Law Council
OF AUSTRALIA

Business Law Section

2022 Foreign Investment Reforms - Exposure Draft Regulations

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Table of Contents

About the Business Law Section of the Law Council of Australia

The Business Law Section was established in August 1980 by the Law Council of Australia with jurisdiction in all matters pertaining to business law. It is governed by a set of by-laws adopted by the Law Council and the members of the Section. The Business Law Section conducts itself as a section of the Law Council of Australia Limited.

The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, as well as enhance their professional skills.

The Law Council of Australia Limited itself is a representative body with its members being:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Operating as a section of the Law Council, the Business Law Section is often called upon to make or assist in making submissions for the Law Council in areas of business law applicable on a national basis.

Currently the Business Law Section has approximately 900 members. It currently has 15 specialist committees and working groups:

- Competition & Consumer Law Committee
- Construction & Infrastructure Law Committee
- Corporations Law Committee
- Customs & International Transactions Committee
- Digital Commerce Committee
- Financial Services Committee
- Foreign Corrupt Practices Working Group
- Foreign Investment Committee
- Insolvency & Reconstruction Law Committee
- Intellectual Property Committee
- Media & Communications Committee
- Privacy Law Committee
- SME Business Law Committee
- Taxation Law Committee
- Technology in Mergers & Acquisitions Working Group

As different or newer areas of business law develop, the Business Law Section evolves to meet the needs or objectives of its members in emerging areas by establishing new working groups or committees, depending on how it may better achieve its objectives.

The Section has an Executive Committee of 11 members drawn from different states and territories and fields of practice. The Executive meets quarterly to set objectives, policy and priorities for the Section.

Current members of the Executive are:

- Mr Philip Argy, Chairman
- Professor Pamela Hanrahan, Deputy Chair
- Mr Adrian Varrasso, Treasurer
- Mr Greg Rodgers
- Mr John Keeves
- Ms Rachel Webber
- Ms Caroline Coops
- Dr Elizabeth Boros
- Ms Shannon Finch
- Mr Clint Harding
- Mr Peter Leech

The Section's administration team serves the Section nationally and is based in the Law Council's offices in Canberra.

For Further Information

This submission has been prepared by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia (the **Committee**).

The Committee would be pleased to discuss any aspect of this submission.

Any queries can be directed to the chair of the Committee, Wendy Rae (at Wendy.Rae@allens.com.au or +61 3 9613 8595) or deputy chair of the Committee Marcus Clark (at Marcus.Clark@jws.com.au or +61 2 8274 9509).

With compliments

Philip Argy
Chair, Business Law Section

Submission

The Committee welcomes the Government's proposals to make changes to the *Foreign Acquisitions and Takeovers Regulation 2015* (**Regulations**) to 'reduce regulatory burdens by clarifying certain aspects of the framework and streamlining some less sensitive types of investment'. However, we submit that certain aspects of the proposed changes do not achieve this objective, or can be fine tuned to better achieve this objective.

1. Moneylending exemption

We support the Government's proposal to amend the definition of “moneylending agreement” subject to the following marked changes (or similar) being implemented. We support the Government’s other proposed changes in relation to the existing moneylending exemption.

moneylending agreement means:

(a) an agreement entered into:

(i) in good faith and on ordinary commercial terms; and

(ii) in the ordinary course of carrying on a moneylending business;

except an agreement dealing with any matter unrelated to the carrying on of that business; or

(b) an agreement entered into:

(i) in good faith and on ordinary commercial terms; and

(ii) relating to the purpose of lending money or otherwise providing financial accommodation; and

(iii) by an entity that was created predominantly for that purpose by a person or entity in the ordinary course of carrying on a moneylending business, a business of promoting the establishment of moneylending businesses or a business of arranging the lending of money or other financial accommodation;

except if the entity that was created predominantly for that purpose, before entering into the agreement, began carrying on a business unrelated to that purpose; or

(c) for a person or entity that:

(i) is carrying on a moneylending business; or

(ii) was created predominantly for the purpose of lending money or otherwise providing financial accommodation by a person or entity ~~in the ordinary course of carrying on a moneylending business~~referred to in sub-paragraph (b)(iii); or

(iii) is a subsidiary or holding entity of a person or entity covered by subparagraph (i) or (ii);

an agreement to acquire an interest arising from an agreement that would be a moneylending agreement (within the meaning of paragraph (a) or (b)) were the person or entity to have been the original holder of the interest.

Sub-paragraph (b)(iii) - promoters and arrangers

Paragraph (b) of the definition addresses a current concern that newly created lenders may not be able to establish that they are carrying on a moneylending business when they first enter into a moneylending agreement. By clarifying coverage of newly created lenders under the moneylending exemption, the Government is removing a potential barrier to entry and, therefore, promoting competition in the finance sector.

As drafted, sub-paragraph (b)(iii) contemplates circumstances in which new lenders are created by existing lenders. For example, this may occur when a lender establishes (A) a new subsidiary through which to carry on a new moneylending business generally or (B) a

special purpose lending vehicle to lend money or otherwise provide financial accommodation to a specific borrower or for a specific project.

However, in our experience, it is often the case that special purpose lending vehicles are formed by persons that do not carry-on moneylending businesses themselves but are in the business of promoting their creation or arranging the lending of money or other financial accommodation.

Our proposed extension to promoters is particularly designed to cover collective investment vehicles created by investment fund managers to lend money or otherwise provide financial accommodation. An investment fund manager may not itself carry on a moneylending business but instead promotes to potential investors the establishment of collective investment vehicles to carry on moneylending businesses utilising funding to be sourced from the potential investors.

Similarly, our proposed extension to arrangers is particularly designed to cover special purpose lending vehicles created by finance arrangers to lend money or otherwise provide financial accommodation to a specific borrower or for a specific project. A finance arranger may not itself carry on a moneylending business but instead carries on a business of arranging finance. In many cases the lending syndicate that is arranged will lend directly with each syndicate member relying on the moneylending exemption; however, in some cases it is more convenient for syndicate members to have their lending arranged through a special purpose lending vehicle.

Note that we are only proposing an extension to persons and entities that carry on business of promoting or arranging – not one-off promoters or arrangers.

Paragraph (b) – entity clarification

The final part of paragraph (b) uses the term ‘entity’ into two contexts – one being the entity created to lend money or provide other financial accommodation and the other being the entity that created the first entity. Our proposed change is designed to clarify that it is the entity created to lend money that cannot carry on a business unrelated to that purpose, not the entity that created it.

Paragraph (c)

Our proposed change to sub-paragraph (c)(ii) is consequential arising from our proposed change to sub-paragraph (b)(iii).

Our proposed change to the final part of paragraph (c) is designed to cover a situation in which a person or entity that qualifies for the moneylending exemption is acquiring an interest in a loan agreement from a person that did not qualify for the exemption. We do not think the unavailability of the moneylending exemption to the assignor of an interest should be relevant to the availability of the moneylending exemption to an otherwise qualified assignee of that interest.

2. Australian media business

We support the proposed changes.

3. Unlisted Australian land entities

We support the Government’s proposal to align the threshold for unlisted Australian land entities with the threshold for listed Australian land entities. However, we recommend that sections 37(2)(c) and 4(c) of the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**) each be amended to refer to a “direct interest” instead of 10%. This would also allow for the deletion of FATR sections 37(2)(d) and (4(d) as these deal with concepts addressed in the definition of “direct interest” (see FATR section 16).

In addition to promoting a consistent approach to thresholds, it would also provide for a lower threshold of 5% to apply in circumstances where there is a “legal arrangement” between the relevant foreign person and the Australian land entity.

4. Acquisitions of interests in securities where proportionate share or unit holding will not increase

We support the Government's proposal to introduce this new exemption.

We note that, in addition to the wholly-owned subsidiary and capital call scenarios, the new exemption can apply where securityholders in an entity are offered for issue a different class of shares (for example, preference shares) on a pro rata basis according to their holdings of existing securities with the objective that no individual securityholder's percentage interest in the entity will increase. It would be helpful if the Explanatory Statement also includes that example.

We are, however, concerned that the proposed exemption as currently worded imposes too high a burden for the foreign person seeking to rely on the exemption. The requirement in the proposed section 41(c) of the Regulations that 'there are reasonable grounds to believe that this percentage interest that the person holds in the entity will not increase as a result of the person’s acquisition' appears (unreasonably) to require the foreign person to form a view as to whether the issuer entity's other securityholders will take up their respective pro rata entitlements.

It would be preferable for the test to be reversed to be: 'the person must not have any reasonable grounds to believe that the percentage interest that the person holds in the entity will increase as a result of the person’s acquisition'.

5. Meaning of rights issue

We support the Government's proposal to define 'rights issue'. However, we have a few concerns about the proposal to incorporate by reference the definition in the *Corporations Act 2001* (Cth) (**Corporations Act**).

(a) From time to time the Corporations Act definition of 'rights issue' is modified by the Australian Securities and Investments Commission (**ASIC**) via regulatory instruments pursuant to its powers under the Corporations Act.

- Some of these instruments are of general application, such as ASIC Corporations (Non-Traditional Rights Issues) Instrument 2016/84) (see https://www.legislation.gov.au/Details/F2016L00334) which modifies the rights issue definition so that the commonly used accelerated rights issue structure – where the offers to institutional securityholders are made prior to offers to retail securityholders to enable the issuer to raise funds more quickly – will also qualify as a compliant rights issue.

- Other instruments are of specific application and given by ASIC to individual issuers on a case-by-case basis.

We assume the Government intends to capture the Corporations Act's rights issue definition as modified by ASIC from time to time. It may be that Part 4 of the *Acts Interpretation Act 1901* (Cth) does cover ASIC modifications, but it is not clear to us that it does.

We recommend that it be made clear, ideally in the Regulations or otherwise in the Explanatory Statement or FIRB Guidance Note, that the Corporations Act's rights issue definition as modified by ASIC from time to time is covered by the definition in the Regulations.

(b) The Corporations Act's rights issue definition (as modified by ASIC from time to time) is appropriate where the issuer is an Australian entity, but not where the issuer is a foreign entity. Because of the tracing rules in the FATA there will be situations where a foreign person could be undertaking a notifiable action or notifiable national security action by acquiring interests in securities of a foreign entity. For example, where a foreign issuer owns an Australian subsidiary that carries on a national security business, the acquisition by a foreign person of 20% or more of the foreign issuer constitutes a notifiable national security action, but for the availability of the rights issue exemption.)

The Corporations Act definition of rights issue requires offers to be made to registered security holders in Australia or New Zealand. However, a foreign entity conducting a rights issue under the laws of its local jurisdiction might, as permitted by those local laws, exclude securityholders in Australia and/or New Zealand (for example, a rights issue by a large foreign company listed on a foreign stock exchange might have only a handful of Australian and New Zealand shareholders, and the relevant local laws could permit the foreign company to exclude shareholders where it would be unreasonably onerous to comply with applicable securities laws, being in this example Australian prospectus rules). This should not mean the rights issue exemption in the Regulations cannot be relied on.

We recommend that rights issues by both Australian and foreign entities be appropriately covered in a definition of rights issue. We suggest a new section 41A(1A) be inserted in the Regulations:

(1A) For the purposes of paragraph (2)(a), ***rights issue*** means:

(a) where the issuer of interests in securities is an entity established in Australia – a rights issue within the meaning of the *Corporations Act 2001* as may be modified from time to time by the Australian Securities and Investments Commission by legislative instrument for the benefit of persons generally or to specific persons; or

(b) where the issuer of interests in securities is an entity established in a jurisdiction outside of Australia – an offer of securities that is made to every person who holds securities in a particular class to issue them, or their assignee, with the percentage of the securities to be issued that is the same as the percentage of the securities in the class that they hold before the offer but disregarding:

(i) the rounding up or down of the number of securities offered to that holder to a whole number; and

(ii) the fact that the offer is not made to holders in relation to whom offers do not have to be made under the laws or other rules (however described) that apply to the offer of securities in the primary jurisdiction applying to the issuer of securities as in force at the date of the offer.

The suggested paragraph (b) is taken from *ASIC Corporations (Foreign Rights Issues) Instrument 2015/356* (see https://www.legislation.gov.au/Details/F2017C00893).

We also submit that the following statement in the draft Explanatory Statement be modified so that it refers to rights issues by both Australian entities and foreign entities: 'The exemption applies to foreign persons when they acquire additional securities in an Australian entity under a rights issue as long as it is a voluntary, pro-rata rights issue under the Corporations Act 2001 (or a law of a foreign country or part of a foreign country)'.

6. Foreign custodian corporations

We support the Government's proposal to amend the exemption for foreign custodian corporations in FATR section 30 except proposed section 30(1)(d), the effect of which would

be to prohibit a foreign custodian corporation from holding assets on behalf of foreign persons.

Background

Custodian corporations play an important role in the Australian financial system with a number of benefits. The Explanatory Statement to the *Foreign Acquisitions and Takeovers Regulation 2015* notes the following benefits:

> Custodians provide a range of services for their clients, who are generally institutional investors, money managers and broker/dealers. These services typically include: settlement of trade and safekeeping of financial assets on behalf of the client; collection of income arising from portfolios; application of entitlements to reduce rates of withholding tax at source and reclaiming tax withheld; and notification and dealing with corporate action.

In addition to the benefit investors derive directly from their services, the Australian financial system as a whole benefits from the role custodian corporations play in easing administration burdens for listed companies (by aggregating investors and thereby reducing shareholder numbers) and facilitating securities lending (again, by aggregating investors).

Custodian corporations that carry on business in Australia are principally regulated by the Australian Securities and Investments Commission as holders of Australian financial services licences or authorised representatives of such holders.

A number of the most active custodian corporations are foreign persons including HSBC Custody Nominees (Australia) Limited, JP Morgan Nominees Australia Pty Limited, Citicorp Nominees Pty Limited, BNP Paribas Nominees Pty Ltd, UBS Nominees Pty Ltd, ABN Amro Clearing Sydney Nominees Pty Ltd and Merrill Lynch (Australia) Nominees Pty Limited.

Our review of the list of top 20 shareholders listed in the most recent annual reports of the top 20 ASX-listed companies by market capitalisation revealed that 14 of the 20 had one or more foreign custodian corporations with a substantial interest.

Name	As at	Substantial Interest Holder and %
Aristocrat Leisure Ltd (ASX:ALL)	17-Nov-2021	HSBC – 35.7% JP Morgan – 20.8%
Coles Group Ltd (ASX:COL)	26-Aug-2021	HSBC – 26.1%
CSL Ltd (ASX:CSL)	11-Aug-2021	HSBC – 32.8%
Fortescue Metals Group Ltd (ASX:FMG)	25-Aug-2021	HSBC – 24.3%
Goodman Group (ASX:GMG)	25-Aug-2021	HSBC – 36.5% JP Morgan – 31.2%
James Hardie Industries Plc (ASX:JHX)	30-Apr-2021	HSBC – 36.8% JP Morgan – 23.5%
Macquarie Group Ltd (ASX:MQG)	31-Mar-2021	HSBC – 27.9% JP Morgan – 18.4%*
Rio Tinto Limited (ASX:RIO)	05-Feb-2021)	HSBC – 33.5% JP Morgan – 19.3%*
Telstra Corporation Ltd (ASX:TLS)	23-Jul-2021	HSBC – 21.3%

Name	As at	Substantial Interest Holder and %
Transurban Group (ASX:TCL)	12-Jul-2021	HSBC – 35.6% JP Morgan – 17.8%*
Wesfarmers Ltd (ASX:WES)	26-Aug-2021	HSBC – 24.0% JP Morgan – 15.4%*
Westpac Banking Corporation (ASX:WBC)	01-Oct-2021	HSBC – 23.4%
Woodside Petroleum Ltd (ASX:WPL)	01-Feb-2022	HSBC – 27.8%
Woolworths Group Ltd (ASX:WOW)	30-Jul-2021	HSBC – 24.7% JP Morgan – 16.4%*

* We have noted a number of cases where a foreign custodian corporation is close to holding a substantial interest.

Limiting exemption to custody services for Australian investors

We understand that the rationale for adopting the proposed FATR section 30(1)(d) is to better reflect the 2015 Explanatory Statement, which provided the following rationale for the exemption:

> Generally, custodians only exercise voting rights attached to their holdings under direct instruction from their client and do not normally exercise influence independent of their client. It would be inconsistent with the underlying rational of the Act to screen the operations of foreign custodians operating in Australian when they act on behalf of Australian investors.

The effect of the change will be to make it difficult for foreign custodian corporations to provide custody services to foreign persons where doing so would cause them to trigger a compulsory FIRB notification – for example, acquiring a substantial interest in an Australian entity (or a direct interest in some cases).

It would also result in significant administrative difficulties for foreign custodian corporations including the following.

(a) For each asset to be held in custody, a foreign custody corporation would have the onus placed on it of having to assess whether its holding of the asset may trigger a compulsory FIRB notification, including:

  (i) in the case of an interest in an entity:

    (A) whether the entity (or any downstream entity caught by the tracing rules) carried on a national security business, an agribusiness or an Australian media business or was an Australian land entity; and

    (B) the value of the total assets of all relevant entities; and

  (ii) in the case of an interest in a land, the relevant classification of the land, consideration paid and (in the case of agricultural land) aggregated consideration.

  Particularly as they are not investors and typically provide custody services to passive investors, custody corporations are unlikely to have (or the means to obtain) access to the information that they would require to make these assessments.

(b) A foreign custody corporation may need to place caps on the assets that it holds to ensure, for example, that it remains below the relevant percentage threshold that would trigger a compulsory FIRB notification. It may be difficult to implement such caps in the

dynamic trading environments that typically exist for market-traded securities without causing significant disruption to the Australian financial system.

(c) A foreign custody corporation would have the onus of identifying each person who held an interest through them and whether the person was a foreign person. Noting that custody arrangements are often underpinned by multiple layers of sub-custody arrangements, we expect that this would be a very difficult task.

We do not think that exemption certificates would provide an adequate means to reduce these difficulties as they are themselves burdensome in terms of transaction reporting requirements and the need to monitor financial condition limits, particularly given trading volumes in market-traded securities.

Given that foreign custody corporations do not hold an economic interest in assets or exercise voting rights other than on direction, and investors who are foreign persons remain subject to relevant FIRB notification triggers regardless of whether they are the holder of an asset on record or the holder of an asset through a custody arrangement, we do not think any policy purpose would be served by limiting this exemption to where a foreign custody corporation is providing custody services only to investors that are not foreign persons.

Further, we think that it would be contrary to the national interest to impose a narrower exemption on foreign custody corporations because the additional burdens would likely have an adverse effect on competition for custody services and create potential for disruption in financial markets.

Reference to legal and equitable interests

An existing problem with the exemption – that is continued by the proposed changes – is the requirement in paragraph (c) that the foreign custodian corporation hold a “legal interest” and the exclusion in paragraph (d) of equitable interests from being held by the foreign custody corporation (under the current exemption) or any foreign person (under the proposed changes). By referring to equitable and legal interests, the drafters appear to be trying to distinguish between economic and non-economic interests. While it is often the case that these concepts operate in parallel, that is not always the case.

The most prominent example of where these concepts do not operate in parallel is the unit trust. Unit trusts are the principal form that collective investment vehicles take in Australia. They are particularly important for infrastructure and property investment.

As unit trusts are products of equitable law, it is not possible to hold a legal interest in them, only an equitable interest. As currently drafted (and proposed), foreign custody corporations cannot rely on the exemption to hold interests in unit trusts.

In addition, the exclusion of equitable interests creates problems for custody arrangements that rely on the use of sub-custodians. In that instance it would only be the sub-custodian at the bottom of the chain that would have the legal interest in the assets.

We recommend the removal of references to legal and equitable interests as noted below.

Recommended modification

We recommend replacing existing FATR sections 30(c) and (d) with the following:

(c) the foreign person holds the interest only as a bare trustee or nominee;

The term “bare trustee” is used in section 609 of the Corporations Act in the context of a holding of shares by a bare trustee being not being considered a holding of a relevant

interest in shares under takeovers law. The meaning of the term has been judicially considered in the following cases:

- *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271 at 281 (Gummow J):

  > A distinction long has been drawn between “active” and “passive” trusts; it was first drawn in sixteenth century decisions which held that the Statute of Uses 1536 (27 Hen VIII, c 10) (Eng) executed passive but not active uses, and remains of importance in some jurisdictions in the United States: *Scott on Trusts*, 4th ed, 1987, § 68, 69.
  >
  > …
  >
  > Today the usually accepted meaning of “bare” trust is a trust under which the trustee or trustees hold property without any interest therein, other than that existing by reason of the office and the legal title as trustee, and without any duty or further duty to perform, except to convey it upon demand to the beneficiary or beneficiaries or as directed by them, for example, on sale to a third party. The beneficiary may of course hold the equitable interest upon a sub-trust for others or himself and others: see *Halsbury's Laws of England*, 4th ed, vol 48, “Trusts”, para 938. The term is usually used in relation to trusts created by express declaration. But it has been said that the assignor under an agreement for value for assignment of so-called “future” property becomes, on acquisition of the title to the property, trustee of that property for the assignee (*Palette Shoes Pty Ltd v Krohn* (1937) 58 CLR 1 at 27) and this trust would answer the description of a bare trust. Also, the term “bare trust” may be used fairly to describe the position occupied by a person holding the title to property under a resulting trust flowing from the provision by the beneficiary of the purchase money for the property.

- *Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 5 ACSR 720 at 746 and 747 (Meagher J):

  > A “bare trust” is one in which the trustee has no active duties to perform and is usually contrasted with a trust where there are such active duties. A recent discussion of the topic may be found in Gummow J's judgment in *Herdegen v FCT* (1988) 84 ALR 271. In that case, his Honour points out that the precise nuances of the phrase must depend on the context in which it is found. As a matter of strict logic a person in Mr Stapleton's position would theoretically have been in a position where he had an active independent duty to perform in some circumstances, for example if he found himself so situated that he had to vote at a formal meeting and C Itoh had declined to instruct him how to exercise his vote. But, as a matter of strict logic, almost no situation can be postulated where a trustee cannot in some circumstances have active duties to perform. The applicants would have the phrase confined to situations where the trustee was immediately bound to transfer the share to his beneficiary. But this, in my view, is too narrow a construction, and would result in reading down the phrase so that it applied only to situations which almost never occur. Bearing in mind the evident statutory purpose, and particularly bearing in mind that s 130 imposes criminal penalties for its breach, I think the expression must be related to situations where a trustee is no more than a nominee or cypher, in a common-sense commercial view.

The second of these cases related to the interpretation of “bare trustee” in the context of relevant interests under an earlier takeovers law. Note that the possibility discussed in *Corumo Holdings Pty Ltd v C Itoh Ltd* that a bare trustee may have a voting discretion in some cases is addressed by FATR section 30(e).

We have recommended the use of term “bare trustee” because it appropriately describes the role of a custodian corporation in Australia. We have included the term “nominee” to address the fact that a foreign custodian corporation operating in a civil law jurisdiction that does not recognise trusts could not be properly described as acting as a bare trustee.