly by ASIC and the ACCC, has been recognised in a number of judgments and there is a relatively significant body of judicial opinion. The judgments in relation to these provisions are regularly cross-referenced and have built up a considerable body of law (Nehme 2012, p. 147).

The introduction of an enforceable undertaking regime would provide the Treasurer and applicants with a regime which is well understood and a significant body of law on which to rely in its interpretation.

2.3 Consequences for breach

One of the characteristics of an enforceable undertaking is the possibility for the regulator to enforce the undertaking in court in case of non-compliance with the terms of the undertaking (Nehme 2007). Existing enforcement models adopted by the ACCC and ASIC adopt as a standard practice the inclusion of undertakings relating to the provision of periodic information and reporting to audit compliance with the undertakings.

The existing ACCC and ASIC enforcement models enable a court to take action if a party breaches a term of an undertaking including:

- an order directing compliance with the undertaking;
- an order for the party to pay an amount up to the amount of any financial benefit that can be reasonably attributed to the breach;
- any order the court considers appropriate to compensate any other person who has suffered loss or damage as a result of the breach; or
- any other order that the court considers appropriate.

If the FATA undertaking provisions were drafted in similar terms to the ACCC and ASIC legislation, then the Treasurer and ultimately the court would have at its disposal a wide range of remedies to apply to the breach beyond either a civil penalty (as currently proposed by the Government) or as is currently the case

divestiture and criminal sanction. This would be a solution that would provide the Government with considerable flexibility in the way it manages conditions and any breaches of them, and that is consistent with the enforcement pyramid discussed above.

2.4 Consistency, precision and transparency

The enforceable undertaking regimes adopted in other contexts and in particular by the ACCC and ASIC require that undertakings are in writing, detailed, specific and free from ambiguity. As a general matter courts have required that the terms of an enforceable undertaking need to be formulated with precision so that they are capable of being obeyed (ACCC 1999; Nehme 2008, p.165).

There is a very real tension between the flexibility of an undertaking model to address particular cases and ensuring consistency and transparency in determining the actual terms of enforceable undertakings. The use of similar structures and wordings helps business to predict with certainty the content of an undertaking that is likely to be acceptable.

Most Australian enforceable undertaking models do not require the regulator to keep a public register of accepted undertakings. Nevertheless most regulators that use enforceable undertakings regularly do both (Johnstone & Parker 2010).

As a practical matter, the adoption of an enforceable undertaking model is likely to mean that some of the more vague language currently used for FATA conditions will need to be improved. Like the ACCC and ASIC, the Government would need to adopt templates and guides in relation to the content of the foreign investment conditions that take into consideration the different decisions made by the courts in relation to the enforcement of ACCC and ASIC undertakings.

3 Treatment of SOEs – conditional approvals a means to manage concerns

A notable trend in FDI in Australia in recent years has been the rising amount of investment by Chinese Sovereign Wealth Funds (SWFs) and State Owned Enterprises (SOEs). In 2013/2014, China was the largest investor in Australia by value of all approvals at 17% of the total value. This marks the first time China was the largest source country for approved investments.

3.1 SOEs

SOEs have been defined as enterprises 'where the state has significant control, through full, majority, or significant minority ownership' (OECD 2005, p.11); giving rise to concerns that a SOE may make an investment, or that a SOE may direct or control companies it has invested in, for political purposes rather than strictly commercial purposes.

SOEs tend to make commercially strategic direct investments such as acquisitions of already listed corporations in international markets, often following national development agendas. In doing so, SOEs have tended to invest in areas of priority for their home-states, being natural resources, utilities, telecommunication services, and defence (Gilligan et al. 2014, p. 4).

Under the Policy (proposed by the Government as part of its modernisation plans to be incorporated in FATA), any direct investment by foreign government investors (an entity in which a foreign government or its agencies have an interest of 15% or more, or an aggregate interest of 40% or more including SOEs and SWFs) is subject to compulsory notification for prior approval regardless of the size of the proposed investment. In addition to these thresholds, control by a foreign government or its agencies or control by virtue of being part of a controlling group would also constitute a foreign government investor. Any investment of 10% or more in an entity is considered to be a direct investment, and an interest of less than 10% may also be considered a direct investment if the investor is using the investment to influence or control the target.

In reality, while it may be that by making commercially strategic direct investments SOEs are following national development agendas, there is little to no support for the proposition that investments by SOEs are politically motivated or would jeopardise the recipient country's national security.

3.2 Behavioural conditions

Since 2008, the Government has managed concerns surrounding the character of SOEs by imposing market based behavioural conditions on them to ensure that they operate in a manner consistent with normal commercial actors and adhere to standards of corporate governance to which an Australian operation would be measured.

These conditions, which have been readily accepted and complied with by SOEs, require them to operate their Australian assets as a separate business unit on an arm's length basis and comply with specific governance conditions.

For example, investment approval was granted to Chinese SOEs in connection with the acquisition of the majority of assets of OZ Minerals Limited by China Minmetals Corporation and Yanzhou Coal's acquisition of Felix Resources on the following conditions:

- that offtake be sold on an arm's length basis with reference to international benchmarks and in line with market practice;
- that the Australian business be incorporated, headquartered and managed in Australia under a predominantly Australian management team, with the CEO and CFO to have their principal place of residence in Australia; and
- that the boards of the Australian businesses have at least two directors whose principal place of residence is Australia and that the majority of all regularly scheduled meetings of those boards are held in Australia.

Then, in approving Shandong RuYi Scientific & Technological Group Co Ltd and Lempriere Pty Ltd's acquisition of Cubbie Group Limited, the Treasurer imposed conditions that:

- Shangdong RuYi Scientific & Technological Group Co Ltd sell down its interest in the Cubbie Group Limited from 80% to 51% to an independent third party (or parties) within three years of completing the proposed acquisition, and investigate the possibility of publicly listing Cubbie Group Limited in order to achieve this sell down;
- the Cubbie Group Limited be managed and operated by a wholly-owned subsidiary of Lempriere Pty Ltd, including the marketing and sale of its cotton production on arm's length terms in line with international benchmarks and standard market practices; and
- Shandong RuYi Scientific & Technological Group Co Ltd and Lempriere Pty Ltd establish and maintain a board of six members comprising two independent directors who are Australian residents with relevant commercial or agricultural experience and one director appointed by Lempriere Pty Ltd.

Others adopt the model

The imposition of behavioural conditions to manage concerns about SOE investment have been adopted elsewhere.

In 2012 following political and community disquiet about foreign investment approval for China National Offshore Oil Corporation's acquisition of Nexen Inc, the Canadian Government announced its new and more stringent Policy Guideline for foreign investment by SOEs (Guideline)[1].

The Guideline sets out new factors that SOE applicants seeking approval will need to address. In particular, the Guideline provides that when assessing an acquisition the Minister will examine the corporate governance and reporting structure of the SOE including whether the SOE adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders), and to Canadian laws and practices.

The Guideline notes that specific undertakings related to these matters may assist an applicant, including the appointment of Canadians as independent directors on the board, the employment of Canadians in senior management positions, the incorporation of the business in Canada, and the listing of shares of the acquiring company or the Canadian business being acquired on a Canadian stock exchange.

4 Race for capital

[1] Guidelines — Investment by state-owned enterprises — Net benefit assessment, viewed 11 June 2015, http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2.

In a global market for capital, the more roadblocks we put in the way of foreign direct investment – the more we aggravate the effect of the gap between our necessarily small domestic savings base and global investment flows. Post GFC there is no doubt that the economics of how investment flows is changing and we need to be nimble to retain our fair share.

For Australia to benefit from its trade relationship with China, including under the China-Australia Free Trade Agreement, it needs to work at being seen to welcome foreign investment in Australia. Consistent with the 2015 Budget under which the Federal Government announced $50 million to support foreign investment in Australia, Australia must continue to promote itself as an investment destination, including by investors and investing nations like China.

Initiatives to strengthen and deepen Australia and China's trade relationship should extend beyond mere platitudes. Continued transparency and consistency are fundamental to an effective foreign investment framework, and will encourage Chinese investors to view Australia as a recipient of their capital in a competitive market for resources. Corporate governance of SOEs is evolving towards a system of market disciplines driven by profit, and demonstrating an appreciation of the dynamic nature of SOE reform and the drivers for SOE investment through engagement and analysis will benefit Australia.

Using the same line of reasoning and having regard to the enforceable undertaking model proposed in this paper, once a SOE has demonstrated commitment to complying with behavioural conditions imposed by the Treasurer in granting foreign investment approval, that SOE should be permitted to fast track the foreign investment framework approval process in future investments. This not only provides an additional incentive to SOEs to comply with existing behaviour conditions, but also facilitates additional FDI in Australia by that Chinese SOE.

Without a demonstrated concern based on fact, imposing onerous restrictions on foreign government investors, including SOEs, or worse yet, rejecting investment proposals on the sole basis of community concern, does nothing more than provide assurance to xenophobic elements of the community.

5 Conclusion

Australia has an enlightened foreign investment framework which has served us well in the development of globally competitive businesses and in addressing community concerns about the potential erosion of Australian sovereignty. There is no doubt that foreign investment has delivered significant economic and social benefits to all Australians.

If our foreign investment framework needs changes - the changes should focus on enhancing the effectiveness of our existing policies. As the former Treasury Secretary Dr Parkinson argued there is not enough capital within Australia to invest in developing assets, this is why foreign investment is in Australia's national interest (Australian Broadcasting Corporation 2011).

We hope that more attention is paid to the facts of foreign investment rather than the hype and that we can have a sensible discussion including some legislative tune ups to reform our foreign investment regime for the 21st Century. There is a path forward that will allow Australia to profit from access to foreign capital while still protecting our 'national interest'. Following that path will require a willingness by business, the academy and the Government to ensure better communication with the wider community about the real facts behind Australia's foreign investment policy, guidelines and decisions.

References

[1] Abbott, T (2012), 'The importance of good government to economic prosperity', transcript, The Liberal Party, 29 August 2012, viewed 11 June 2015, https://www.liberal.org.au/latest-news/2012/08/29/importance-good-government-economic-prosperity.
[2] Australian Broadcasting Corporation (2011), 'Australians must increase productivity: Treasury head', 1 July 2011, viewed 11 June 2015, http://www.abc.net.au/news/2011-07-01/australians-must-increase-productivity-treasury/2778520.
[3] ACCC (1999), Australian Competition and Consumer Commission v Real Estate Institute (WA) Inc (1999) 161 ALR 7.
[4] Ayres, I and Braithwaite, J (1992), Responsive Regulation: Transcending the Deregulation Debate, Oxford University Press, New York.
[5] FIRB Publications: Annual Reports, viewed 13 February 2014, http://www.firb.gov.au/content/publications.asp?NavID=5.
[6] Foreign Acquisitions and Takeovers Act 1975 (Cth).
[7] Gilligan, G, O'Brien J, and Bowman, M (2014), 'Foreign Investment Law and Policy in Australia: A Critical Analysis' CIFR Paper No. 008/2014.
[8] Hockey, J (2013), 'Address to 2013 Foreign Investor Dialogue- International CEO Forum', transcript, Joe Hockey, 26 June 2013, viewed 11 June 2015, http://www.joehockey.com/media/speeches/details.aspx?s=120.
[9] Johnstone, R and Parker, C (2010), Enforceable Undertakings in Action-Report of a Roundtable Discussion with Australian Regulators, viewed 11 June 2015, https://www.law.unimelb.edu.au/files/dmfile/ParkerandJohnstoneEnforceableUndertakingsinActionReportofaRoundtableDiscussionwithAustralianRegulatorsFinalEUWorkingPaper17Feb20101.pdf.
[10] Australian Treasury (2015a), Modernising Australia's Foreign Investment Framework, viewed 11 June 2015, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Modernising-Australias-foreign-investment-framework.
[11] Nehme, M (2007), 'Enforceable Undertakings: A New Form of Settlement to Resolve Alleged Breaches of the Law', University of Western Sydney Law Review, Vol. 11 No. 1, pp104-123.
[12] Nehme, M (2008), 'Enforceable Undertakings and the Court System' Company and Securities Law Journal, Vol. 26, pp147-171.

[13] Nehme, M (2008), 'The Use of Enforceable Undertakings by the Australian Competition and Consumer Commission', University of Tasmania Law Review, Vol. 27 No. 2, pp. 197-228.
[14] OECD (2005), Guidelines on Corporate Governance of State-owned Enterprises, OECD Publishing, viewed 11 June 2015, http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf.
[15] Robertson, A. (2014), 'Statutory undertakings: their history, use and utility and the perspective of the Court', paper presented at the 12th Annual University of South Australia Competition and Consumer Workshop, 10-11 October 2014, Adelaide, Australia.
[16] Australian Treasury (2015b), Strengthening Australia's Foreign Investment Framework, viewed 11 June 2015, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Strengthening%20Australias%20foreign%20investment%20framework/Key%20Documents/PDF/Australias%20foreign%20investment%20framework.ashx.
[17] The Treasurer (2015), Australia's Foreign Investment Policy, viewed 11 June 2015, http://www.firb.gov.au/content/_downloads/AFIP_2015.pdf.
[18] Guidelines — Investment by state-owned enterprises — Net benefit assessment, viewed 11 June 2015, http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2.