



Law Council
OF AUSTRALIA

Business Law Section

Manager
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Foreign Investment & Trade Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
Via email: ForeignInvestmentConsultation@treasury.gov.au

17 July 2015

Dear Sir or Madam,

Submission on Foreign Investment Reforms – Draft Legislation

Attached is a submission prepared by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia (“**Committee**”), in response to the draft legislation to implement the Australian Government’s proposed foreign investment reforms (“**Submission**”).

We welcome the Government’s proposal to modernise and improve the foreign investment framework of Australia.

However, we are concerned that the short exposure time does not allow a proper consideration of the proposed amendments. We request an opportunity to meet with representatives of the Treasury and the Minister’s office to discuss the comments we have made.

In the first instance, please contact:

- Committee Chair, Malcolm Brennan, on 02-6217 6054 or via email: Malcolm.Brennan@au.kwm.com
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Yours faithfully,

John Keeves, Chairman
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**FOREIGN INVESTMENT COMMITTEE OF THE BUSINESS LAW SECTION
OF THE LAW COUNCIL OF AUSTRALIA**

SUBMISSION ON FOREIGN INVESTMENT REFORMS – DRAFT LEGISLATION

This is a submission prepared by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia (“**Committee**”), in response to:

- the exposure draft of the Foreign Acquisitions and Takeovers Legislation Amendment Bill 2015 (“**Draft FATA Amendment Bill**”), attaching at Schedule 1 the amendments to the current legislation (“**Draft Act**”);¹
- the draft Foreign Acquisitions and Takeovers Regulation 2015 (“**Draft Regulations**”);
- the exposure draft of the Register of Foreign Ownership of Agricultural Land Bill 2015 (“**Draft Agricultural Land Register Bill**”),

(“**Submission**”).

We welcome the Government's proposal to modernise and improve the foreign investment framework of Australia. Particularly welcome are:

- the lifting of the substantial interest threshold to 20%; and
- the capacity to extend the time period for the Treasurer's determination in relation to a notification without the need to withdraw and re-submit the application.

Given the importance of the proposed changes to the Foreign Acquisitions and Takeovers Act 1975 (“**Act**” or “**FATA**”) and the magnitude and potential complexity of the amendments, great care is required to ensure that any amendments operate as intended and there are no adverse long term implications on Australia's competitiveness in attracting foreign investment.

We are concerned the short exposure period does not allow a proper consideration of the proposed amendments. Given the available time, our Submission is inevitably high level and we are unable to cover all issues exhaustively. We request an opportunity to meet with representatives of the Treasury and the Minister's office to discuss our Submission further. We would be happy to provide a more detailed explanation of any of these comments if that would assist the Government in preparing a revised draft of the legislation.

Below are our comments and recommendations on the proposed legislation.

1 THE IMPORTANCE AND MECHANICS OF THE REGULATIONS AND EXEMPTIONS

In general, we consider the use of regulations and the inclusion of waiver or exemption powers in the regulations to be an appropriate structure to adopt. We submit that it would be best to avoid further complexity or detailed prescription in the Act itself. Rather, additional detailed drafting should be included in the regulations where it can more easily be amended to address any uncertainty or inconsistency and improve the drafting and policy over time. We also suggest including sufficiently broad powers of waiver and exemption in the Act to allow appropriate flexibility.

To create greater flexibility to deal with anomalies that might be identified over time, we suggest that maximum flexibility be built into the regulation power in Part 2 (section 60) to also allow the regulation to modify the meaning of significant action, notifiable action, substantial interest, aggregate substantial interest and direct interest in particular identified circumstances. As noted in this Submission paragraph 2.2(h) below, we suggest the regulation power explicitly extend to the association definition.

¹ Unless specified, section references are to sections in the Draft Act.

We understand that the regulations will be subject to further consultation later in the year. Given their significance, we urge that the Government provide a reasonable period of time for extensive and proper consideration of these regulations, in particular as they concern the proposed fee regime and the agricultural land definition (which we submit requires further work).

We have commented on the Draft Regulations where possible, but apart from the moneylending exemption we have not undertaken a detailed analysis at this point. We assume some of the issues raised in our prior submissions will be addressed in a revised draft of the regulations (see our comments in this Submission paragraph 9.3).

2 STRUCTURE OF THE NEW REGIME FOR COMMERCIAL TRANSACTIONS

We support the general structure of the new regime generally (significant action and notifiable action). It is unfortunate that these provisions are complex and it will be important that plain English summaries are prepared and available in a variety of foreign languages as part of the promulgation of the new provisions.

We have the following key comments on the general structure of the regime as it applies to commercial transactions.

2.1 Relief for Australian entities deemed foreign

We welcome the change in Draft Regulation 32 that addresses to a large extent the significant red tape compliance issue for widely held ASX listed companies deemed foreign because of foreign persons holding an aggregate substantial interest, by disregarding holdings of less than 5% from the calculation of aggregate substantial interest. As noted in paragraph 1, we recommend that there also be a power to modify the definition of “aggregate substantial interest” to ensure Draft Regulation 32 achieves its intended effect.

2.2 Definition of associate

We welcome the proposal to modernise and improve the definition of “associate” in the Draft Act. In particular, we welcome the proposed omission of the existing provision that makes a person an associate if they are an associate of another associate (including through prior applications of the provision). This provision has created significant difficulty in the past and is unnecessary for the proper operation of the Act.

We also support much of the proposed redrafting of the definition. However, we have a number of suggestions that we believe would help to make the provisions operate more smoothly:

- (a) **Clarify reference point for action in concert.** We support the proposal to include section 6(1)(b) (dealing with persons acting in concert). However, it is unclear what the reference point for any acting in concert is intended to be. In the Corporations Act, for the purposes of Chapter 6 (and related provisions), people are treated as being associates “in relation to [a] designated body” if they are acting, or proposing to act, in concert “in relation to the designated body’s affairs”.² We believe the FATA provision needs to operate in a similar way. People may act in concert in relation to one entity or asset but not others. It would plainly be wrong to treat people as associates for all purposes simply because they have acted in concert in relation to one particular investment. Accordingly, the FATA provision needs to be redrafted in a similar fashion to the relevant Corporations Act provision.³

² See section 12(2)(c) of the Corporations Act. It appears the provision in the Draft Act may have been modelled on section 15(1)(a) of the Corporations Act, but this provision has not operated for Chapter 6 purposes since Chapter 6 was re-written in 2001. In our view, it is the Chapter 6 provisions that are most relevant for FATA purposes.

³ As noted below, this comment applies to other sections of the definition of “associate” as well. It would therefore seem sensible to split the definition into two – covering those relationships which give rise to an association for all purposes (such as relatives) and those which only give rise to associations for specific purposes separately.

- (b) **Exclude persons who become associated in any way.** We oppose the proposal to include section 6(1)(c) (dealing with persons who are, or propose to become, associated formally or informally, in any way). This provision appears to be modelled on section 15(1)(c) of the Corporations Act. However, the Courts have criticised this provision as being vague and imprecise and have had considerable difficulty in giving it effective operation. See for example the comments of O'Bryan J in *TVW Enterprises Ltd v Queensland Press Ltd* [1983] 2 VR 529 at 546 and the decision of Owen J in *Bank of Western Australia Ltd v Ocean Trawlers Pty Ltd* (1995) 13 WAR 407. Principally for these reasons, the provision no longer has any operation in relation to Chapter 6 of the Corporations Act and for the reasons noted above, we believe the FATA definition should be more closely aligned with the Chapter 6 definition.
- (c) **Limit association by partnership.** While section 6(1)(d) closely corresponds to section 6(1)(b) in the current Act, we believe it needs to be revised for three reasons:
- (a) First, it fails to take account of the commonplace use of limited partnerships by many investment funds. The limited partners in these funds are typically passive investors and the general partner controls all of the fund's investment activities. In light of this, limited partners in a limited partnership should not automatically be treated as associates.
- (b) Secondly, as with our comments on the "acting in concert" limb of the definition, section 6(1)(d) should only operate for designated purposes. Partners should only be treated as associates in relation to an entity or asset if their partnership relates to that entity or asset.
- (c) The provision may have anomalous operation in relation to large-scale professional partnerships. Accordingly, it would be desirable to exclude partnerships referred to in regulation 2A.1.01 of the Corporations Regulations from its operation.
- (d) **Delete association of other senior officer.** Section 6(1)(g) should be deleted. Senior officers will be associates of their corporation but it should not follow that they are associates of each other unless they are actually acting in concert with each other.
- (e) **Delete association of trustee and substantial holder.** Sections 6(1)(l) and 6(1)(m) should be deleted. The acting in concert provision should adequately cover situations in which a trust and a trust beneficiary should be considered to be associated. Note that, unlike a company in which a foreign person invests, the trustee of a trust in which a foreign person invests may carry on business activities for their own account or for the account of other trusts that are completely unrelated to the investment by the foreign person.
- (f) **Delete automatic association for foreign government investors from a single country.** As noted in this Submission paragraph 4.3 below, we believe that section 6(1)(n) (dealing with foreign government investors from a single country) operates too broadly and should be deleted.
- (g) **Delete association in anti-avoidance schemes.** We oppose the inclusion of section 6(1)(o) (dealing with parties to anti-avoidance schemes). Section 83 only applies to a scheme when the Treasurer is satisfied that any of the parties to the scheme had the requisite anti-avoidance purpose. But section 6(1)(o) may then retrospectively treat all parties to the scheme (including persons who did not share that purpose) as associates. In our view, it would be far preferable for section 83 to be a self-contained provision dealing with anti-avoidance schemes. If need be, this could then include prospectively designating some or all of the parties to the scheme as associates for particular purposes. However, persons should not be exposed to being

retrospectively treated as associates as a result of the exercise of an administrative discretion.

(h) **Use regulations and exemption certificates to declare persons not associates.** Finally, we believe it would be desirable to include provisions:

- (i) to make it clear the regulations can declare persons (or classes of persons) not to be associates; and
- (ii) to allow the Treasurer to grant exemption certificates to declare persons not to be associates.

It is unclear whether section 43 currently extends the regulation-making power this far and experience with the equivalent provisions in the Corporations Act shows that it is essential to have a non-legislative mechanism for dealing with unintended consequences that may be discovered over time (particularly when the provisions have only been exposed for comment for such a short period). We submit regulations would be the more appropriate mechanism for dealing with issues of this sort if time permits, but the Treasurer should also have a power to grant exemption certificates on a case by case basis (somewhat akin to ASIC's power to modify the corresponding provisions of the Corporations Act).

2.3 Concepts of entities – trusts and unit trusts

We submit that there are difficulties in the current drafting of the Draft Act as it applies to trusts. We support the extension of the concept of an Australian entity to include a trust as well as a corporation, but believe further drafting is required.

Our key comments on this issue are as follows:

- (a) **An entity should include a trust generally and not just a unit trust.** The definition of Australian entity (section 4) refers to an Australian unit trust that is then further defined (section 4), limiting these concepts to a unit trust (which is primarily a commercial concept rather than the terms of the legal basis on which a trustee holds assets for beneficiaries). We consider that the definitions should extend beyond unit trusts to trusts generally to achieve the policy objective. This comment is also relevant to the definitions of significant action and notifiable action (section 46(4)(c) and section 52(4)(b)).
- (b) **Deemed interest too broad.** The deeming provision that extends the rules relating to determining percentages of interests in entities to any potential beneficiary of a discretionary trust (section 18(3)) is overbroad. A discretionary trust may include extensive and potentially indeterminate categories of potential beneficiaries. We would either suggest its removal (and rely on the anti-avoidance provisions) or alternatively the deeming provision should only extend to beneficiaries that are nominated as beneficiary by the trustee of a discretionary trust and have received 20% or more of the capital or income of the discretionary trust over the previous 3 years.

2.4 Concepts of entities – limited partnership

We think that there is a cogent basis for extending the concept of entities to treating limited partnerships in a similar manner as unit holders in a unit trust, i.e. the general partner like the trustee is taken to have the primary interest but the limited partners would not be taken to have the same interest as the general partner unless they owned more than 20% of the limited partnership interests.

2.5 **Amendment versus entry into an agreement**

At a practical level, we do not think that the amendment or variation of an agreement should be considered a further entry of an agreement (section 25(1)(b)). For example, it is common for parties who have entered into a sale and purchase agreement and obtained FIRB approval to have a completion accounts dispute and enter into an agreement to resolve it. That should not require re-notification.

2.6 **Substantial interest to better align with the Corporations Act takeovers provisions**

To better align with the Corporations Act takeovers provisions, we recommend that substantial interest be set at “more than” 20% and not “at least” 20%.

2.7 **Deemed 20% voting power through veto power too broad**

We think that the automatic deeming of 20% potential voting power (and thereby a substantial interest) as a result of the granting of veto rights on any resolution of the board or general meeting (section 22(4)) needs to be deleted. Typically co-investment arrangements will provide for certain minority protections which do not confer control or influence but protect the substance of the minority’s investment (for example, no changes to constitution or rights attaching to certain securities without the approval of the minority). These are vastly different veto rights than a veto over something fundamental like the budget and business plan. We do not think it is practicable to define all potential indicia of control which is why we think that this can be removed, relying on the provisions of section 59 (which will be interpreted in light of the CanWest Federal Court decision regarding de facto control).

2.8 **Interest in security and asset**

We make the following comments regarding the meaning of interest in a security (section 9) and interest in an asset (section 10).

- (a) **Exclude pre-emptive rights from interest in a security.** There is some uncertainty as to whether some rights amount to equitable interests in securities. For example, pre-emptive rights and compulsory transfer rights following an event of default. The Corporation Act, excludes from consideration pre-emptive rights on the transfer of securities contained in a constitution if all members have pre-emptive rights on the same terms. While the Corporations Act section 609(8) relevant interest exclusion does not go as far, we recommend that the definition of an “interest” in a security in section 9(1) should expressly exclude any interest that arises solely because of pre-emptive rights or compulsory transfers under a shareholders agreement or a constitution if all members have pre-emptive rights on the same terms as it should not matter which document the rights are contained in for the exclusion to apply. This could be dealt with in the regulations.
- (b) **Redefine right attached to the security.** It is unclear what is meant by a right attached to the security (section 9(2)). Does it only include rights linked to the security itself such as the right to receive declared dividends and the right to vote at general meetings or does it extend to the ability to sell? It would be better to start with the approach used in Chapter 6 of the Corporations Act: (a) power to exercise, or control the exercise of, a right to vote attached to the security and (b) power to dispose of, or control the exercise of the power to dispose of, the security. If desired, other matters could be added such as the right to receive dividends.

2.9 **Cessation of control should not be a significant action**

It is not clear why a person ceasing to control an entity or business of itself should constitute a change of control giving rise to a significant action (section 59(3)(b)). If the intention is to capture cases where control becomes concentrated in the hands of foreign persons, we suggest that section 59(3)(b) be clarified to “a person would cease, or has ceased, to be a person who controls the entity or business *and as a result there is an increase in control of the*

entity or business by one or more foreign persons". In our view, there should not be a change of control involving a foreign person merely because someone else ceases to have control.

2.10 **Exempt accelerated rights issue and distribution reinvestment plans**

We recommend that the exemption for rights issue (Draft Regulation 34) be clarified to apply to accelerated rights issue where there is a separation between the institutional and retail offer. Under the Corporations Act, this was achieved by modifying the section 9A definition through ASIC Class Order 08/35. We suggest that the reference to section 9A of the Corporations Act be extended to "...as modified by ASIC class orders".

As noted in our prior submission, we recommend that a similar exemption be available to dividend or distribution reinvestment plans.

2.11 **Staple provisions and unified entity provisions**

The Draft Act introduces new deeming provisions for stapled entities and unified entities (section 70 and section 29(3)(4)). We support the extension of the legislation in this way.

3 **AGRICULTURAL LAND AND AGRIBUSINESS REGULATION**

Save for the percentage interest thresholds referred to below, the approach to the regulation of agricultural land and agribusiness appears in keeping with the Government's stated approach to the sector.

We have the following key comments on the regulation of investments in agribusiness, agricultural land and the agricultural land register.

3.1 **Agricultural land definition too broad**

We consider the definition of agricultural land as land that is used, or that could reasonably be used for primary production business to be too broad and uncertain (section 4). It is not clear at what point land could be said to reasonably be used for such a purpose. For example, land that could reasonably be used for a primary production business may include:

- (a) vacant "rural" land held by a mining company for bio-diversity reasons and not for primary production;
- (b) vacant land held by a subdivision developer pending development;
- (c) mining tenements that cover land suitable for primary production where mining operations have not yet started;
- (d) mining tenements that cover land where mining operations have started but which could, following the cessation of mining operations and extensive remediation, be suitable for primary production in the long term future; and
- (e) land that is used as buffer land for mining.

We are concerned that the proposed definition will require an extensive assessment by miners of all their land holdings in order to determine whether they could reasonably be used for a primary production business. Miners may not have the necessary expertise to make this assessment themselves. Some may be attracted to an approach whereby they simply assume all their land holdings are agricultural land and file notifications with the Australian Taxation Office for that purpose.

Comments made in paragraph 2.40 of the explanatory material appear to encourage a very broad approach being taken to classifying land as agricultural land given the emphasis on the theoretical feasibility that land may be agricultural land rather than the actual likelihood that it ever will be used for a primary production business in the foreseeable future.

To take one of the above examples, while vacant land on the urban fringe may well be suitable for primary production, the likelihood is very remote that a developer who purchases the land will put it to that use rather than for residential subdivision.

Similarly, a miner who acquires land as a buffer to its mine is unlikely to reverse course and use the land other than as a buffer while its mine is in operation. As with the mine itself, it is possible that, one day, the land may revert to use for a primary production business but, if that day is many years away, it doesn't seem sensible to classify the land as agricultural land in the present.

Aside from the regulatory burdens that a wide definition will cause, it is quite likely to result in significant landholdings being included in the Register of Foreign Ownership of Agricultural Land (as it relies on the same definition) which are not used for primary production and are unlikely to be so used in the foreseeable future. This will frustrate one of the objects of establishing the Register: an increase in transparency on the levels of foreign ownership of agricultural land in Australia.

Alternative formulation

We suggest an alternative formulation whereby land not currently used for a primary production business is only caught by the definition if it is able to be used immediately and in its present state for a primary production business.

Exceptions in regulations

Alternatively, the Draft Act indicates that regulations may be made to remove types of "agricultural land" from the Act. We suggest the following exceptions be included:

- (f) land that is not used for a primary production business and which is the subject of a residential or commercial development application or approval;
- (g) land that is not used for a primary production business and which comprises a mining tenement; and
- (h) land that is held or used for a business purpose that is incompatible with the use for a primary production business.

Whilst the example in section 58(2) notes that an interest in land may cover an interest in a mining tenement and an interest in agricultural land, it does not assist with the understanding of whether the land could be reasonably used for primary production.

It should also be made clear that an interest in Australian land (including agricultural land) generally does not include an exploration permit unless the exploration permit:

- (a) allows for rights of occupation, over and above the right to enter and explore; or
- (b) provides for the sharing of income or profits from the underlying land.

3.2 Clarify when land must be notified under the agricultural land register

The Draft Agricultural Land Register Bill uses the same definition of agricultural land in the Draft Act. Land held by a foreign person must be notified under the agricultural land register when the land becomes, or ceases to be, agricultural land.

Under the current proposed definition, it is too uncertain when land could become, or cease to be, reasonably used for primary production business and hence when the notification obligation arises. We believe the definition as proposed in this Submission paragraph 3.1 (Alternative formulation) above would be clearer.

Alternatively, we recommend that the Minister uses his/her powers to make rules under section 35 of the Draft Agricultural Land Register Bill to exempt the categories of land described in this Submission paragraph 3.1 (Exceptions in regulations) above.

3.3 Increase percentage threshold for agricultural land corporation

The current policy is that interests of 15% or more in a rural land rich corporation are to be notified. The proposed legislation reduces this to any interest in an agricultural land corporation. We submit that a 20% threshold matching that of the general corporate threshold be adopted.

3.4 Clarify agribusiness definition and rationale for direct interest notification threshold

The definitions of agribusiness and agricultural land result in certain entities being caught by one or both definitions. We assume this was intended.

It is not clear why acquisitions of 5%/10% or more (direct interest) in an agribusiness is the relevant notification threshold, rather than 20%, being the proposed threshold for acquiring a substantial interest in an Australian entity. We submit that the threshold for non-foreign government investors should match the 20% interest.

3.5 Impossible to value proportion of assets, revenue and profits attributed to agribusiness

We submit that the proposed approach regarding the approach to determining an agribusiness is flawed. The proposed legislation provides that an Australian business is an agribusiness, and an Australian entity carries on an agribusiness, if the value of assets used in, or profits derived from, carrying on an agribusiness is at least 25% of the total assets value or total revenue or profits (as relevant).

Where the agribusiness operations forms part of a larger business, there will be practical issues in isolating the assets, revenue and profits attributed to the agribusiness operations. This information may not be available publicly or at all, as financial reports are not generally based on the Australian and New Zealand Standard Industrial Classification Codes. There will also be shared resources and mixed revenue and profits that cannot be attributed solely to the agribusiness operations.

It will not be possible for a potential acquirer to ascertain whether the 25% threshold is exceeded. In all likelihood it will not be practicable for the target to make this assessment either.

With the suggestion of requiring direct interests (which may be as small as 1%) to be compulsorily notified, it is fundamentally wrong to impose an offence in circumstances where the acquirer will not have the ability to determine whether the target meets the agribusiness test. We suggest that an exemption or waiver power be available in circumstances where there is limited ability to determine whether a target's assets/operations are such as to meet the agribusiness threshold.

If a percentage threshold is to be used, it should be increased to 50% so that there is a greater margin for error. This is also the threshold for other land corporations and land trust estates. The relevant period in which the revenue and profits are generated also needs to be defined.

4 FOREIGN GOVERNMENT INVESTORS

We support the structure of the proposed legislation as it applies to foreign government investors ("direct interest" and "foreign government investor" defined through the Draft Regulations and made both a significant action and a notifiable action (Draft Regulation 39(3)).

However, a foreign government investor is defined broadly and simplistically to include entities in which governments, their agencies or related entities have an interest above a prescribed threshold. Such a definition ignores significant differences in the types of entities that have a degree of government ownership. A more express welcoming attitude to sovereign wealth funds (“**SWF’s**”) and private equity foreign direct investment would benefit Australia’s national interests having regard to the ongoing importance of SWF’s in areas such as the development and operation of infrastructure.

We have the following key comments on the proposed legislation:

4.1 **Distinguish certain sovereign wealth funds and state owned enterprises**

As set out in our prior submissions to Treasury, we believe SWF’s and state owned enterprises (“**SOE’s**”) are an increasingly important type of investor that should be encouraged to invest in Australia over other destinations for foreign direct investment.

We understand public concern that the Australian Government should be aware of what foreign governments are doing in Australia and government policy concerns that there is a risk SWF and SOE investments might not be commercial in nature or could be undertaken in pursuit of political or strategic objectives that may be contrary to Australia’s national interest. As we noted in our prior submission, we believe there is a significant difference between an investment by a foreign government or its instrumentalities and most investments by SWFs or SOEs. That difference should be recognised in Australia’s regulatory regime.

Further, while SWF’s are a heterogeneous group and the influence of government is always present as it is in SOE’s, SWF’s may be more readily distinguishable from SOE’s as special purpose funds or arrangements owned by the general government. They are commonly established from balance of payments surpluses, official foreign currency operations, the processes of privatisations, fiscal surpluses and/or receipts from commodity exports. The influence of government ownership upon SWF’s and their investment strategies may be less direct than it is for SOE’s and more predictable.

For example, Canada has adopted a regime that is more relaxed than that set out in the proposed legislation. We have suggested in our prior submissions a more relaxed passporting set of criteria for recognised SWF investors and recognised SOE investors that we believe has merit for consideration.

4.2 **Further distinguish financial sponsors from SOEs and SWFs**

Again, as set out in our prior submissions to Treasury, the broad definition of foreign government investors inadvertently captures domestic and offshore private equity funds whose investors include SWFs and other state owned entities such as pension funds and state owned university investment funds which invest in private equity funds. In the United States in particular, the level of ownership of these investors is often greater than 15% in any one fund (or more than 40% in aggregate by these types of investors). Importantly, however, such investments are usually passive and none of the relevant government entities have any influence or control over the investment or operational decisions of the private equity fund. In the experience of Committee members one of the most common investment forms is a limited liability partnership where the SWF investor holds passive limited partnership interests. It is the general partner of such an entity that exclusively makes investment decisions.

We believe that these types of investors should be excluded from the foreign government investor regime.

4.3 **Associate reference extends too far**

The associate definition in the Draft Act that deems all foreign government investors of a country to be associates of each other (section 6(1)(n)) extends too far and is inconsistent with current FIRB policy which does not treat SOE’s or SWF’s of a particular country to be associates of each other. For example, we consider that to treat all SOE’s of China or GIC

and Temasek of Singapore or all of the pension funds of Canada to be presumptively associates extends the associate reference beyond what is reasonable. Instead, as with other investors, there should be some evidence of action in concert before an association is justified between such investors. This provision should be deleted as it applies to foreign government investors.

We also note that if the proposed drafting was to be retained, this would give rise to all sorts of compliance and red tape issues for foreign government investors. For example, in determining whether or not the threshold test is met under section 57(b)(i), a foreign person must take account of interests in agricultural land held by their associates. A private equity fund in which a Canadian pension fund holds a 15% interest would be classified as a foreign government investor and would be required to take account of the interests of all other entities in which a Canadian foreign government investor held an interest. This is unworkable as that type of information is not publicly available.

4.4 **Other technical comments relating to foreign government investors**

We also have the following more technical comments on the drafting of the proposed legislation:

- (a) The definition of direct investment as it relates to an interest of 5% and the entry of a legal arrangement (Draft Regulation 11(b)) is overbroad. As with the existing policy it should be the existence of influence or control of the entity that enlivens a lower threshold. For example, if an Australian entity conducting a resources business was to enter an offtake agreement on arm's length terms with an SOE, that should not reduce the review threshold. We instead suggest a similar concept of influence to the existing section 21 of the Act.
- (b) The definition of direct investment as it relates to an interest of 1% and a previously held interest of 5% in the last 12 months (Draft Regulation 11(c)) lacks a proper policy basis. We believe there is no policy justification to reduce the investment threshold to 1% if such a holding existed, as there would be no evidence of control or influence to justify review at below 10%.
- (c) The definition of direct interest as it refers to the ability to influence or participate in policy of the entity (Draft Regulation 11(d)(ii)) is overbroad. As currently expressed the term could be considered to extend, for example, to situations where the Australian entity and the foreign government investor have entered into arm's length arrangements concerning the business of the Australian entity (again, for example, the offtake agreement referred to above). Again we suggest a similar concept of influence to the existing section 21 of the Act.
- (d) The definition of foreign government investor refers to the trustee of a trust where a foreign government or separate government entity has the required interest (Draft Regulation 12(e)). The definition should also focus on the beneficiaries of a trust.
- (e) The associate definition that excludes foreign government investors that are defined as such by investments that are aggregate substantial interests (section 6(2)) is too complex and we believe that there is no policy basis to exclude aggregate substantial interests but not substantial interests.

5 **MONETARY THRESHOLDS**

We set out below our comments on the application of the monetary threshold tests.

5.1 **Double counting of total asset value of consolidated group**

We note that sections 29(1) and (2) of the Draft Act largely reflect section 13B of the current Act. However, to the extent these provisions refer to the "aggregate value" of the assets of each entity that is a member of a consolidated group, they potentially lead to double counting

errors. For example, if a holding company raises capital (say \$100m), lends that to a subsidiary (Sub 1), which on-lends it to another subsidiary (Sub 2), which then buys an asset, each of the three members of the group has an asset of \$100m – an aggregate value of \$300m. However, in truth, the group only has consolidated total assets of \$100m.

Also for example when determining whether a corporation is an Australian land corporation or agricultural land corporation under sections 26(2) and 26(4) respectively, while the potential for double counting in the denominator is eliminated by para 29(2), there remains the potential for double counting in the numerator. This is because an interest in Australian land of a holding entity will include the shares in its subsidiaries if they are Australian land corporations or Australian land trusts.

Under accounting standards, this issue is dealt with by eliminating in full intra-group assets and liabilities in consolidated financial statements – see for example paragraph B86 of AASB 10. In our view, section 29 should be amended to reflect this.

The amendment should apply equally in respect of stapled entities and entities operating on a unified basis since intra-group investments are just as likely to exist in these forms of consolidated group.

5.2 Difficulties in determining total issued securities value of consolidated group

A similar issue arises in relation to section 30 to the extent sub-section 30(3) will aggregate the value of the issued securities of the holding entity and each of its relevant subsidiaries. In our view, it is very rare for an entity's total issued securities value (a measure reflecting its net assets) to exceed its total asset value (a measure reflecting its gross assets) so this provision is of limited relevance. However, if it is to be retained, we submit it should refer to the total issued securities value of the parent entity alone (which will automatically reflect the value of the holding company's investments in its subsidiaries).

As regards sub-section 30(4), we note this formula implicitly assumes that all issued securities are of the same class. To the extent securities may have different rights (and values), it may either overstate or understate the total issued securities value of an entity.

Given sub-sections 29(4) and (5) deal with the total asset values of stapled entities and entities operating on a unified basis, we query whether similar provisions should also apply under section 30. One corollary of this is would be that, in working out the percentage interests a person may have in a group of entities operating on a unified basis, the denominator in the formula should be the total issued securities of all of the parent entities in the unified group.

5.3 Technical accounting and valuation issues

We make the following technical comments on a number of accounting and valuation issues:

- (a) **Allow auditor-reviewed balance sheet.** As set out in our prior submission, we suggest that section 31 be expanded to allow the use of an auditor-reviewed balance sheet for a half-year period where it is more recent than the audited balance sheet.
- (b) **Reasonable value impractical and too vague.** When it comes to ascribing a value of an asset generally by reference to its book value, there is an exception where the value shown is not reasonable value (section 31(2)). We do not think that the carve out is satisfactory especially as the foreign person may not have the information to make that assessment, for example, in the case of a non-negotiated transaction. Also, the reference to "reasonable value" is too vague. More specific guidance should be provided if this concept is retained.
- (c) **Allow determination of value of trust assets from accounting records.** If a trustee includes the value of an asset it holds on trust in its accounting records, we

submit that this should be a basis for determining value as it is in the case of entities. A valuation process under section 32 should not be required.

- (d) **Clarify drafting of valuation process.** We suggest making the following changes to section 32 to clarify the operation of the valuation process:
- (i) section 32(a) – this paragraph can be deleted. It is unclear what this achieves given that the opening paragraph includes the words “at the time of the valuation”;
 - (ii) section 32(b) – need to include the words “at a particular time” after “value” in the opening paragraph in order for the references to “particular time” in para (b) to make sense; and
 - (iii) section 32(b)(ii) – this is not appropriate as it would require, in all cases, a new valuation to be undertaken where the value has increased significantly.

6 POWERS OF TREASURER

We support the structure of the legislation as it applies to the approval process and the powers of the Treasurer.

We have the following key comments on the approval process and the powers of the Treasurer.

6.1 Treasurer’s ability to change conditions or decisions

On many occasions conditions on approvals are extensive and heavily negotiated.

The Treasurer should not be able to impose a new condition or vary a condition without the consent of a person affected.

This is particularly so because:

- (a) a new or altered condition may affect property rights and potentially have significant financial consequences;
- (b) contravention of a new or altered condition may constitute an offence or grounds for a civil penalty order and, in the case of conditions relating to an acquisition of residential land, grounds for the issue of an infringement notice, and because of the potential liability of officers under sections 106 and 107; and
- (c) contravention of a new or altered condition may constitute grounds for a disposal order.

The same rules should apply to variation of a condition to an exemption certificate. These will usually apply to real estate acquisitions and the variation of a condition could impact a range of parties involved in a development or other real estate project including financiers.

We would also suggest great caution be used if the Treasurer gives approval to a multi-stage transaction which is only in part implemented and a further application is made for the residual stages and the Treasurer arrives at a different decision (see section 79(8)). Many significant infrastructure and other acquisitions will occur over a long investment horizon and the investing parties need certainty that they will be able to implement a plan previously agreed to by the Treasurer.

7 PENALTY PROVISIONS

As we set out in our prior submissions we have concerns with the revamped penalty provisions that are proposed and the retrospectivity of the offence and civil penalties provisions.

We have the following key comments on the regime.

7.1 Limit publicity around infringement notices

As previously announced by the Government, the infringement notice regime will only be applied in relation to breaches of the legislation with respect to acquisitions of residential land.

The revised version of the Commonwealth Guide to Framing Commonwealth Offences, Infringement Notice and Consequential Orders (initially issued in June 2011) contains a minimum amount of information as to what can or cannot be included in the context of the issue of an infringement notice and the publicity surrounding the issue of an infringement notice. We are concerned that there are some regulators which have not complied with the spirit of these regulations. It is hoped that the use of infringement notices in the area of foreign investment regulation will not suffer from the same problems.

There is no admission of liability when an infringement notice is issued and the fine paid. The fact that an infringement notice has been issued can be notified and one cannot guard against over enthusiastic newspaper or other media reaction to the report of the issue of an infringement notice. However, it is vital that the limitations on exposure to publicity should be maintained in accordance with the guide issued by the Commonwealth Government referred to earlier.

7.2 Reversal of onus of proof in civil penalty and strict liability provisions

The Draft Act adopts a surprising approach to the classification of the relevant offences under the penalty regime.

Under the provisions in the Draft Act (Part 5) a person is deemed to commit an offence or contravene a civil penalty provision if the person fails to give notice under section 85, enters into an agreement to take a notifiable action pursuant to section 86, contravenes an Order under Part 3, or contravenes a condition in a no objection notification or an exemption certificate. If a person is caught by proposed section 92, a strict liability offence has occurred. The relevant penalties that may be "imposed" for breaching any of these provisions is a maximum period of 3 years imprisonment or 750 penalty units or both.

In contrast, civil penalty orders, which may be sought by the relevant regulator for breaching other relevant provisions (see sections 94 and following which do not apply to residential land), trigger a process in which an action must be taken in a court, and for a court order to be made with respect to the alleged breach. These matters must proceed pursuant to the rules established in the Regulatory Powers (Standard Provisions) Act 2014, civil penalty provisions are enforceable under Part 4 of that legislation in the Federal Court of Australia, the Federal Circuit Court of Australia or a Supreme Court of a State or Territory. The penalties that may be imposed in relation to a breach of one of the relevant provisions is of a lower scale to those that apply for a breach of the residential land contraventions.

The continued use of the strict liability regime (often linked to a reversal of onus of proof regime) was criticised by the then Corporations & Markets Advisory Committee in its 2006 report which recommended that the governments of Australia review the legislation containing strict liability/reversal of onus of proof provisions. The Council of Australian Governments ("COAG") undertook in around 2011 a nationwide process of requiring all Australian governments (Commonwealth, State and Territory governments) to review all 700 plus pieces of legislation in which the strict liability/reversal of onus of proof process was utilised. COAG agreed in July 2012 that the *Personal Liability for Corporate Fault - Guidelines for applying the COAG Principles* will be applied by all jurisdictions when drafting future legislation.

No justification has been made in the Draft Act and explanatory material for the use of the strict liability regime with respect to sections 92 and 120. A differentiation not only in this approach, but also in the penalties which are made available for the relevant breaches in this context, and in the general prohibitions covered by the civil penalty regime set out in Division 3 of Part 5 of the proposed legislation, is not explained.

The Corporations Committee of the Business Law Section of the Law Council of Australia has previously made submissions in relation to the process of reviewing strict liability/reversal of onus of proof legislation. The views that were expressed by the Corporations Committee, whilst acknowledged by the Commonwealth Government, have never been fully embraced. We reiterate the submissions made by the Corporations Committee on the Derivative Liability Legislation (20 May 2011) and the Personal Liability for Corporate Fault Reform Bill 2012 (30 March 2012), copies of which can be found on the Law Council of Australia website.

7.3 Failure to distinguish between civil and criminal liability

An added concern is that the proposed legislation intends to extend the application of the Commonwealth Criminal Code, and in particular Part 2.4 of the Code to an assessment of officers of corporations who authorise or permit contraventions of the relevant legislation.

By incorporating the Commonwealth Criminal Code provisions in Part 2.4, which deal specifically with extensions of criminal responsibility, provisions in the Draft Act which clearly are intended to operate in the context of a civil penalty regime seem to be muddled by the unfortunate failure to differentiate between civil and criminal liability. The two liability regimes should be clearly distinguished.

7.4 Retrospective offences and civil penalties for breach of existing conditions

We are very concerned that the transitional provisions retrospectively make breaches of conditions attached to existing approvals an offence and impose civil penalties. Such retrospectivity is contrary to fundamental principles of Australian law and should not be imposed unless there are clear and justifiable policy grounds.

Item 10 of Schedule 3 (Application and transitional provisions for Schedules 1 and 2) of the Draft FATA Amendment Bill applies Part 5 (offences and civil penalties), except for sections 106 and 107 of the new provisions, to conduct engaged in after commencement (including in relation to orders or notices given before commencement).

8 RECORD KEEPING OBLIGATIONS

We set out below our other general comments regarding the record keeping obligations.

8.1 Record keeping provisions are too broad

We are greatly concerned with the broad drafting and lack of clarity in sections 118 – 120 of the Draft Act:

- (a) It is not clear who the person is – is it every person involved in a transaction?
- (b) The use of the word “relating” in section 118(1) (i.e. “every act, transaction, event or circumstance relating to the following”) is extremely broad. The term “relating” has traditionally been used in legal drafting to capture the widest range of conduct; when coupled with the fact that records must be kept of “every act”, this provision could require potential foreign investors to keep every email regarding a potential acquisition, or a file note of each phone call, even if insignificant. (We note that in regards to significant actions and notifiable actions (section 118(1)(a)), it is specified that the records are to be “relevant to an order or decision under Part 3”. However, “relevant” is undefined and therefore does not help to clarify or narrow the scope of material which the Government intends these provisions to capture.)

- (c) It is not clear when a person needs to start keeping records. For instance, is a person required to start record keeping when they first contemplate taking a relevant “action”, once they have determined the scope of their proposed acquisition, or once they start preparing an application? The current drafting of the provisions suggests that records may need to be kept as early as when a foreign person first contemplates taking an “action” captured by section 118.
- (d) Further, the meaning of “keep”(ing) a record is unclear. Section 118(1) states that a person must “keep” records, but this term is not defined. By way of contrast, Taxation Ruling 96/7 clarifies that “keeping” records means both to “retain” records and “make” records where appropriate. It is not clear if the proposed drafting of section 118 is intended to have the same effect.

In the context of business transactions, the current broad drafting of the provisions could result in thousands of emails and other records of correspondence being required to be kept by potential foreign investors for up to 5 years (depending on the subsection), most of which will have no bearing on the application of the Act to the transaction in question. This lack of clarity in the provisions, is particularly troubling, due to the strict liability nature of a breach. We also note that the existing drafting may also require those who choose not to notify the Government of their significant actions (assuming those actions are not notifiable actions) to still keep potentially onerous and broad records of all relevant material, even though the relevant matter is not a notifiable action. We submit that this is unreasonable.

The broad approach taken in these provisions contrasts to the approach that is often used in Australian legislation, which is both narrower and provides more clarity (see for example section 28 of the *Taxation Administration Act 1996* (NSW) and section 286(1) of the Corporations Act, set out in Schedule 1 to this Submission).

We urge the Government to, as a minimum, provide more clarity regarding the scope of these provisions. The fact that a breach of these provisions constitutes an offence, and an offence of strict liability at that, makes it particularly important that clarity is given.

More specifically, it is our view that:

- (a) the Government should narrow the scope of the documents required to be kept, so that the only records required to be kept are those of the foreign investor involved in the significant action or notifiable action “necessary to enable” the Government to make the assessment that it needs to, such as core records, or records that are “sufficient to explain” the key details of the transaction; or
- (b) failing this, the Government should at least make a distinction between the records that need to be kept for acquisitions of residential land as opposed to all other land (with the scope of the records for all other land being narrower). While it may be reasonable to keep all records in regards to residential acquisitions in some circumstances, we emphasise that in the business context the records “relating” to a transaction and “every act” and “circumstance” within that transaction would be vast and could encompass thousands of documents. The Government could provide this clarity in the regulations if it does not have time to amend the Draft Act.

8.2 Australian vendors of residential land subject to record keeping requirements

The provisions as currently drafted result in Australian vendors being required to comply with the record keeping requirements when selling residential land.

The provisions on record keeping are currently drafted to apply to a “person”, rather than to a “foreign person”.

While the provisions may refer to a “person” intentionally to ensure that associates of a foreign person (who may not be foreign persons themselves) are captured where appropriate, the Law Council is concerned with the effects of using the term “person” in section 118(1)(d) of

the Draft Act. Section 118(1)(d) states that a person must keep records which relate to the “disposal of an interest in residential land”, where the **acquisition** of the land is a significant or notifiable action (or would have been if the action had not been specified in an exemption certificate).

The fact that any person must keep records which relate to the **disposal** of an interest will have the result that Australian vendors, who sell interests in residential land to foreign persons are captured by section 118(1)(d), and are consequently required to comply with broad and potentially onerous record keeping provisions. The Law Council submits this is not in line with the purpose of the record keeping provisions or the foreign investment framework generally, given the objective of both is to monitor the conduct of foreign investors. Further, many Australian vendors will not be aware of these obligations, given that they would not otherwise be required to deal with the foreign investment framework. This could result in unjust outcomes for these vendors, particularly given the strict liability nature of the offence of breach.

We submit that the Government should amend section 118(1)(d) to make clear that these requirements do not apply to Australian vendors who are not associates of foreign persons for the purposes of a given acquisition.

8.3 **Unclear how to keep the records “in English or a form readily convertible to English”**

Many foreign investors would not keep many of their records in English, which would often not be their country's national language. If the draft provisions are implemented as is, with their broad scope, it will be very onerous for many foreign investors to either keep their records in English or have thousands of documents in a form that is “readily accessible and easily convertible to English”.

Further, it is unclear what is meant by “readily accessible and easily convertible into English”. It appears that the Government's intention is not that the records must be kept in electronic form, as the draft explanatory memorandum (p 78) states that the records “may be kept in hard copy or electronic form”. If this is the case, it should be clarified that a person will comply with the relevant sections if the records are kept in a form where they can be translated if that is ultimately required. We also submit that there should be no requirement on the investor to provide any such translation of its records, it should be sufficient for an investor to keep its records in a form in which they can be translated if required, given the volume of records and potential expense of any such translation. Again, the Government could provide clarity in the regulations if it does not have time to amend the Draft Act.

9 **ADDITIONAL GENERAL COMMENTS**

We set out below our other general comments regarding the proposed legislation.

9.1 **Moneylending exemption**

We support the inclusion of a moneylending exemption at Draft Regulations 5 and 17, though some of the requirements can be clarified. We set out our detailed comment in Schedule 2.

9.2 **Tighten drafting and address various technical issues**

We have set out in Schedule 3 of this Submission a list of technical drafting issues to be addressed. We would be happy to discuss these further with the Government when preparing the revised legislation.

9.3 **Add exemptions in the regulations and allow adequate time for consultation**

We have proposed in our prior submissions that the Government consider a number of exemptions. It is unclear whether (or how) they have been addressed in the current draft legislation. If they have not been included, we assume they will be incorporated in the revised

Draft Act or Draft Regulations. We would appreciate an opportunity to confirm this with the Government.

In particular, it is unclear to us whether (or how) the following are dealt with in the current legislation:

- (a) acquisitions by an existing majority holder (greater than 50 per cent);
- (b) foreign government investors setting up special purpose vehicles that has no assets and has not commenced business;
- (c) competitive bids where bidder is unsuccessful;
- (d) acquisitions of a property comprising a number of parcels of land.

SCHEDULE 1 – PROVISIONS RELATING TO RECORD KEEPING

The broad approach taken in the record keeping provisions at sections 118-120 of the Draft Act contrasts to the approach that is often used in Australian legislation, which is both narrower and provides more clarity. For example:

Section 28 of the Taxation Administration Act 1996

Requirement to keep proper records

(1) A person must keep, or cause to be kept, such records as are necessary to enable the person's tax liability under a taxation law to be properly assessed.

This makes it clear that only such records that “are necessary to enable the person's... liability.. to be properly assessed” must be kept, rather than potentially all documents relating to a matter. Another example is:

Section 286(1) of the Corporations Act 2001

A company, registered scheme or disclosing entity must keep written financial records that:

(A) correctly records and explain its transactions and financial position and performance; and

(B) would enable true and fair financial statements to be prepared and audited.

We note the proposed provisions for record keeping are similar to section 466 of the Tax Assessment Act 1999 which states that:

Section 466 of the Tax Assessment Act 1999

Manner in which records required to be kept

A person who is required by this Division to keep records must:

(a) keep the records in writing in the English language or so as to enable the records to be readily accessible and convertible into writing in the English language; and

(b) keep the records so as to enable the person's liability under this Act to be readily ascertained.

SCHEDULE 2 – MONEYLENDING EXEMPTION

1 Definition of moneylending agreement under Draft Regulation 5

A moneylending agreement under the Draft Regulations is defined as:

- (a) *an agreement entered into in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business (a **money lending business**) of lending money or otherwise providing financial accommodation, except an agreement dealing with any matter unrelated to the carrying on of that business.*
- (b) *for a person carrying on a moneylending business - an agreement to acquire an interest arising from a money lending agreement (within the meaning of para (a)).*

1.2 Issue 1

It is unclear what the new requirement that a moneylending agreement be “on ordinary commercial terms” means. Under section 609 of the Corporations Act it is the security interest which must be taken “on ordinary commercial terms” In this context the “on ordinary commercial terms” terms could be read to apply to the business of lending money or otherwise providing financial accommodation. Is this intended? For example, does this inclusion introduce a test in relation to the pricing of a particular loan agreement? We suggest this additional requirement is deleted or limited to the terms of the security interest.

1.3 Issue 2

Paragraph (b) appears to introduce a permission for a person carrying on a moneylending business to enter an agreement to acquire an interest in a moneylending agreement through secondary trading. This is a helpful addition to the exemption reflecting normal practices of debt trading.

However, paragraph (b) remains limited to persons carrying on a moneylending business. Should this include funds or other secondary market investors that carry on a business of purchasing (and selling) secured debt but do not have any business of lending on newly originated loans?

A bank or other financial institution may have operations for both lending money and trading on the secondary debt market. If the two businesses operate quite distinctly and have separate business plans and operations, would this still constitute a moneylending business for the purposes of paragraph (b)?

Also, it should be considered whether it is appropriate that an agreement to acquire an interest under a moneylending agreement appropriately captures secondary debts. The proposed drafting specifies that in these circumstances it will be the agreement to acquire the interest rather than the acquired moneylending agreement (within the meaning of paragraph (a)) which will be the moneylending agreement.

This raises two questions. First, is paragraph (b) intended to capture transfer mechanisms other than contractual agreements, such as statutory transfers of obligations for example? Second, does the designation of an agreement to acquire an interest as a moneylending agreement achieve the desired outcome when read in connection with Draft Regulation 17(1)? We suggest that in respect of a bank acquiring a secured loan through a secondary market trade its interest is not held solely by way of security for the purposes of the agreement to acquire the interest but instead solely by way of security for the purposes of the moneylending agreement (within the meaning of paragraph (a)) which it acquires.

2 Draft Regulation 17(1) Moneylending agreements

This section applies in relation to an interest in a security, asset, trust or Australian land if:

- (a) *the interest is:*
 - (i) *held solely by way of security for the purposes of a moneylending agreement; or*
 - (ii) *acquired by way of enforcement of a security held solely for the purposes of a moneylending agreement; and*
- (b) *the entity that holds the interest is:*
 - (i) *the entity (the **lender**) that provided the money or financial accommodation under the moneylending agreement; or*
 - (ii) *a subsidiary or holding entity of the lender; or*
 - (iii) *a person who is (alone or with others) in a position to determine the investments or policy of the lender; or*
 - (iv) *a security trustee on behalf of the lender; or*
 - (v) *a receiver, or a receiver and manager, appointed in relation to the lender.*

2.2 Issue 1

The interaction of Draft Regulation 17(b)(i) with limb (b) of the definition of moneylending agreement is unclear. Is the intention that a “lender” under this Draft Regulation could be an acquirer of an interest arising from a moneylending agreement (for example under a secondary trade)? If so, in this context would it be relevant whether the acquirer or some other party had paid the money (or other consideration) under the agreement to acquire the interest? We think this interaction should be clarified.

2.3 Issue 2

Draft Regulation 17(b)(iii) appears to allow an exemption for third party managers that advise a particular lender that may otherwise be found to have control of voting power in an entity by way of influence over decisions of a lender who holds security over shares or units in that entity, whether by arrangements or practices. Is this the intention of the provision?

2.4 Issue 3

Consider whether the words “in relation to the lender” in Draft Regulation 17(b)(v) should be extended to include any of the other parties listed in Draft Regulation 17(b)(ii) to (iv) as well as a lender. Such parties are also permitted to hold security so may appoint a receiver or receiver and manager.

3 Draft Regulation 17(2)

The Act does not apply in relation to the interest if:

- (a) *the interest is in residential land; and*
- (b) *all of the following apply in relation to each holding entity of the entity that holds or acquires the interest:*
 - (i) *there are at least 100 holders of securities in each of those holding entities;*

- (ii) *each of those holding entities are listed for quotation in the official list of a stock exchange (whether or not in Australia);*
- (iii) *each of those holding entities are ADIs or otherwise licensed as financial institutions.*

3.1 Issue 1

If our submission on Draft Regulation 17(4) is accepted the exemption in this Draft Regulation will only be relevant to lenders who are foreign government investors, because Draft Regulation 17(4) will exempt other lenders.

The Draft Regulation as currently drafted effectively excludes lenders who do not meet the tests in Draft Regulation 17(2)(b) – holding entities that are listed on a stock exchange with a spread of at least 100 holders – from participating in the residential lending market. Requiring clearance effectively excludes them from the market, because in order to compete they must be able to offer finance unconditionally and without the delay caused by the need to obtain clearance. It would also increase the timing, administrative and cost burden for routine secured financial accommodation from such financiers if they still chose to compete.

The scope of disapplication of the exemption in respect of interests in residential land seems to go beyond what is necessary to protect the retail residential mortgage market and will reduce competition and negatively affect the availability of finance to the Australian corporate debt market.

As well as excluding lenders who do not have stock exchange listed holding entities, it appears to exclude financial institutions which satisfy all of the tests in sub-paragraphs (i) to (iii) but do not themselves have holding entities that are ADIs or licensed as financial institutions. It would be unusual for the holding entity of an international bank (many of whom have substantial government holdings) to itself be an ADI or licensed as a financial institution. The inclusion of the words “each holding entity” also implies that all subsidiaries in the ownership chain need to satisfy the tests in sub-paragraphs (i) to (iii) which is unlikely to be the case. We suggest this is altered so that only the entity holding the interest needs to satisfy the tests in sub-paragraphs (i) to (iii).

It also appears to exclude security trustees referred to in s17(1)(b)(iv).

We submit:

- Draft Regulation 17(2) should be the general exemption for banks or lenders who are foreign government investors and who are themselves ADIs or licensed as financial institutions, regardless of the status of their holding entities as being listed on a stock exchange or not (which is the current position under the Policy).
- Draft Regulation 17(2) should not be limited to residential land. There is no distinction under the current Policy between lending on the security of residential land or other assets.

We suggest that it is clarified that licensing as a financial institution may be in Australia or elsewhere if that is the intention.

4 Draft Regulation 17(3)

- (3) *The Act does not apply in relation to the interest if:*
 - (a) *the interest is held or acquired by a foreign government investor; and*
 - (b) *the interest is not in residential land; and*
 - (c) *if the foreign government investor is an ADI or a subsidiary of an ADI—either:*

- (i) 12 months have not passed since the acquisition of the interest; or
 - (ii) the foreign government investor is making a genuine attempt to dispose of the interest; and
- (d) if the foreign government investor is not an ADI or a subsidiary of an ADI— the foreign government investor is making a genuine attempt to dispose of the interest.

4.2 Issue 1

Paragraphs (c) and (d) address interests acquired through exercise of security. However, neither this Draft Regulation nor any other section on the current drafting addresses interests acquired by foreign government owned lenders through taking security (except in relation to residential land by stock exchange listed banks – see above on Draft Regulation 17(2)). Draft Regulation 17(3) seems to be seeking to formalise the current position under the Policy that “... the investor must notify the Government and get approval if the security is enforced, and the investor gains control over the asset(s) and retains it for more than 12 months.” We submit this is best done by modifying Draft Regulation 17(2) as noted above, and confining Draft Regulation 17(3) to the requirement that banks or other ADI lenders who qualify as foreign government investors must obtain clearance or dispose of their interests within 12 months of enforcement.

If this position is accepted Draft Regulation 17(3)(b) should be deleted.

4.3 Issue 2

In respect of the references to ADI in paragraphs (c) and (d) (and also in Draft Regulation 17(2)(b)(iii)) a number of banks which are ADIs often participate in financings for Australian businesses through foreign branches. Is it intended that banks which are ADIs but which participate in moneylending agreements through offshore branches would be considered to be ADIs for the purposes of these provisions?

4.4 Issue 3

In paragraph (d) a foreign government investor which is not an ADI must upon acquiring an interest through enforcement of a security interest immediately seek to dispose of that interest. Foreign government investors which are ADIs are allowed 12 months before seeking to dispose of assets recognising that an enforcing party may need to take some time to assess the market and disposal options before executing an enforcement sale. In most financings foreign government investors which are not ADIs will not be willing to make loans or otherwise advance financial accommodation without some certainty that some flexibility on disposal upon enforcement is permissible (as a lender will not wish to be in a position where an enforcement process is compromised due to lack of necessary approvals whether or not enforcement is currently contemplated). Suggest considering extending the 12 months period to foreign government investors which are not ADIs.

5 Draft Regulation 17(4)

- (4) *The Act does not apply in relation to the interest if the interest is not:*
- (a) *an interest in residential land; or*
 - (b) *an interest acquired by a foreign government investor.*

Issue 1

Draft Regulation 17(4) should not refer to residential land. For the reasons set out above residential land should not be treated as a special case. Our submission is that Draft

Regulation 17(2) should address additional requirements for foreign government investors and other foreign persons should not be affected by that Draft Regulation.

Issue 2

Draft Regulation 17(4)(b) refers to an interest “acquired” by a foreign government investor whereas Draft Regulation 17(3)(a) refers to an interest “held or acquired” by a foreign government investor. Suggest it is clarified whether Draft Regulation 17(4)(b) is intended to be limited to interests acquired by way of enforcement of security or whether it extends also to interests held solely by way of security by a foreign government investor.

SCHEDULE 3 – TECHNICAL DRAFTING ISSUES

FOREIGN ACQUISITIONS AND TAKEOVERS ACT 1975

Foreign person

- Australian citizens should be excluded from the definition of foreign person regardless of where they reside and the exemption should be extended to the application of the Act generally and not just in relation to Australian land.

Relevant Australian assets

- Water rights should be specifically included as many water rights are no longer attached to land.

Senior officer

- Para (a) – Remove reference to secretary. While a secretary is an officer of a corporation his or her authority as secretary is quite limited and administrative in nature. If a particular secretary has other roles in a corporation which results in him or her having investment or policy responsibilities then this would be caught by paragraph (c).
- Para (b)(ii) – The carve-out for independent directors of a listed entity does not work because the independent director will be a director of the trustee rather than a director of the unit trust. Also, it is fairly unusual for trustees to be listed – it would usually be a holding company of the trustee that is listed.
- Para (a) and (b)(ii) – The carve-out for independent directors should be expanded to catch unlisted entities and listed entities whose stock exchange does not include criteria for independence in its rules. It should be noted that independent directors of ASX-listed entities would not qualify for the exemption because the ASX listing rules do not include the criteria for independence; instead, the criteria is included in the ASX Corporate Governance Principles and Recommendations which are non-binding and quite vague in nature.
- Para (c) – The reference to “determine” is too narrow as it will often only catch the Board of Directors thus missing senior executives who may be responsible for recommending investment and policy proposals to the Board and then implementing those proposals. Consider, as an alternative, paragraph (b) of the definition of “officer” in section 9 of the Corporations Act. Its use would have the benefit of incorporating existing jurisprudence.

Section 11 Meaning of interest in a trust

- Para 11(b) – This should be deleted as it is already covered in section 9 (a “security” is defined to include a unit in a unit trust).

Section 12 Meaning of interest in Australian land

- Para (1)(a) and (c) – It is anomalous that an easement or profit a prendre for five years or less will be an interest in Australian land whereas a lease or licence for the same period will not be an interest in Australian land.
- Para (1)(c) and (d) – Paragraph (d) should be qualified by paragraph (c) as, otherwise, a lease or licence which provides for a profit or income sharing element (e.g. turnover rent or rent partly based on crop yields) will be an interest in land even if its term is for five years or less. This would appear to be anomalous.
- Para (3) – Presumably paragraph (a) is intended to capture changes to the nature of an existing interest (eg. from leasehold to freehold). If so, this should be clarified – paragraph (a)

could read "the person has previously acquired an interest in Australian land and the interest is of a different type to that previously acquired".

Section 17 Meaning of interest and aggregate interest of a specified percentage in an entity

- Paras (1)(b) and 2(b) – The reference to paragraph 15(1)(c) should be removed because paragraphs 17(1)(b) and (2)(b) only refer to the issue of securities whereas paragraph 15(1)(c) only refers to the transfer of securities.

Section 18 Rules relating to determining percentages of interests in entities

- Para (2) – This seems to refer only to the interests in shares arising from the exercise of rights held by the person in question, and not to all rights held by all persons (eg. if there are 100 shares on issue, and the person in question has 10 options and another person has 20 options, the total issued shares denominator is 110 (ie. 100+10), not 130 (ie. 100+10+20)). This seems fair, and para (s) should clarify this.

Section 22 Meanings of voting power and potential voting power

- Para 1 – it is simple to calculate the maximum number of votes where there is only one class of issued shares, such as ordinary shares. But it is more complicated where there are multiple classes of shares on issue – say ordinary shares and preference shares – with different voting rights attached to each class. We suggest that paragraph 1 adopt the approach in section 610 of the Corporations Act, ie. you look at the maximum number of votes that can be cast on a poll to elect a director.
- Para 3 – Similar to the comment for section 18(2), it should be clarified that you only take into account the rights held by the person in question, and not to all rights held by all persons.

Section 29 Meaning of total asset value, section 33 Consideration and generally

- The Act should specify how values, amounts and consideration not denominated in A\$ should be converted to A\$.

Section 30 Meaning of total issued securities value

- Para 4 – As noted in section 5.2 of this Submission, the formula assumes that the securities to be acquired are in the same class as securities already on issue. The formula should instead refer to securities in the same class, and the result obtained using the formula should be aggregated with the value of the issued securities of all other classes – where such 'value' should be the higher of book value and the price last paid for a transfer of securities in that class.

Section 46 Meaning of significant action – entities

- Para (2)(d) – The way this is drafted it may have a far narrower application than intended given that the senior officers of an entity will not be under an obligation to act if they are not themselves parties to the agreement relating to the affairs of their entity, particularly given the use of the words "under which" in paragraph (d)(ii).

Section 52 Meaning of notifiable action – general

- Para (4)(c) – Unclear why this is necessary given the tracing of substantial interests.

Section 75 Limitation on making disposal orders

- Para (2) – The requirements for making an order under section 74 seem restrictive.

Section 77 Publication and commencement of orders

- In the case of interim orders, it should be possible to avoid the need for publication if the applicant consents to the order. This will enable confidentiality to be preserved. The same comment applies to section 82(3)(b) which provides for the gazettal of interim orders.

Sections 108-112 Subdivision C – Recovering unpaid penalties

- Section 108 – No link is made between the offences and the land.
- Section 109 – Where the offence relates to a particular interest in land, the charge should be created over that interest rather than the whole land. For example, it seems incredibly unfair (section 112 notwithstanding) that a landlord would suffer a charge over land because of an offence relating to the assignment of a lease.
- Section 111 – By ignoring the interests of mortgagees, lessees and other persons with a claim on land the Commonwealth may be facilitating a windfall gain for the owner of land that is confiscated at the expense of the Commonwealth. This is because section 111 directs that the remainder of the proceeds be paid to the former owner of the land notwithstanding the existence of a mortgage, lease or other claim. The former owner receives funds that it may not be entitled to and the innocent party has a right to compensation from the Commonwealth.

Section 116 Waiver and remission of fees

- The reference to exceptional circumstances should be removed.

FOREIGN ACQUISITIONS AND TAKEOVERS REGULATION 2015

We understand that the regulations will be subject to further consultation later in the year. We have commented on the Draft Regulations where possible below, but apart from the moneylending exemption (see Schedule 2 of this Submission) we have not undertaken a detailed analysis at this point.

Regulation 5 Definitions

- Vacant – This definition is used in the context of “commercial land that is vacant”. If agricultural land is not used wholly and exclusively for a primary production business then, in addition to being agricultural land, it will be commercial land. It follows that a reason the agricultural land is commercial land is because some of the land is used for another purpose (e.g. a quarry) or for no purpose. It then follows that all the land may be classified as vacant, even though most of it is used for a primary production business, because of the absence of substantive permanent buildings on the land. As a result, para 37 will apply and the land will have a zero dollar threshold. This appears to be an anomalous result. The definition should be amended as follows:

land is vacant if it is not used for a business (other than a business of selling land) and there is no substantive permanent building or other man-made structures on the land that can be lawfully occupied or otherwise used by persons, goods or livestock.

Regulation 24 Convertible instruments that include a requirement for loss absorption if entity becomes non-viable

- Para (b) – Does not work (it should be the forced conversion that is exempt).

Regulation 25 Acquisitions by persons with a close connection to Australia

- Para (b) and (c) – The reference to “only because” should be replaced with a “but for” concept. For example, an Australian corporation that is a foreign person because it is 35% owned by an Australian citizen who is not ordinarily resident in Australia and 6% by a foreign citizen not ordinarily resident in Australia should be able to rely on the exception.
- Para (b) and (c) - – The reference to “held directly” is unnecessary. It leads to an anomalous result of an Australian corporation being able to rely on the exception but its wholly-owned Australian subsidiaries (which will be foreign persons because the Australian corporation is still a foreign person) not being able to rely on the exception.

Regulation 26 Acquisitions by funds and schemes

- Item 4 – The word “primarily” is vague. Consider tightening drafting.

Regulation 31 Meaning of foreign person—disregarding small holdings of securities in primary listed entities

- Para (2) – This para seems obscure and is unclear. What is intended?

Regulation 33 Tracing of substantial interests in corporations and trusts

- This regulation seems obscure and is unclear. What is intended?

Regulation 34 Exemptions where proportion of securities does not change

- Para 2 – The words “as a result of a rights issue” is too broad (should only extend to acquiring proportionate entitlement). Consider tightening drafting.