Post-implementation review of the Foreign Acquisitions and Takeovers Amendment Act 2010 and its associated Regulations

Overview

On 12 February 2009, the Treasurer announced changes to the foreign investment review framework to ensure that it would apply equally to all foreign investment proposals irrespective of the way they were structured. In particular, the changes were to ensure that newer investment structures, including instruments such as convertible notes, would be captured by the review framework. A Regulation Impact Statement was required for this announcement but was not prepared. As a result, a Post-implementation Review is required, in line with the Government's best practice regulation requirements.

Amendments were made to the *Foreign Acquisitions and Takeovers Act 1975* (the Act) to clarify that complex investment structures, that may provide avenues of control beyond that provided through traditional shares or voting power, are required to be notified. Associated changes were made to the *Foreign Acquisitions and Takeovers Regulations 1989* (the Regulations) to ensure that Australian companies were not inadvertently treated as foreign persons because of the changes made to the Act.

The main finding of the Post-implementation Review is that the regulatory change was effective in meeting the policy objective. It clarified an uncertain part of the Act by making it clear that foreign investors using newer investment instruments, such as convertible notes, need to notify the Government and seek prior approval for their investment proposals. While it is difficult to quantify, feedback from the consultation process suggests that the amendments had only a minor regulatory impact on foreign investors and their advisors, and any additional compliance costs associated with the regulatory measure have been negligible.

The review did highlight unintended changes to the operation of the Act. In practice though, the effect of these changes is minor and does not warrant action. Consideration is being given to providing further guidance on the Foreign Investment Review Board website on the treatment of newer investment structures.

Introduction

The Government welcomes foreign investment because it plays an important and beneficial role in the Australian economy. It provides additional capital for economic growth, creates employment opportunities, improves consumer choice and promotes healthy competition amongst our industries. Foreign investment can also help deliver improved competitiveness and productivity by introducing new technology; providing much needed infrastructure; allowing access to global supply chains and markets; and enhancing Australia's skills base.

However, the benefits of foreign investment are not always immediately recognisable and some foreign investment proposals could be detrimental to Australia's interests. Successive governments have reviewed foreign investment proposals on a case-by-case basis to ensure that they are not contrary to the national interest. The foreign investment review framework is a well-established process that strikes a balance between protecting the national interest and ensuring that Australia remains an attractive destination for foreign investors.

The review framework comprises the Act, its associated Regulations and Australia's Foreign Investment Policy (the Policy). The Act provides the legislative framework to review foreign investment proposals and the Policy provides guidance to foreign investors to assist their understanding of the review process. The Policy also identifies a number of investment proposals that need to be notified even if the Act does not apply (for example, certain investments by foreign governments and their related entities).

The Foreign Investment Review Board was established in 1976 to examine foreign investment proposals and advise the Treasurer on the national interest implications. Responsibility for making decisions rests with the Treasurer. The Act requires foreign investors to notify the Treasurer of their transactions in certain circumstances and provides the Treasurer with the power to block, or place conditions upon, those proposals that involve a foreign person obtaining control of an Australian company that would be contrary to the national interest. The Treasurer's powers operate according to the nature of the investment, including acquisitions of shares, acquisitions of assets, agreements relating to directorate of corporations and arrangements relating to control of Australian businesses.

Problem identification

The notion of control is a fundamental concept in the Act. For the Treasurer to exercise his or her powers under the Act — other than in relation to acquisitions involving interests in urban land, where a change in control is not required — (assuming relevant monetary thresholds are met) he or she must first be satisfied that a foreign person (or persons) has acquired or will acquire a controlling interest in an Australian corporation. The notion of control relies on the foreign person (or persons) holding a substantial interest and being in a position to determine the policy of the corporation.

Prior to the amendments, the Act provided that a 'substantial interest' meant a person (together with their associates) holding 15 per cent or more of the 'voting power' or the 'issued shares' in a corporation. An 'aggregate substantial interest' meant two or more persons (together with their associates) holding an aggregate of 40 per cent or more of the 'voting power' or the 'issued shares' in a corporation.

Overall, these provisions had worked well. However, the use of complex financing arrangements in several large foreign investment transactions (which cannot be disclosed for confidentiality reasons) had highlighted that while these types of investment arrangements may have a solid commercial basis (they are being used for other reasons — not necessarily to avoid foreign investment review), they could have the effect of delivering influence or control in ways that were not necessarily envisaged when the Act was being drafted in the mid 1970's.

This meant that ownership and control events could potentially arise in a variety of ways other than through traditional shares or voting power and it was therefore not clear that the Act covered such transactions. For instance, an 'interest in a share' was defined to include 'rights' and 'options' to acquire shares but it was unclear whether it extended to include other types of financial instruments or commercial arrangements which may provide an interest in the corporation (but which are not in the legal form of a share) or which could be converted to newly issued or to existing shares in the future (such as convertible notes).

In the absence of regulatory measures to clarify that these newer types of investment structures were subject to foreign investment review, proposed investments that were essentially the same in economic substance to traditional share acquisitions or changes to formal voting rights, but structured differently, may not have been notified to the Treasurer.

To make it clear that newer forms of investment instruments were subject to foreign investment review, on 12 February 2009, the Treasurer announced that the Government would amend the Act to 'clarify the operation of the foreign investment screening regime … to ensure that it applies equally to all foreign investments irrespective of the way they are structured'. The Treasurer's Press Release (see Attachment A) indicated that these amendments would apply retrospectively from the date of announcement to ensure that proposals entered into after that time would be captured.

Government objectives

The Government's main objective was to clarify an uncertain part of the Act to ensure that modern investment structures, including instruments such as convertible notes, would be able to be scrutinised in the same way as investments using traditional shares or voting power.

Possible implementation options

There were four broad options that could have been implemented in order to try and achieve the Government's objective.

As there was uncertainty around whether these types of investment structures were captured by the legislation (and some investors would have been notifying voluntarily in any event) one option would have been to leave the existing arrangements in place. The shortcoming with the **'no change' option** was that it would have resulted in continued uncertainty as to whether particular structures required notification. This in turn could have led to a growing awareness that certain structures may not require notification and that the Treasurer may not have powers under the Act to deal with these cases. Those investors seeking to abide by the spirit of the law would be subject to a greater regulatory burden than those seeking to avoid the screening requirements. In addition, costs would arise for parties seeking clarification of their legal position.

Another possible option would have been to **amend the Policy** to make it clear that foreign investors were expected to notify the Treasurer where there is a possibility that the type of investment arrangement being used would deliver influence or control over an Australian company. This would have made clear the Government's expectation, but would have lacked legislative backing. This option may have also drawn attention to possible deficiencies in the Act and could have made enforcement action more difficult.

An additional option would have been a **comprehensive rewrite of the Act** to modernise its operation and ensure that it operates efficiently and effectively to facilitate foreign investment that is not contrary to the national interest. However, a complete overhaul of the Act would have been far more resource-intensive than the option chosen (or other alternatives) and would have taken more time to implement. This would have also imposed significant transitional costs on foreign investors and their advisers who would need to familiarise themselves with new legislation.

The option chosen by the Government was to **amend the Act** in a minimalist way to clarify that the review framework applies equally to all foreign investment proposals irrespective of the way they are structured.

Implementation of the proposed regulatory measure

Foreign Acquisitions and Takeovers Amendment Act 2010

Following the Treasurer's announcement on 12 February 2009, amendments to the Act were developed in consultation with the Australian Government Solicitor, the Office of Parliamentary Counsel, the Department of Foreign Affairs and Trade and the Office of International Law.

The Foreign Acquisitions and Takeovers Amendment Bill 2009 (the Bill) was introduced into Parliament on 20 August 2009. The Bill aimed to clarify the operation of the Act by explicitly requiring foreign investors to notify the Treasurer where there is a possibility that the type of investment structure being used will deliver control over an Australian company, either currently or at some time in the future. The amendments specifically included transactions or agreements that involve instruments which eventually convert into shares or share-like interests or voting power.

The Bill expanded the definition of voting power so that it covers the number of votes able to be cast on the assumption that a future right is exercised, and clarified the section of the Act dealing with interests in shares. The provision that a person is deemed to hold an interest in a share if the person has a right to acquire a share or have a share transferred to the person was clarified to make it clear that a right includes a right under an instrument, agreement or arrangement, whether the right is exercisable presently or in the future and whether on the fulfilment of a condition or not.

In particular, the Bill expanded the definitions of 'substantial interest' and 'aggregate substantial interest' from holding at least 15 per cent or 40 per cent respectively of the voting power or the issued shares in a corporation to also include holding at least 15 per cent or 40 per cent of the **potential** voting power, or **rights to** issued shares. The definitions of interest in a share and voting power were also clarified. A summary of the key changes is provided in Attachment B.

Following the Bill's introduction, several issues (mainly relating to the expanded definition of 'substantial interest') were identified as requiring further clarification. Treasury undertook some confidential consultation with a small group of foreign investment advisors to ensure that the amendments worked effectively and did not raise any subsequent issues. Consultation highlighted some uncertainties that were addressed by several minor technical amendments to the Bill.

These amendments aimed to clarify:

- how to determine 'substantial interest' with respect to rights over a yet-to-be-determined number of shares or voting power;
- that the regulation-making provision includes prescribed interests in shares for the purposes of a prescribed provision;
- that the tracing provisions incorporate the expanded definition of substantial interests;
- that the deeming provisions currently applicable to options over shares and assets also apply to other types of rights over shares and assets; and
- that the transitional provisions extend to interests in Australian urban land captured by the compulsory notification requirements.

The revised Bill was passed on 2 February 2010 and the *Foreign Acquisitions and Takeovers Amendment Act 2010* (the Amendment Act) received Royal Assent on 12 February 2010. Importantly, the amendments did not change the examination procedures undertaken by the Foreign Investment Review Board. The screening and examination procedure is a well-established process, and the decision to block or impose conditions on foreign investment proposals continues to be exercised by the Treasurer and based on whether an investment has altered the control of an Australian business or corporation and whether the investment is contrary to the national interest.

Foreign Acquisitions and Takeovers Amendment Regulations 2010 (No. 1)

The expanded definition of 'substantial interest' and 'aggregate substantial interest' had the unintended consequence of making some 'Australian' companies foreign persons under the Act (as the definition of foreign person includes a corporation in which a foreign corporation has a substantial interest or foreign persons have an aggregate substantial interest). This could have been problematic as these companies may not have been able to calculate the level of foreign control due to convertible instruments being traded off-market.

The *Foreign Acquisitions and Takeovers Amendment Regulations 2010 (No. 1)* (Amendment Regulations) were drafted to address this issue by ensuring that Australian companies are not inadvertently treated as foreign companies for compulsory notification purposes. The Amendment Regulations ensure that only currently held shares and voting power (not rights to future shares and voting power) are taken into consideration when determining if an investor is a 'foreign person' under the Act.

Transitional Provisions

As the amendments applied retrospectively from the date of the Treasurer's announcement, a transitional period applied from 12 February 2009 to the date of Royal Assent to ensure that foreign investors were not adversely affected by the start date of the amendments.

During the transitional period, there were no criminal penalties for failure to notify the Treasurer of a proposed investment of the type covered by the amendments. The transitional arrangements allowed foreign investors to notify the Treasurer within 30 days if, during the transitional period, they had entered into a transaction of the type covered by the amendments and had not already provided notification to the Treasurer. The Government did not receive any retrospective applications during the 30 day 'amnesty period'. This was expected as the proposed amendments had been widely anticipated.

Consultation process to assess the impact of the regulatory measure

Consistent with Office of Best Practice Regulation requirements, Treasury undertook a consultation process as part of the post-implementation review to assess the impact of the amendments. This involved consultation with the legal profession.

Given the technical nature of the amendments and the small number of investors that would likely have been impacted by them, it was decided that targeted confidential consultation would be most effective. The views of sixteen law firms who regularly deal with foreign investment business applications were sought.

The Executive Member of the Foreign Investment Review Board wrote to each firm seeking feedback on the amendments and these letters were followed up with a phone call. Around one third of these firms provided substantive comments, including through written submissions, by phone and face-to-face meetings.

The consultation process sought specific feedback on whether the changes clarify the Act sufficiently; views on the degree to which the amendments impacted investors (including the increase in the number of proposals that now had to be submitted); and whether there was an increase in compliance costs for investors wanting to invest in Australia. Each law firm was also asked to comment on any other aspects of the amendments that raised issues.

Impact analysis of the regulatory measure

The review considered the changes implemented through the Amendment Act and the associated Amendment Regulations to determine whether the Government's objective of clarifying the operation of the Act with regards to newer investment structures had been met. The review also sought to assess the impact of the changes on foreign investors and their advisors.

Improving clarity

The main objective of the regulatory changes was to improve the clarity of the Act. The consultation process confirmed that the changes clarified the operation of the Act sufficiently. It is now clear that newer investment instruments, including convertible notes, are subject to the compulsory notification provisions in the Act.

Several lawyers indicated that that they welcomed the changes because it is now clear that foreign investment proposals involving newer investment instruments, particularly those involving convertible notes, require notification. They prefer to be able to provide clear advice to their clients. Previously, they had to advise clients that it was questionable whether their investment was required to notify, but that it was good practice to lodge a notification anyway to be sure that the Treasurer's powers would be extinguished and thereby remove the possibility of future divestment action. This uncertainty made it more difficult to provide legal advice on foreign investment requirements — particularly when dealing with investors unfamiliar with Australia's regulatory framework.

Regarding sufficiency, some feedback suggested that the amendments could have been broader (that is, this opportunity could have been used to modernise other aspects of the legislation). As discussed above, the changes were focussed on improving clarity around convertible instruments and other newer types of investment instruments. A complete overhaul of the Act would have been far more resource-intensive and would have taken significantly longer to implement.

The fairness of the retrospectivity of the amendments was also questioned. In relation to this point, it is noted that no applications were submitted during the

30-day ‘amnesty period’ which indicates that investors were well are of their obligations.

Impact on foreign investors and their advisors

Parties impacted by the changes include those actual or potential foreign investors whose intended investments are structured in such a way that they may not have been required to notify prior to the changes, but are now required to provide such notification.

It is difficult to quantify the number of additional notifications that are now received by the Government. This is partly due to evidence from the consultations which indicated that many foreign investors were taking a cautious approach and notifying these types of investment structures regardless. Lawyers responded that in their experience, most investors followed their advice and submitted a notification to the Treasurer, so that the powers would be extinguished if no action is taken (that is, if no objections were raised in relation to the proposal it could not be later subject to divestment). This indicates that the number of additional notifications is small. This is supported by the fact that the Government did not experience any perceptible change in the number of applications following the Treasurer’s press release.

In terms of quantifying the impact of the amendments on these investors, in the event that they now notified when previously they may have chosen not to, there would be additional compliance costs. These additional costs would take the form of legal fees in preparing and submitting a foreign investment notification, and the time taken waiting for approval. While there will be additional costs, these have to be considered against the total cost of concluding an investment deal.

The feedback was that foreign investment proposals using these types of structures would generally be large transactions (which are already navigating a number of different regulatory requirements) so any additional burden of submitting a foreign investment notification and awaiting clearance was minimal. This view is supported by overall foreign investment approval statistics which indicate that most business proposals are approved without conditions, and usually within 30 days.

Overall, the number of additional foreign investors that are now required to notify is likely to be small and any additional compliance cost associated with the changes is likely to be negligible. As the Government did not experience any perceptible change in the number of foreign investment applications, any additional administrative costs are also negligible.

In addition to considering the impact on those investors that are now notifying additional proposals, the review also sought to assess whether the amendments have reduced Australia's attractiveness as an investment destination. Are there potential investors that may have previously chosen to invest in Australia (using instruments such as convertible notes) but are now reluctant given these changes?

While this is difficult to judge, it would seem very unlikely that there are many investors in this category. As mentioned above, proposed investments using newer investment instruments are likely to be large proposals and the additional cost (and perceived risk) of submitting a foreign investment notification is unlikely to sway a potential investor's decision to invest. Treasury officials meet regularly with potential investors and their advisors and rarely hear that they are choosing not to invest in Australia because of the foreign investment review requirements. Therefore, it would seem even more unlikely that potential investors were choosing not to invest because of the changes implemented by the Amendment Act.

While difficult to quantify, the number of foreign investors that were likely to be affected by these changes is small and any additional compliance costs would be negligible. Generally, only large investors are using these types of investment structures and the small compliance cost in cases where investors were not previously notifying, is minimal relative to the cost of finalising a large investment deal.

It could be argued also that, to the extent that there was some uncertainty previously as to the notification requirements, the changes to clarify the operation of the Act may have reduced some of the legal costs in seeking advice and reduced uncertainty for potential investors.

These findings are consistent with compliance cost expectations at the time of implementation. The Explanatory Memorandum to the Amendment Act noted that the compliance cost impact is expected to be low as 'the number of foreign investment proposals that are likely to be affected by the amendments is very small and any additional compliance costs will be largely insignificant'.

Other issues

The consultation process also encouraged foreign investment advisors to provide further feedback on the changes.

A concern was raised that the Amendment Regulations did not go far enough to remove the application of the Act to 'Australian' companies. As discussed above, the expanded definition of 'substantial interest' and 'aggregate substantial interest' had the unintended consequence of making some 'Australian' companies foreign persons under the Act as the definition of foreign person includes a corporation in which a foreign corporation has a substantial interest. While the Amendment Regulations removed the compulsory notification requirement for these companies if they subsequently acquired a substantial interest in another Australian corporation (and hence removed the application of the offence provisions), a concern was raised that these 'Australian' companies may still have to voluntarily notify their acquisitions to extinguish powers that may be available to the Treasurer.

To exercise his or her powers, the Treasurer has to be satisfied that the acquisition would result in a foreign person acquiring a controlling interest (other than for interests in Australian urban land), and conclude that this would be contrary to the national interest. The decision to submit a voluntary notice is one for each applicant, weighing up the costs of notification against the future risk that the proposal could be deemed to be contrary to the national interest. While the risk would appear small, further consideration could be given to revisiting this issue in the future if other amendments are being made, or providing further guidance on the website.

The Act previously provided that notifications of acquisitions of options over shares or assets are deemed to include the exercise of those options, ensuring that a second notice was not required upon the exercise of those options at a later date. The Amendment Act clarified these provisions so it is clear that they extend to other types of rights (such as convertible instruments).

Foreign investment approval is normally provided for a period of 12 months for the proposal to be undertaken. The approval period is limited because approvals relate to the market conditions and circumstances at the time. A further notification is normally required if the proposal is not implemented within the 12 months. Some concerns were raised that the 12-month period does not allow for situations where the conversion of the instrument was going to take a longer time. It was suggested that it should be made clearer to applicants that approval for a longer period could be considered if sufficient reasons are provided when the original notification is submitted.

A concern was also raised that consequential amendments to the compulsory notification provisions have inadvertently made offshore acquisitions subject to compulsory notification. Offshore acquisitions — where a foreign company acquires another, or part of it, and in so doing also acquires an interest in its Australian business or assets — are not required to notify but as the transaction may be subject to the Treasurer's divestment powers under the Act, the investor may choose to voluntary notify so that the Treasurer's powers can be extinguished.

The compulsory notification provisions in the Act previously referred to acquisitions of 'substantial shareholdings'. To ensure that the compulsory notification provisions were broad enough to capture other financing arrangements (other than traditional shares), all references to ‘shares’ and ‘shareholding’ were replaced by references to ‘substantial interest’ or ‘rights’.

It was suggested during the consultations that these changes now make offshore acquisitions subject to compulsory notification (and hence it is an offence not to notify). This issue was raised with Treasury after the initial Bill had been introduced into Parliament (prior to the revisions being made) and the legal advice we received at the time was that the consequential changes to the compulsory notification provisions flowing from the amendments would not affect the treatment of offshore acquisitions.

Conclusion

The increasing use by foreign investors of newer and more complex investment structures has been evident in recent years. While these investment structures may have a solid commercial basis, until the changes that are the subject of this review were implemented, it was not clear whether the Act was sufficiently broad enough to capture these types of investment instruments.

The main finding of the Post-implementation Review is that the regulatory change was effective in meeting the Government’s policy objective of clarifying an uncertain part of the Act. It is now clear that newer investment instruments, including convertible notes, are covered by the Act.

It is not possible to accurately determine whether the regulatory change impacted either commercial behaviour generally (that is in terms of foreign investors restructuring their proposals or potential investors deciding not to invest in Australia) or lodgment of notifications under the Act (that is the exact number of additional proposals that are now received). One of the reasons is that many investors would have taken a cautious approach and chosen to notify their proposal regardless. Given it is not possible to accurately determine the impact on commercial behavior or notification under the Act, the broader impacts of the amendments could not be ascertained or quantified. However, feedback from the legal community indicated that the amendments had only a minor impact on foreign investors and their advisors, and any compliance costs associated with the regulatory measure were likely to have been negligible.

The review did highlight several consequential changes that the amendments have caused to the operation of the Act. In practice though, the effect of these changes is minor and does not warrant action. Consideration is being given to providing further guidance on the Foreign Investment Review Board website on the treatment of newer investment structures.

Attachment A — Treasurer’s press release

Amendments to Foreign Acquisitions and Takeovers Act

Today I am announcing that the Commonwealth Government will seek to amend the Foreign Acquisitions and Takeovers Act 1975 (the Act).

The Act provides the basis for the Treasurer to examine proposed foreign investments in Australian businesses and assets to ensure they are not contrary to the national interest.

Even in the face of a global economic recession, investors recognise the underlying strengths of the Australian economy, and we are seeing strong interest in investments in the Australian resource sector.

The Government welcomes foreign investment in the development of Australia's resources.

In light of the growing use of more complex investment structures, the Government intends to clarify the operation of the foreign investment screening regime.

The Government will amend the Act to ensure that it applies equally to all foreign investments irrespective of the way they are structured.

In particular, the amendments will ensure that any investment, including through instruments such as convertible notes, will be treated as equity for the purposes of the Act.

It is our intention to introduce the amendment into Parliament as soon as practical and will be effective from today.

It is important to note that this announcement clarifies the operation of the Act, but does not pre-empt any final decision on any current or future investment proposal.

All applications before the Foreign Investment Review Board are examined on a case by case basis against the national interest.

There has also been some media commentary about the implications for the Australian tax system of various resource investment proposals. These issues are within the terms of reference of Dr Henry's Review of Australia's Future Taxation System.

THE HON WAYNE SWAN (MP),

TREASURER

CANBERRA

12 February 2009

Attachment B — Comparison of the key changes made to the foreign investment review framework

Changes made	**Previous law**
Substantial interest is holding at least 15 per cent of one or more of: • voting power; • potential voting power; • issued shares; or • rights to issued shares.	Substantial interest was holding 15 per cent or more of the voting power or the issued shares in a corporation.
Aggregate substantial interest is two or more persons holding at least 40 per cent of one or more of: • voting power; • potential voting power; • issued shares; or • rights to issued shares.	Aggregate substantial interest was two or more people holding 40 per cent or more of the voting power or the issued shares in a corporation.
An interest in a share was clarified so that it is clear that a right to a share includes a right to acquire a share or have a share transferred under an instrument, agreement or arrangement, whether the right is exercisable presently or in the future and whether on the fulfillment of a condition or not (such as convertible notes).	An interest in a share included a right to acquire a share or have a share transferred to them.

Changes made	**Previous law**
Definition of voting power has been clarified so that it explicitly includes potential voting power. Potential voting power is the number of votes that could be cast if it is assumed that a future right is exercised.	Voting power was the maximum number of votes that can be cast at a general meeting.
The Treasurer also has the power to prohibit a proposed acquisition of an interest that would result in a foreign person having control of the *potential* voting power in a corporation if it is considered contrary to the national interest.	The Treasurer had the power to prohibit a proposed acquisition of shares that would result in a foreign person having control of the voting power in a corporation if it was considered contrary to the national interest.
Compulsory notification for proposals involving the acquisition of a substantial *interest*.	Compulsory notification for proposals involving the acquisition of a substantial *shareholding*.