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Langton Crescent
Parkes ACT 2600

Via email: ForeignInvestmentConsultaton@treasury.gov.au

29 March 2017

Attention: Michele Arcaro, Senior Adviser, Foreign Investment Division
Anita Levanat, Policy Analyst, Foreign Investment Division

Dear Sir or Madam,

I have pleasure in enclosing a submission in response to the Treasury's Consultation Paper on the Foreign Investment Framework – 2017 Legislative Package.

The submission has been prepared by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia Limited.

If you have any questions in relation to the submission, in the first instance please contact the Committee Chair, Malcolm Brennan, on 02-6271 6054 or vial email:
malcolm.brennan@au.kwm.com

Yours faithfully,



Teresa Dyson, Chair
Business Law Section

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**FOREIGN INVESTMENT COMMITTEE OF THE BUSINESS LAW SECTION
OF THE LAW COUNCIL OF AUSTRALIA**

SUBMISSION ON FOREIGN INVESTMENT FRAMEWORK 2017 LEGISLATIVE PACKAGE

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 Consultation Paper on Foreign Investment Framework 2017 Legislative Package (“**Consultation Paper**”) (“**Submission**”).

We welcome the Commonwealth Government’s objective of resolving unintended consequences stemming from the 2015 reforms to Australia’s foreign investment framework and providing an opportunity to reduce red tape.

We understand that the Commonwealth Government intends to focus on the areas of residential land, non-vacant commercial land, low sensitivity business investment and fees. While it is not proposed to amend the *Foreign Acquisitions and Takeovers Act 1975* (“**FATA**”), we understand that the Government is open to amending the *Foreign Acquisitions and Takeovers Regulations 2015* (“**Regulations**”) as well as the process under which applications are assessed.

Paragraphs 1 to 4 below address each of the issues and associated options identified in the Consultation Paper.

Paragraphs 5 to 12 set out some additional changes we recommend that the Government address in its 2017 legislative package.

We also note our earlier letter dated 14 February 2017 in relation to the application of the definition of foreign government investors to private equity and venture capital. We recommend that the Government also address this issue in its 2017 legislative package. We enclose this letter for your reference as part of this Submission.

ISSUES FROM THE CONSULTATION PAPER

1 Residential land

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| <p><input type="checkbox"/> Option 1: No change</p> <p><input type="checkbox"/> Option 2: Introduce a new exemption certificate(s) for new dwellings and vacant residential land</p> <p><input type="checkbox"/> Option 3: Introduce a new exemption certificate for failed off-the-plan settlements</p> <p><input type="checkbox"/> Option 4: Amend the treatment of residential land used for commercial purposes</p> <p><input checked="" type="checkbox"/> Option 5: Introduce Options 2-4</p> |
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We support the introduction of Options 2-4 above.

In relation to Option 2, we suggest that the new exemption certificate need not relate to a specific property, and need not be specific to acquisitions by way of auction (but rather should apply to any acquisition mechanism).

In relation to Option 3, we welcome the Government’s approach in introducing a new exemption certificate for developers to cover dwellings subject to a failed settlement as consistent with the commercial position that a dwelling is not sold until settlement. We also refer to paragraph 8 below regarding conditional contracts.

In relation to Option 4, we note there is a discrepancy between the legislation and Guidance Note on aged care facilities. The definition of "commercial residential premises" from the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ("**GST Act**") does not expressly exclude aged care facilities, yet the Guidance Note suggests that such facilities are excluded and provides a complicated approach to the assessment of such facilities under the foreign investment regime. Arguably, the catch all in the GST Act definition of "anything similar to * residential premises described in paragraphs (a) to (e)" is wide enough to bring within scope a broad range of commercial operations including aged care facilities, hospices and even hospitals.

Whilst there is some utility to using constant definitions over a range of legislation, there are different policy approaches under the tax system to the foreign investment national interest test. Accordingly, until the FATA can be amended, we suggest that the "commercial residential premises" definition be further refined by the Regulations and the Guidance Note updated accordingly.

Question for consultation: How should student accommodation be defined?

As regards student accommodation, we suggest that the definitions used in FATA create an artificial distinction between different types of student accommodation facilities (eg off-campus vs on-campus). We are not aware of any sensible policy reason for these distinctions.

The problem primarily arises from FATA's adoption of the definition of "commercial residential premises" from the GST Act. This definition expressly excludes premises "to the extent that they are used to provide accommodation to students **in connection with an education institution that is not a school**" (emphasis added). Under the GST Act, universities and other tertiary education providers are not "schools".

On that basis, student accommodation facilities would only be "commercial residential premises" if they are not "in connection with" a university or tertiary education provider (eg because there is no university involvement in the ownership, development or management of the facility).

On the other hand, if a university or other tertiary education has some ongoing involvement with the facility (eg in relation to shared services or amenities, marketing or branding activities, or selection and referral of tenants), the facility might be "in connection with" an education institution that is not a school, and therefore expressly excluded from the definition of "commercial residential premises".

This generally means that off-campus student accommodation (without a contractual connection with a university) will be "commercial residential premises", whereas, for example, on-campus student accommodation (which generally involves contracting with a university) would not be "commercial residential premises". In our view, there is no foreign investment policy rationale to draw this distinction.

Until the FATA can be amended, or the definition of "commercial residential premises" is changed in the GST Act, we suggest that the Regulations should contain an express acknowledgement that "Student Accommodation" will be treated as "commercial residential premises" for the purposes of the FATA, with the following definitions adopted:

Rooming House means a building in which there is one or more rooms available for occupancy on payment of rent in which the total number of people who may occupy those premises is 10^{1*} or less.

¹ We have selected "10" here, but are not necessarily wedded to this number. (10 reflects the number of dwellings below which land may be regarded as residential land")The point is that, below a de minimis number, these types of accommodation facilities are more properly characterised as boarding / rooming houses, as opposed to commercial accommodation. However, we do think it is important that a bright line (ie a hard number) be adopted so that it is clear when accommodation is Student Accommodation as opposed to a Rooming House.

Education Course has the meaning given to it in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

Student Accommodation means premises whose primary purpose is to provide accommodation for students undertaking an Education Course, but does not include:

- a Rooming House; or
- land on which the number of dwellings that could reasonably be built is less than 10².

We also note certain inconsistencies in the administration of commercial residential land between the Foreign Investment Review Board (“**FIRB**”) and the Australian Tax Office (“**ATO**”). It would be desirable for FIRB to continuously advise the ATO of policy grey-areas and seek to ensure a consistent approach between FIRB and the ATO.

2 Non-vacant commercial land

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| <input type="checkbox"/> Option 1: No change |
| <input checked="" type="checkbox"/> Option 2: Narrow the scope of the ‘low-threshold’ non-vacant commercial land definition |
| <input type="checkbox"/> Option 3: Remove the ‘low-threshold’ land notification requirement |

We support the narrowing of the scope of the ‘low-threshold’ non-vacant commercial land definition. We appreciate that the Australian community may wish to see some of the land listed at Regulation 52(6)(c) continue to be screened at a lower threshold. Accordingly, we understand it may not be desirable to remove the ‘low-threshold’ land notification requirement altogether.

To reduce unnecessary red tape, we suggest removing or at least further narrowing the following from the low threshold definition:

- prescribed airspace;
- land leased to the Commonwealth, a State, a Territory or a Commonwealth, State or Territory body. This definition captures all shopping centres housing a Centrelink or an Australia Post office;
- the failure of part of a network unit on the land will result in telephony or interest services not being provided on other land. (This item needs to be redrafted and the sensitivity clearly explained).

As a drafting matter, if the land leased to the Commonwealth, State/Territory remains sensitive commercial land, then local governments should be specifically added. This is because elsewhere the legislation treats local governments as separate to the States and Territories.

Is there an issue with heritage listed property not being separately reviewed

We remain of the view that removal of heritage listed properties from sensitive land does not adequately address community concerns. Whilst State and Local Government level requirements will apply, there is an expectation that proposals by foreign persons should be reviewed by FIRB.

² the number prescribed by the regulations for the purposes of subparagraph (a)(ii) of the definition of residential land in this section

3 Low sensitivity business investment

- Option 1: No change
- Option 2: Introduce new exemption certificates for low sensitivity business proposals
- Option 3: Exempt low sensitivity business proposals from notification requirements

We welcome the Government's proposal to reduce red tape for low sensitivity business proposals. We think that either Options 2 or 3 (or both) could be beneficial.

Some suggested non-sensitive transactions could include index trading and public markets trading by pension funds as well as private equity.

If Option 2 is adopted, we recommend that the Government provide further guidance as to when the new exemption certificates would apply. In relation to a new foreign government investor exemption certificate, we consider it beneficial to provide professional private equity or venture capital sponsors treated as foreign government investors an opportunity to apply for an exemption certificate as we described in our letter of 14 February 2017.

If Option 3 is adopted, the categories of exempted transactions could be tightly defined to alleviate community concerns. One possible restriction would be countries where there are free trade agreements, agreement country investors or TPP countries are eligible for the exemption.

An additional relaxation would be to provide agreement country foreign government investors with the general \$252 million threshold in non-sensitive sector acquisitions.

As a separate point, we understand that the underwriting exemption certificate is seldom applied for because underwriters can agree not to acquire 20% or more. However, this solution does not work for the media industry where the notification threshold is 5%. We believe the better solution is to legislate for an underwriting exemption from a notifiable action and a significant action and remove the requirement for an application. The exemption can include the condition that the underwriter must have an Australian financial service licence.

4 Commercial fees

- Option 1: No change
- Option 2: Minor changes to the fees framework (legislate existing fee waiver principles and expand the definition of internal reorganisation)
- Option 3: Streamline the fees framework
 - Option 3a: Flat fee structure
 - Option 3b: Tiered fees based on consideration

We support streamlining the fees framework. The existing fees framework is too complicated. It diverts excessive amounts of time and resources to deal with fee issues for both applicants and Treasury officers. It is unnecessary red tape and a distraction from the substance of the application and the investment in question.

In addition, applicants often delay applications until such time as greater transaction certainty is achieved (to avoid the application fee until absolutely necessary), which places time pressure on FIRB to meet commercial deadlines.

We support either a flat fee structure or tiered fees based on consideration structure. The simplicity of four flat fees is particularly attractive.

In a simpler flat fee structure, we understand that it is proposed that reorganisations will still attract a lower fee than the other transactions (currently \$10,100). The definition of internal reorganisation should be expanded to capture more transactions, including the below which were mentioned in the Consultation Paper:

- newly created interests in addition to the transfer of existing interests, for example a subsidiary acquiring a leasehold interest in land from the subsidiary owning the freehold interest; and
- non-subsidiaries such as where either the existing holder or new holder does not qualify as a subsidiary of the same group. The definition should capture all intra-group reorganisations not just reorganisations involving subsidiaries.

In addition, there should be some flexibility to capture intermediate steps in a reorganisation which have not been specifically identified, as otherwise an additional application fee may need to be paid whenever a new step has to be notified.

In a simpler flat fee structure, we recommend that the Government apply the lower fee of \$10,100 to offshore acquisitions by foreign government investors regardless of value. For transactions with de minimis value, retaining a lower fee of \$1,000 would address equity concerns.

The majority owners' fee approach of no fee should be retained and simplified. All majority owners regardless of what the action is or if they are foreign government investors should not pay a fee when adding any interest to their existing greater than 50% interest. The current provision regarding majority owners is ambiguous and unclear with respect to foreign government investors.

Fees for agricultural land should not be tied to the residential land category. Agricultural land is land related to a business – ie primary production – and should be treated as a business for fee purposes. The current position of the highest \$101,500 fee applying to a \$10 million farm when that fee only applies to a \$1 billion business acquisition is out of balance and an investment disincentive.

ADDITIONAL ISSUES

5 Consortium exemption

Regulation 45(1) only exempts an entity in which Consortium members directly hold interests and does not apply to subsidiaries of that entity. The exemption should be redrafted so that it also applies to subsidiaries of consortium entities.

6 Creation of entities with foreign government ownership

We suggest a redraft of regulation 56(3).

We question whether the current exemption relating to 'wholly-owned subsidiaries' established by a foreign government investor (contained in section 56 of the Regulations) should be broadened to 'subsidiaries' established by a foreign government investor.

In addition, the exemption should be redrafted to cover:

- the incorporation of a shell JV vehicle established by a consortium with foreign government investors; and
- the acquisition of 100% of a shelf entity.

No separate approval is noted in no objections notifications obtained by shell acquisition vehicles regarding their foreign government investor ownership. Amending this definition will give effect to the original intent of regulation 56(3) which was to remove doubt about the

notification of the establishment new entities where foreign government ownership was involved.

7 Offshore acquisitions by foreign government investors

We note that the 1% and \$10 million exemption thresholds are too low. If it is decided not to proceed with Option 3 of the low sensitivity business investment proposals, we suggest increasing these thresholds to:

- 5%, being the accounting benchmark for when materiality starts to be considered; and
- \$55 million for most transactions, with possibly a lower \$15 million threshold for agricultural land.

8 Approach to conditional agreements as “binding”

We note that there has been a recent change in the interpretation of the legislative provision on conditional agreements. FIRB considers that a foreign person must obtain FIRB approval before signing a conditional agreement. In the commercial world, under a conditional agreement, acquisitions could not occur until conditions precedent are satisfied and if the conditions precedent are not satisfied, the transaction does not proceed.

Resolving this issue may need a change to the FATA which may not be possible in the near future. We submit that the Government should take a practical approach and revert to its original interpretation of conditional agreement. That is, an agreement is not taken to have been entered until such time as the as the transfer becomes binding. For the most part this will be on settlement of a transaction and the transfer of title of the item being acquired (shares, land assets.) This will avoid the confusing position that has arisen under the new legislation and reduce the number of retrospective applications being made as the commercial world does not understand the FIRB interpretation. Once the Act is amended it will also avoid the need for the off the plan remedy noted above.

We understand that FIRB is concerned to understand what influence or control a foreign person has over Australian shares, land or assets, however, the mere signing of a conditional agreement gives very little control or influence and certainly not sufficient to warrant a national interest concern.

9 Clarify “vacant” land

We suggest that vacant land should not be regarded as vacant land if public infrastructure is located on the land, so that land without buildings but with structures like solar farms, pipelines, jetties or wharves are not subject to the vacant land development conditions. We agree that powerlines or roads on land of themselves should not cause land to be non-vacant.

10 Clarify agricultural land for non-rural uses eg wind/solar farm

We note the exclusion of mining land from the agricultural land definition and suggest that a similar exclusion be added to cover wind/solar farms. The blade swept zone for a wind turbine cannot be occupied and cannot be used for primary production. The purpose of the exclusion is so that wind/solar farm operators are not considered to be agricultural land entities.

11 Treatment of custodians in the 5% exemption for “accidental foreigners”

We note that custodian holdings do not apply to the 5% exemption for “accidental foreigners”. This is because the custodian exemption only applies to the excluded provisions and does not apply to the definition of foreign person. We consider the custodian exemption should be moved to the same Division as the money lending exemption (Part 3 Division 2), so that it applies to the definition of foreign person.

Also, the custodian exemption refers to the custodian holding a legal interest (regulation 30(c)). Strictly speaking, a custodian holding a unit holds only an equitable interest.

(As an aside, we note that the Agricultural Land Register and the Water Rights Register, whilst adopting the "foreign person" definition from FATA, do not adopt all of the exceptions to the foreign person assessment.)

12 Guidance note for ownership structure disclosures in applications

We suggest that the requirement for an application to disclose the investor's ownership interests of 5% and above and all foreign government investors should be stated in a Guidance Note. At present, this requirement only appears in a checklist for the application.

This will assist applicants in clearly understanding what is required in the assessment of an application.

13 Guidance note 19: Vacant land – conditions on development

The standard conditions contemplated by Guidance Note 19 restrict the disposal of vacant commercial land, but do not contain customary exemptions for disposals required by domestic or foreign law or regulation. We suggest that such exemptions should be included as a matter of course.

14 Definitions of foreign person and foreign government investor - interests in trusts and limited partnerships

The definitions of foreign person (FATA s4) and foreign government investor (regulation 17) are commonly interpreted to refer to interests in either a trustee or trust or interests in either the general partner or the limited partnership, as applicable. However, this is not clear from:

- FATA ss4(d) and 4(e) and regulation 17(1)(c) which each opens with "the trustee of a trust"; or
- regulation 17(1)(d) which opens with "the general partner of a limited partnership".

We suggest that these provisions be modified to reflect the common interpretation.

15 Previous acquisition of interest in Australian land

It is unclear whether the words "the person has previously acquired an interest in Australian land" in FATA s12(3)(a) covers only an increase in a percentage interest (eg increase from 50% freehold interest as tenant-in-common to 70%) or a change in the nature of the interest (eg leasehold to freehold). It is understood that the intention is to cover both (eg see regulation 56(2)), so we suggest this be clarified.

16 Starting to hold additional interests

It appears that the words "start[s] to hold additional interests in the issued securities in the entity" in FATA ss 20(1)(c)(ii) and (iii) covers only an increase in a percentage interest (eg. increase from 50% to 70%), and not also a change in the nature of interest with no change in percentage (eg. from a traced interest to a direct holding). It is understood that the intention is to cover both (eg. see regulation 56(2)), so we suggest this be clarified.

Similarly, it appears that the words "start[s] to hold additional interests in assets of the business" in regulation 6(1)(c) covers only acquisition of an interest in assets, in which a person did not previously have an interest, and not also a change in the nature of an existing interest (eg. change from equitable interest as mortgagee to a legal interest). It is understood that the intention is to cover both, so we suggest this be clarified.

17 Apportionment based on EBIT

- (a) The apportionment wording in regulation 14(5) assumes that the target foreign entity owns 100% of an Australian business or entity, but does not expressly cater for a situation where a sub-100% interest is owned (particularly if it is less than a controlling interest and earnings of the Australian business or entity are not consolidated with the foreign entity's accounts). We suggest that the regulation be modified so that the foreign entity's proportionate ownership can be applied to the earnings of the Australian business or entity when assessing the consideration for the Australian component.
- (b) We suggest that, for the purposes of regulation s52(4) item 2, where there is a traced interest in an agricultural land entity (eg. via holding shares in a foreign company which holds shares in an agricultural land corporation), the value of the interest for the purposes of this provision should be the Australian-specific value only, determined in accordance with apportionment principles similar to regulation 14(5).

18 Exemption for acquisitions from government

We note that the exemption in regulation 31(1) refers to Australian businesses and interests in Australian land. We believe the intention is to also cover Australian entities, but that is not specified. We suggest that Australian entities be included.

19 Investments in financial sector companies

It is not clear whether regulation 32(1) operates to exclude the acquisition of traced interests in the securities of entities which sit beneath a financial sector company, in addition to excluding the acquisition of interests in shares in a financial sector company. We submit that regulation 32(1) should operate to also exclude traced interests, so that only the *Financial Sector (Shareholdings) Act 1998* (Cth), and not also FATA, is applicable for transactions involving acquisitions of shares in a financial sector company. We suggest the regulation be modified to provide for this.

20 Exemptions for sole member entities

Given FATA s20(1)(c)(ii), it is possible for a foreign person who is the sole member of a company to need FIRB approval to subscribe for additional shares. This is an anomalous outcome as there is no change of ownership or control. In practice this is not an issue because the rights issue exemption in regulation 41(2)(a) can be relied on. However, it is preferable if the regulations expressly provide that the 'excluded provisions' do not apply to acquisitions by sole members of companies or sole beneficiaries of trusts.

21 Selective capital reductions and selective share buy-backs

There is uncertainty as to whether selective capital reductions and selective share buy-backs are caught by the FATA. That is to say, whether the increase by a foreign person of their percentage interest in a company as a result of another person having their shares cancelled or bought-back can constitute a notifiable action and/or signification action.

The uncertainty arises because:

- In relation to the test for notifiable actions, it is difficult to conclude a foreign person whose percentage interest has increased as a result of a selective capital reduction or share buy-back, which the foreign person did not participate in or vote on at the relevant shareholders' meeting, can be considered as an 'action' that is 'taken' by the foreign person (FATA s 47(5)). The conclusion might be different if the foreign person was actively involved in developing the proposal or whose vote at the relevant shareholders' meeting was determinative to the proposal being approved.

- In relation to the test for significant actions, there is no 'taking of action' requirement for an acquisition of interests in securities (FATA s40(5)). This could lead to the outcome where the increase in a foreign person's percentage interest in a company as a result of a selective capital reduction or share buy-back is a notifiable action but not a substantial action.
- Where an Australian company undertakes a share buy-back, the shares are transferred to the company and are taken to be cancelled immediately after the transfer is registered (Corporations Act, s 257H). This raises the questions of whether the company has acquired a substantial interest in itself (for the purposes of the notifiable action test) or acquired interests in securities in itself (for the purposes of the substantial interest test).

We submit that foreign persons should not be subject to a FIRB notification requirement or be at risk of adverse orders under the FATA for increases in percentage interests due to a corporate action which the foreign person does not participate in and has no control over. In light of this, we suggest that the regulations provide that the 'excluded provisions' do not apply to a foreign person whose percentage interest in an entity increases as a result of a capital reduction or buy-back in which the foreign person did not participate, did not propose and, where the reduction or buy-back required security holder approval, the foreign person either abstained from voting or voted against the proposal.

We also suggest that the regulations provide that the 'excluded provisions' do not apply to an Australian company which acquires shares in itself in accordance with the buy-back provisions of the Corporations Act.

22 Disposal restrictions and interests in shares

We suggest that a guidance note be issued stating FIRB's view on whether a mere power to restrict disposal of a security constitutes a 'right attached to the security' (FATA s 9(2)(b)) – if so then it is an interest in the security. A person who has a mere right to prohibit disposal of a security does not have a legal or equitable interest in the security (FATA s 9(1)), however the reference to 'right attached to the security' in FATA s9(2) provides uncertainty.

23 Approvals for acquisitions of convertible instruments

We suggest that, as a practical matter, where FIRB has approved the acquisition of options or convertible securities the FIRB approval letter state whether the subsequent acquisition of underlying securities upon the exercise of the options or conversion of convertible securities:

- is taken to be covered by the approval, such that the subsequent acquisition need not require FIRB approval irrespective of when it occurs provided that the acquisition of the options or convertible securities occurs within the period stated in the approval letter; or
- needs to occur within the period stated in the approval letter for acquisition of the options or convertible securities.

24 Standard Tax conditions

We suggest that it be made clear when the tax conditions will not be applied. For example where there is an offshore transaction involving a foreign government investor that is acquiring less than a substantial interest on a passive basis. It does not warrant the time and cost involved in ascertaining if the tax conditions are acceptable only to find out that they would not have been imposed in the first place.

25 Monetary thresholds for Australian land entities

We understand that it is FIRB's intention that the relevant threshold for acquisitions of interests in Australia land entities that hold low threshold (ie, sensitive) land to be \$55 million. However, we submit that the drafting of regulation 52(5) item 3 should be drafted consistently with the approach taken for regulation 52(4) item 2 and regulation 52(5) item 4 to make it clear

that the \$55 million threshold is available for 'indirect' acquisitions as well as 'direct acquisitions'. Without this consistent approach to the drafting, there can be some uncertainty as to the applicable threshold. In addition, we submit that FIRB should provide investors with additional guidance around Australian land entities more broadly, including as to the tracing provisions and the valuation of non-freehold interests for entities that are not holding entities.

26 Media

The concept of 'media' is used in the definition of 'sensitive business' at regulation 22(2)(a)(i). This is distinct from what constitutes an 'Australian media business', which is separately defined for the purposes of regulation 55. In addition, Guidance Note 25 broadly refers to investments in the 'media sector'. We submit that further guidance in Guidance Note 25 on FIRB's views on the scope of the terms 'media' and 'media sector' as compared to 'Australian media business' would assist investors.

27 Securitisation

It appears that regulation 27 may not completely exempt securitisation of residential mortgages by foreign persons engaged in money-lending businesses. We understand that FIRB is aware of this drafting issue from previous discussions with industry and submit that the drafting be amended to include such forms of securitisation.

28 Acquisitions from Government

We understand that it was intended to include acquisitions from statutory authorities in the exemption in regulation 31. While the reference to 'wholly owned' in regulation 31(1)(b) is being interpreted by FIRB to include statutory authorities, we suggest that the drafting could be made clearer by including an express reference to acquisitions from these types of entities.



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Via email: adam.mckissack@treasury.gov.au

14 February 2017

Attention: Mr Adam McKissack

Dear Mr McKissack,

**Private Equity and Venture Capital
Submission re Low Sensitivity Business Investment**

The Foreign Investment Committee of the Business Law Section of the Law Council of Australia welcomes the Australian Government's initiative in reviewing the 2015 reforms to the foreign investment framework. We also appreciated the opportunity to meet with you to discuss some preliminary potential changes.

You indicated in that meeting that if there were any additional matters which we felt should be included in the Consultation Paper, we should send you details with our thinking on why they should be included.

One matter which has been identified, and which was discussed at our meeting on 3 February, is the fact that some investments of relatively low value and low sensitivity have been caught in the regulatory net. This particularly relates to some persons caught by the definition of "foreign government investors" (FGIs).

We understand that one approach being considered to address this is the introduction of a new exemption certificate for interests in securities that would provide broad pre-approval for foreign persons acquiring securities.

We are broadly supportive of an approach of this kind and are aware of the submissions that have been made to the Government by the Australian Private Equity and Venture Capital Association (AVCAL) supporting such an approach.

However, we would go further and submit that it is an "overreach" for commercial private equity and venture capital organisations to be regarded as FGIs. We would request that

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you consider including a proposal in the Consultation Paper to exclude organisations of this kind from the definition of "foreign government investor".

There do not appear to us to be any sound policy reasons for private equity and venture capital organisations to be caught in this definition. It seems to us that this has resulted not only in an unnecessary and, in our view, unjustified regulatory burden on this industry but also in matters being required to be considered by the FIRB when there appears to be no real policy sensitivity.

We say this because the structure of these private equity and venture capital funds is such that the limited partners or investors in funds managed by private equity or venture capital are entirely passive investors. All decision making power is exercised by the fund manager or general partner pursuant to a limited partnership agreement or management agreement.

This has resulted in:

- The FIRB having to consider and process proposals for acquisitions of companies and businesses of less than \$252 million in non sensitive businesses by entities that are clearly "commercial", imposing an unnecessary burden on the FIRB and unnecessary "red tape".
- Fairly small downstream acquisitions by investee companies owned by private equity or venture capital funds also having to be processed as proposals by FGIs. It seems to us to be overreaching to consider investee companies of this kind to be FGIs as well as an unnecessary burden on the system, which is currently straining to meet timeframe expectations. To quote one active PE fund executive, " ever since we started paying fees the response times have considerably lengthened "

In our submission, where the general partner or fund manager of a private equity or venture capital fund of this kind has clear management control, and the investors or limited partners are clearly passive, with no participation in the management or control of the partnership or the relevant entity, then the fund should not be regarded as a FGI. They would still be a 'foreign person' if the relevant thresholds (i.e. 20% individually or 40% in aggregate) were met.

In our submission, this would ensure that true foreign government investors were treated as such, with the consequence that proposals by private equity or venture capital fund managers, that are clearly low risk from a policy perspective, are no longer taking up the finite resources of the FIRB.

If there was a concern about investments in sensitive businesses, a lower threshold limit could be specified for funds of this kind in respect of specified sensitive businesses.

There is some precedent for this approach in the regulations in regulation 45(3), where limited partners are not taken to be associates of each other if they are not in a position to participate in the management or control of the partnership or of any of the general partners.

In summary, we submit that:

- There is no sensible policy rationale for treating private equity or venture capital funds as FGIs - this has resulted in proposals of low or no sensitivity being required to be considered by the FIRB.
- Policy could be adequately met by having entities of this kind treated as non government foreign persons provided that the management and control was vested in the general partner or fund manager, and the investors or limited partners are passive investors.

In our view, this could be achieved by relatively simple amendments to the FATA regulations.

We would urge Treasury to consider including a proposal of this kind in the Consultation Paper which it proposes to release later this month. That would enable Treasury to receive feedback on this potential approach and test whether there were any sensitivities or concerns.

If you have any question in relation to this submission, in the first instance please contact the Committee Chair, Malcolm Brennan, on 02-6217 6054 or via email: malcolm.brennan@au.kwm.com

Yours sincerely,



Teresa Dyson, Chairman
Business Law Section