AUSTRALIA'S FOREIGN INVESTMENT POLICY

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NEW ZEALAND BUSINESS : ENTERING THE AUSTRALIAN MARKET

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We are fortunate in the timing of this seminar in terms of being able to give an up to date commentary on Australia's foreign investment policy.

On 29th October, 1985 the Prime Minister used the occasion of the Business Council of Australia's annual meeting to announce a number of areas in which foreign investment policy had been relaxed. This follows and in part flows from earlier and significant relaxations in policy regarding the entry of foreign banks into Australia and the permissible degree of foreign ownership of stock broking companies. All of these moves can be seen as consistent with the present Government's espoused policy of deregulation of the financial sector.

In this paper I will trace briefly the evolution of our foreign investment policy, explain the constituent elements of that policy and in so doing pinpoint the most recent changes.

It was in 1972 that the Australian Government first introduced legislation aimed at restricting the foreign acquisition of Australian owned companies. Prior to that the only restrictions on foreign investment arose directly from the operation of exchange control regulations administered by the Reserve Bank of Australia.

These regulations dealt mainly with the movement of funds in and out of Australia and were not directed at specific forms of investment.

The 1972 legislation was introduced by a Liberal Government which previously had exhibited a comparatively open approach to foreign investment. December, 1972 saw a change of government in Australia and until November, 1975 we experienced government by a labor party which had strong negative views concerning foreign investment and ownership of Australian assets. This attitude lead in particular to an almost complete embargo on foreign participation in exploration and development of natural resources.

In its last year of office the Labor Government introduced the 1975 Foreign Takeovers Act which replaced the 1972 legislation. Subject to a number of comparatively minor amendments the 1975 Act exists today as the legislative arm of Australia's foreign investment policy. In March, 1976 the then recently returned Liberal Government issued a detailed policy statement on foreign investment (the "guidelines") and established the Foreign Investment Review Board. Allowing for additions and refinements introduced in order to reflect shifts in policy in specfic areas these guidelines, which work in parallel with the Act have remained substantially as first issued.

In 1984 and 1985 we have seen very significant changes in policy with regard to foreign participation in the financial sector of the economy.

This was an area always regarded as sensitive and one in which the nature and extent of foreign ownership was closely monitored.

The decision to invite a limited number of foreign banks to apply for Australian banking licences was a decision taken by the Government outside the normal foreign investment administrative structure. It was initially announced that the interest of a foreign bank in a new Australian banking entity should not exceed 50%. This in itself represented an overall relaxation in policy, as for some years past it had been difficult for a foreign party to acquire more than say a 25% holding in a merchant bank or other financial intermediary. Moreover, as it turned out in the case of foreign banks, of the 16 invited to establish in Australia, 3 only have met the proposed requirement for 50% Australian equity and 6 will apparently have no Australian equity. Of the remainder most will have Australian equity of less than 50% with several not yet having announced final plans. This represents a major departure from the level of foreign ownership envisaged by the Foreign Takeovers Act and the guidelines.

Having indicated that a limited number of banking licences would be issued, the Government recognised that this would necessitate or provoke a deal of restructuring of the equity of overseas banks in Australian merchant banks. The Government therefor announced a 12 months moratorium during which the Foreign Takeovers Act would not apply with regard to the restructuring of foreign shareholdings in existing merchant banks or the establishment of new merchant banks in Australia by foreign interests.

The October 29 statement extended indefinitely this moratorium and I think it is of sufficient importance to quote the relevant part of the statement:-

> "The Goverment has decided that, in the light of the measures it has taken to deregulate financial markets, and the foreign investment policy moratorium in respect of merchant banking, it would not make any sense to revert to the previous, restrictive policy. Under the moratorium of the part 12 months 24 merchant banks have been restructured while around 60 new merchant banks have been established. These developments should be of significant benefit to Australian consumers of such services, as well as providing a useful boost to activity in the service sector."

While the moratorium is in place a foreign interest can acquire up to 100% of a merchant bank in which it holds a lesser interest or a foreign interest can establish a wholly owned merchant bank in Australia. This previously would have been thought impossible.

Separate from, but almost coinciding in time with the entry of foreign banks, has been the restructuring of broking firms following partial deregulation of the stockbroking industry. Of relevance here were the decisions to allow broking firms to incorporate and to allow up to 50% shareholding by non stock exchange members. In the case of overseas shareholdings in stock broking corporations the initial shareholding limitation was 15%.

However, this limitation was subsequently relaxed and an overseas interest is now permitted to acquire up to 50% of an Australian stock broking corporation.

Having dealt firstly with these very significant deviations I would now like to explain the structure and operation of Australia's foreign investment policy generally.

Foreign investment policy is the responsibility of the Australian Treasurer and in discharging this responsibility the Treasurer is advised by the Foreign Investment Review Board. This is a non-statutory body owing its origin to the 1976 policy statement previously referred to. To understand the policy it is necessary to know the structure and operation of both the Foreign Takeovers Act and the guidelines and the manner in which they interrelate.

Foreign Takeovers Act

The primary purpose of the Foreign Takeovers Act is to give the Australian Treasurer the right to examine and in some cases to prohibit the acquisition of shares in Australian companies or the acquisition of assets of an Australian business. Current practice is that except in special circumstances the Treasurer will not intervene where the total assets of the target company or business are less the $5,000,000. Prior to the October 29 announcement this administrative threshold had been $2,000,000.

The Foreign Takeovers Act is a relatively short statute but one I suggest you will have great difficulty in first reading because of its infuriating complex of definitions and cross references. Once you master the definitions the mechanical structure of the Act is comparatively simple.

The Act contains only one major statutory proscription: it is an offence for foreign persons to acquire or agree to acquire a substantial interest in an Australian corporation without the prior approval of the Treasurer. A "substantial interest" is 15% or more of a company held by one foreign person or an aggregate of 40% or more held by a number of foreign persons.

A foreign person is a natural person who is not ordinarily resident in Australia, a corporation in which such a person or a foreign corporation holds 15% or more of the voting power or issued capital, or a corporation in which unrelated foreign persons hold 40% or more in aggregate of the voting power or issued capital.

The Treasurer has a very broad power to deal with an application to acquire shares (section 18). He may prohibit the proposed acquisition if he is satisfied that a single foreign interest would control 15% or more of the company or foreign interests in aggregate would control more than 40% of the company and that this result would be "contrary to the national interest".

It is difficult to think of a broader or more unexaminable statutory test than "contrary to the national interest".

The guidelines however, attempt to articulate somewhat more specific criteria as to what should be taken into account.

In summary, a foreign interest wishing to acquire 15% or more of an Australian corporation must seek the prior approval of the Treasurer. The Treasurer may disapprove if he concludes the acquisition would be "contrary to the national interest".

Needless to say, the Treasurer has divestiture powers when shares are acquired in violation of the Act.

The Act also controls the foreign acquisition of assets of an Australia business. Although there is no requirement for prior notification the Treasurer is given power to prohibit asset acquisitions (or to require divestiture) if as a result of the acquisition an Australian business would become controlled by foreign persons and the result would be "contrary to the national interest". The Treasurer is however directed by the act not to make such an order unless the foreign interest or interests "are in a position to determine the policy of the business".

Because of the rather drastic effects which might be occasioned by divestiture, the Act provides for a voluntary notification program so that a pre-clearance can be obtained (section 25).

There are of course other ways to take over or acquire control of a corporation. In recognition of this the Act empowers the Treasurer to make appropriate orders where an agreement or an amendment to a constituent document (e.g., the Articles of the company) would require a director or the directors to act in accordance with the wishes or instructions of a foreign person who holds 15% or more of the company. There, the Treasurer must be satisfied that the foreign person is in a position "to determine the policy" of the corporation and that the resulting control is "contrary to the national interest". Again the emphasis is on control rather than ownership.

In addition, the Act attempts to encompass other means of obtaining control by generally empowering the Treasurer to prohibit or undo arrangements for the use of assets (including in particular by way of leasing arrangements) or for the participation by foreign persons in the profits or management of an Australian business.

The Treasurer's power is again available only if the arrangement (or the termination of an arrangement) would have the result that a foreign person or persons would be in a position to determine the policy of the business and if that result would be contrary to the national interest.

As in the case of the acquisition of shares, the Government will not usually prohibit proposals involving less than $5,000,000 (previously $2m) worth of assets except where the acquisition involves real estate or other restricted industries.

Foreign Investment Guidelines

The guidelines attempt to set out the principles and criteria which will be applied in evaluating foreign investment proposals. In so doing they provide insights into the ways in which proposals should be structured and submissions presented.

Foreign investors sometimes face difficulty in separating the statutory provisions of the Act from the stated policy of the Government as expressed through the guidelines. This is possibly of importance only where a foreign investor wishes to play by the letter of the law rather than in accordance with the spirit of the Government's policy.

It is certainly possible that much of the regulation imposed by the policy (as opposed to the Act) may have little legal or constitutional foundation. Nonetheless Governments often have, or are thought to have, sanctions which are as effective as criminal penalties and although one hears of avoidance of the Act and of the guidelines, there has not to my knowledge been a direct legal challenge to the Act or guidelines.

In addition to the proposals required to be examined in accordance with the Act, the guidelines previously called for the following proposals to be submitted for examination:

- Proposals to establish a new business or project, irrespective of size, in sectors said to be subject to special restrictions. These sectors were finance, insurance, media, civil aviation and uranium.

- Proposals to establish new businesses in other sectors of the economy where the total amount of the investment was $5,000,000 or more.

- Direct investments by foreign Governments.

- Certain proposals to acquire real estate and real estate development projects.

The October 29 statement exempted from screening or approval proposals for new businesses in the finance and insurance sectors involving investment of less than $10,000,000. With regard to the finance sector, proposed new businessess involving investment of $10,000,000 or more and takeovers of existing businesses will be approved unless it is considered that they would be contrary to the national interest. This is in contrast to the normal requirement to establish net economic benefits - a matter which I will be touching on shortly. Proposals for new insurance businesses involving investment of $10,000,000 or more and takeovers of existing businesses will be subject to the normal requirements under the guidelines including the requirement to establish net economic benefits. In relation to other new businesses (except those remaining subject to special restrictions) the October 29 statement increased the new business investment threshold from $5,000,000 to $10,000,000.

A new business is said to include the establishment of a business in Australia by a foreign interest which is not already operating in Australia, a new mining or minerals processing project, a new project in the agricultural, pastoral, forestry or fishing sectors, and a new real estate development project including businesses such as hotels.

The diversification by a foreign interest into an activity not previously undertaken by it in Australia is also regarded as an investment in a new business. However, the expansion of an existing Australian activity of a foreign interest is not subject to examination unless the expansion is by way of a takeover of an existing business or involves the development of a new project in the natural resources or real estate sectors.

So far, the only criterion I have mentioned is "the national interest" as referred to in the Foreign Takeovers Act. That notion is as broad as it is long and would virtually permit a Government to interpret it any way it saw fit.

The guidelines attempts to give some guide to the way this national interest notion should be applied. However, given the vast flexibility the Government wishes to retain, it is not surprising that the guidelines are themselves vague and incapable of concrete application.

The basic proposition is that foreign investment must be in accordance with Australia's interests and that its benefits are maximised and its costs minimised. Next, we are told that proposals to acquire Australian businesses should offer sufficient benefits within stated criteria to outweigh any costs, including those associated with a reduction of Australian ownership and control. If as a result of this qualitative weighing process it is thought the net benefits would be small, approval will depend on the structure of the project minimising any reduction of Australian ownership and control.

A series of criteria are set out in the guidelines:

(a) It must be considered whether, against the background of existing circumstances in the relevant industry, the proposal would produce, either directly or indirectly, net economic benefits to Australia in relation to the following matters:

- competition, price levels and efficiency. introduction of technology or managerial or work-force skills new to Australia.

- improvement in the industrial or commercial structure of the economy or in the quality and variety of goods and services available in Australia.

- development of or access to new export markets.

The following matters are also taken into account:

(b) Whether the business or project concerned could be expected to be conducted in a manner consistent with Australia's best interests in matters such as:

- local processing of materials and the utilisation of Australian components and services.
- involvement of Australians on policy-making boards of businesses.
- research and development.
- royalty, licensing and patent arrangements.
- industrial relations and employment opportunities.

(c) Whether the proposal would be in conformity with other Government economic and industrial policies and with the broad objectives of national policies concerned with such matters as Australia's defence and security, Aboriginal interests, decentralisation and the environment, as well as with Australia's obligations under international treaties.

(d) The extent to which Australian equity participation has been sought and the degree of Australian management and control following implementation of the proposal.

(e) Taxation considerations.

(f) The interests of Australian shareholders, employees, creditors and policy holders affected by the proposal.

(g) The extent to which commercial opportunities are provided for Australian contractors and consultants to participate in any construction work.

(h) The contribution a proposal would make to the improved utilisation of resources, or the expansion of productive capacity arising from the introduction and diffusion of new technology and other skills.

(i) Benefits and costs to Australia of any export franchise limitations.

The term "criteria" is really a misnomer. The categories mentioned are merely checklists by suggesting ways in which projects may provide economic and other benefits in the national interest. The Government itself points out that not every criterion must be satisfied.

Practice suggests that the FIRB has become more concerned about Australian control and Australian equity participation in projects. Indeed, in December 1983 the current Government stated that equity participation was a major pillar of its Foreign Investment Policy.

In sectors where foreign ownership or control is already substantial, significant economic benefits must be demonstrated. In such areas, the retention of substantial Australian equity is usually required. A good example is the Australian advertising industry which is dominated by international groups (especially US-based agencies). It would only be in the most unusual circumstances that a major US advertising agency would be allowed to acquire more than 50% of a remaining independent Australian agency.

As part of the examination process the FIRB adopted what was known as the "opportunities test". This required demonstration that through newspaper advertisements or otherwise, potential Australian participants knew of proposed sales and had the opportunity of competing with intending foreign purchasers. This had obvious disadvantages to the foreign investor and also tended to impact adversely on the business subject to the transaction. The discontinuance of the practice was included in the October 29 statement.

Applications to the FIRB can be discussed on a no-names basis, although few detailed observations will be made until names and specific structures are put forward.

Once a proposal has been formulated, it is usual to present it in draft form for discussion. In a case to which the Act applies, lodgement of an application in final form starts the statutory clock ticking and unless the Board can consider the matter within a prescribed period the applicant can be faced with a 90-day freeze order. For this reason it is often desirable to advance discussions as far as possible before lodging formal application.

All applications are usually maintained as confidential, at least within the Board and its officers. However, in many instances copies will be sent to various federal government departments for their comment. Prominent amonq these is the Australian Taxation Office which has a particular interest in structures designed to avoid Australian tax. (e.g. It will usually insist (via FIRB) that the debt/equity ratio not exceed 3:1, thus ensuring that a foreign parent does not extract all profits by way of tax - deductible interest at limited withholding tax rates).

Depending on the circumstances, a copy of a proposal may also be sent to the Trade Practices Commission, the National Companies and Securities Commission, State Governments and even to local government bodies. It is during this process of dissemination to other parties that confidentiality could be at risk.

It is not uncommon for the FIRB to suggest that approval will be forthcoming if the applicant agrees to various conditions. The most common of these relates to the introduction of Australian equity (or greater Australian equity) within a specified period.

The legal validity of conditional approvals must be very much in doubt. Under the Act, the Treasurer's ultimate power is to prohibit or disapprove a transaction. An approval subject to conditions would presumably rest for its enforcement in contract rather pursuant to the Act. However, as a practical matter, no foreign investor has yet challenged the validity of conditions so imposed.

Specific Industries

The guidelines contain specific provisions in relation to certain industries:-

Mineral Exploration

Mineral exploration may be carried on solely by foreign investors. However, any development arising out of exploration activities is subject to examination under the guidelines. For this reason, a program of Australian involvement should be considered from the outset. The Foreign Takeovers Act is to be amended to exempt from its operation acquisitions by foreign interests of existing mining exploration rights.

Mining (other than uranuim)

A proposal for a new mining business or project involving a total investment of $10,000,000 (previously $5,000,000) or more will usually be allowed to proceed only if it includes 50% Australian equity and 50% Australian voting power on the board.

A proposal which does not meet these guidelines may proceed if the government considers that Australian equity capital is unavailable and the development of Australia's natural resources would be unduly delayed.

Uranium

Requires special approvals.

Minerals Processing

The government wants what it calls an appropriate level of Australian equity participation in new minerals processing projects. No specific levels are suggested because the government is pragmatic enough to realise that persons prepared to provide the capital and technology for such projects usually have sufficient power and alternative foreign sights to negotiate from a position of relative equality.

Agricultural, Pastoral, Forestry and Fishing

Proposals to establish a new business or project in these sectors, involving investment of $10,000,000 (previously $5,000,000) or more, should be submitted to the FIRB. As a general rule, the Board requires at least 50% Australian equity and control.

Rural Properties

Severe restrictions are imposed on rural property acquisitions.
Because an acquisition of rural property can be said to involve a business, a proposal to acquire an Australian rural property falls under the Act. The guidelines say that approval is normally restricted to the following proposals:

- where the purchasers have firm plans to establish residency in Australia.

- those offering significant economic benefits.

- where an effective partnership (usually 50/50) between Australian and foreign investors exists in the ownership and control of the property.

The present Government has announced that proposals for investment in large tracts of rural land (100,000 hectares or more or valued at $1,000,000 or more) will be required to provide for an effective Austraian/foreign partnership or have economic benefits of national or regional significance.

Real Estate

For some reason foreign investment in real estate remains an emotional issue. Acquistions of urban real estate to a aggregate value of $600,000 (previously $350,000) may be made without seeking foreign investment policy approval.

Real estate investments above the $600,000 threshold are examined closely and will not be permitted if involving a significant element of capital gain or investment income.

There was previously a requirement for 50% Australian equity in proposals for the development and sale of real estate. The October 29 statement excluded from this requirement developments costing up to $10,000,000 and taking less than 5 years to complete. The requirement for 50% Australian equity in proposals for development and retention still applies.

Future Policy

I did not intend to end on a restrictive or pessimistic note which the immediately preceding comments might suggest. Indeed, I believe that we will see a progressive lessening of restrictions on foreign investment. As evidence of this, we have the significant moves in the financial sector, the lifting of threshholds and other changes in the October 29 statement and the Government's stated policy generally with regard to deregulation. Added to this is what I understand to be a commitment from the opposition parties to disband the Foreign Investment Review Board upon obtaining Government.

If further relaxations in policy are contemplated, I would suggest that the real estate sector be the next to receive attention. Particularly with regard to rural properties, it could be argued strongly that it would be in the national interest to broaden the base of potential purchasers. I have always had difficulty in accepting the reasons for restrictive policies on the ownership of real property and changed circumstances, particularly in the rural sector, have tended to erode what may have been the former validity of those reasons.