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Memorandum

Be Wary of Australia's Foreign Investment Review Requirements:

New Regulations Significantly Increase Reporting and Disclosure Obligations

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Late last year, the Australian government overhauled the Foreign Acquisition and Takeovers Act of 1975, which requires approvals for certain inbound foreign investments. In the ensuing nine months, it has become clear that the ramifications for foreign investors are profound, particularly for private equity firms investing through funds that include as limited partners sovereign wealth funds and other foreign government investment entities, such as state pension funds. The revised notification and disclosure requirements related to "foreign government" investors are far-reaching (and catching some investors unaware) due to minority interest and aggregation rules that affect more than traditional state-owned entities or sovereign wealth funds. Where a target has A$10 million in assets in Australia, and a non-Australian private equity fund is the foreign acquiring party or investor, there is a good chance that a mandatory foreign investment control filing will be triggered in Australia. Overlooking this risk and getting it wrong can mean both criminal and civil exposure for the foreign investor.

What Are the Substantive Changes?

The new changes were introduced in three separate bills: The Foreign Acquisitions and Takeovers Legislation Amendment Bill of 2015; the Register of Foreign Ownership Agricultural Land Bill of 2015, and the Foreign Acquisitions and Takeovers Fee Imposition Bill of 2015 (collectively, the "2015 Regulations").[1] The amendments altered the reach and scope of the Foreign Investment Review Board ("FIRB" or the "Board"). FIRB is a non-statutory body that examines proposals by foreign investors to undertake investments in Australia and makes recommendations to the Australian Treasurer on whether those proposed transactions are suitable for approval under the Australian government's policy.

[1] In 2016, the Australian Parliament further amended the FIRB application process with the Foreign Acquisitions and Takeover Amendment (Government Infrastructure) Regulation 2016 (the "2016 Amendment"). As of March 31, 2016, FIRB now has the power to review the sale of a critical state-owned infrastructure asset to foreign investors. Foreign Acquisitions and Takeovers Amendment (Government Infrastructure) Regulation *2016* (Cth) (Austl.).

The 2015 Regulations give the Treasurer authority to block or restrict certain "significant actions" taken by foreign investors. A "significant action" is defined as acquiring an interest in securities, assets, or Australian land above the statutory thresholds. For an action to be considered significant, it must result in the change or increase in control involving a foreign person.[2] A significant action also includes activities, such mergers and acquisitions that change the control of a corporation, unit trust, or business above the statutory threshold.[3] The Treasurer has the power to prohibit, impose conditions upon, or undo any significant action.[4]

All significant actions are also "notifiable actions" under the current FIRB regulations, requiring the foreign person to give notice to FIRB ***before taking the action.***[5] FIRB will review the proposed action and, unless substantive issues are identified, generally give clearance within 40 calendar days of receiving the notice and required application fee.[6] If FIRB needs more time for review, it may request that the Treasurer issue an interim order prohibiting the transaction for up to 90 calendar days.[7] In practice, FIRB will request that the investor agree to an extension by the Treasurer in lieu of issuing an order. FIRB consults other agencies during the course of its review, including the Australian Competition and Consumer Commission, and generally will not recommend clearing a transaction pending review and sign-off from other agencies. This agency consultation process could delay the FIRB process beyond 90 days.

The monetary thresholds for significant and notifiable actions are relatively high for ***non-foreign government*** investors. For non-agribusinesses, the statutory threshold for foreign entities and businesses is A$1.094 billion for American, Chinese, New Zealand, Chilean, Japanese, or South Korean investors. The threshold for all other foreign investors is A$252 million.[8] A notifiable action includes a foreign investor's acquisition of a direct interest[9] in an Australian agribusiness (actions taken by any foreign person where the

[2] *Foreign Acquisitions and Takeovers Act 1975* (Cth) pt 2 s 39 (Austl.).

[3] *Id.*

[4] *Foreign Acquisitions and Takeovers Act 1975* (Cth) pt 1 s 3 (Austl.).

[5] *Foreign Acquisitions and Takeovers Act 1975* (Cth) pt 4 s 49 (Austl.).

[6] *Foreign Acquisitions and Takeovers Act 1975* (Cth) pt 4 s 80 (Austl.).

[7] *Id.*

[8] *Id.*

[9] "Direct" in this context is defined broadly to mean either 1) an interest in at least 10% of the entity, 2) an interest of at least 5% in the entity if the person who acquires the interest has entered a legal arrangement relating to the businesses of the person and the entity, or 3) an interest in any percentage of a company if the person who acquired the interest is in the position to influence the central management, control, or policy of the entity. *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) pt 2 s 16 (Austl.).

value is A$55 million or higher),[10] a substantial interest (at least 20%) in an Australian entity,[11] or an interest in Australian land (as defined in Section 12 of the 1975 Act).[12]

While the thresholds for non-foreign government investors are relatively high, ***the threshold for foreign government investors is essentially $0.*** There is a de minimis exception for non-sensitive sectors but only if the target's Australian assets are valued at under A$10 million and the target's Australian assets comprise less than 1% of the target's worldwide asset value. Given these low trip wires, this de minimis exemption often may be unavailable, particularly if the target has a subsidiary in Australia. Tracing rules also apply, such that a direct (*e.g.*, 10% or more) investment in a non-Australian business that itself has a direct investment interest in an Australian business could be a notifiable transaction.

Implications for Investment Funds with Foreign Government Limited Partner Investors

The definition of "foreign government investor" is not limited to entities that are wholly-owned, or even majority-owned, by a single state actor. An entity is considered a "foreign government investor" when a foreign government owns a "substantial interest" in the company, which is defined as holding 20% or more of voting control or shares in the company.[13]

Moreover, ***foreign government interests in an entity are aggregated***, such that different foreign government investors from the same country are counted together to determine if the 20% substantial interest threshold is met. ***This means that an investment fund with investors from different U.S. state pension funds will be considered a foreign government investor if the aggregate interests of those different state pension funds exceeds 20%***, regardless of whether any of the state pension fund investors, individually or together, have any control rights in the fund.

Even where no investor or group of investors from a single country exceeds the threshold, if in the aggregate investors ***representing two or more foreign governments comprise 40% or more of the voting control or shareholding interest***, that entity is a foreign government investor under the FIRB regulations.

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[10] *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) pt 4 s 80 (Austl.).

[11] *Id.* at s 51.

[12] *See Foreign Acquisitions and Takeovers Act 1975* (Cth) pt 1 s 12 (Austl.).

[13] *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) pt 2 s 17 (Austl.).

Given the low thresholds for foreign government investors, there is a great likelihood that many private equity fund transactions involving a target with $A10 million in assets in Australia will trigger FIRB mandatory notification and pre-approval requirements.

The identity of the foreign government investors triggering the FIRB notification must be disclosed in the application. The practice around disclosure of foreign government investors in the notifications is not settled, with some Australian practitioners advising that parties disclose all foreign government investors holding a 5% or greater interest in the investing fund, with others advising disclosure upfront of all foreign government investors, no matter how small their stakes, to avoid delays during the review process. Either way, this can be problematic for financial sponsors depending on the specific confidentiality obligations they may have negotiated with their limited partners.

Fees, Penalties, and Exceptions

Application Fees. As of December 1, 2015, foreign purchasers of any type of property are required to pay a fee with their application to FIRB. The fee structure was updated in 2016. For example, the fee for applications for commercial real estate investments is A$25,300 for developed commercial real estate or A$10,100 for vacant commercial land. Agribusiness acquirers, and all foreign government investors acquiring a notifiable interest in an entity, must pay A$25,300 for a transaction valued at A$1 billion or less.[14] The fee is A$101,500 for those transactions whose value exceeds A$1 billion.[15]

Penalties. Like the 1975 Act, the 2015 amendments allow the government to levy civil and criminal penalties against those investors who do not comply, in addition to potentially blocking or restricting the transaction. The maximum criminal penalties have increased to $A130,000 for individuals and $A637,000 for companies. No criminal sentence may be longer than three years. Serious civil liability exists for companies who do not comply with the notification requirements.

Notable Exemptions. A foreign investor acquiring shares in a financial sector company (within the meaning of the *Financial Sector (Shareholdings) Act 1998*) may be exempt from FIRB notification.[16] Acquisitions by certain funds and schemes operating in Australia such as a life company, a general insurer, or a managed investment scheme registered under Section 601EB of the *Corporations Act 2001* may be exempt if they

[14] Foreign Investment Review Board, *Fees 2016-17*, available at https://firb.gov.au/2016/06/fees-indexation/. ("Section 12 of the *Foreign Acquisitions and Takeovers Imposition Act 2015* provides that fees for applications and notices are indexed each financial year.").

[15] *Id.*

[16] *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) pt 3 s 32 (Austl.).

meet the circumstances outline in Section 36 of the 2015 Regulations.[17] There are a number of other exemptions detailed in the FIRB regulations, and local counsel should be consulted to determine if any apply to a specific transaction.

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[17] *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) pt 3 s 36 (Austl.).

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