HERBERT SMITH FREEHILLS

AUSTRALIAN FOREIGN INVESTMENT REVIEW

IN THIS ISSUE

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WELCOME

Herbert Smith Freehills' *Australian Foreign Investment Review*.

In this edition of the *Australian Foreign Investment Review*, we focus on the key takeaways from FIRB's 2015-16 Annual Report, the upcoming changes to Australia's foreign investment laws and some of the key recent developments in foreign investment in Australia.

Firstly, Tony Damian and Malika Chandrasegaran provide a summary of the recent FIRB 2015-16 Annual Report, highlighting the key messages and themes.

Simon Haddy takes a look at the upcoming changes to Australia's foreign investment laws announced in the recent Federal Budget and flags the proposed key changes you need to be aware of. Damien Hazard and Jenny Altherr also consider the proposed changes in the context of financial sponsors and discuss some issues with the legislation that still require further clarification.

Robert Nicholson recaps the six months since the introduction of the Critical Infrastructure Centre. Paul Branston and Nick Harding review the Kidman saga, one of the most high profile FIRB decisions in recent years, and extract the lessons learned for those considering Australian agribusiness investments.

Finally, Matthew FitzGerald and Ben Sheehan look back at the 18 months since the introduction of FIRB application fees and consider any impact this may have had on Australian M&A and inbound foreign direct investment.

We trust you will enjoy the eighth edition of the *Australian Foreign Investment Review*.

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'THEY HAVE MORE DEPTH ON THE BENCH BY QUITE A MARGIN; THERE ARE SEVERAL LAWYERS THERE I COULD GIVE A COMPLEX M&A MATTER TO'
(AUSTRALIA) – CHAMBERS ASIA PACIFIC 2017

ABOUT HERBERT SMITH FREEHILLS

Herbert Smith Freehills has one of Asia-Pacific's leading M&A legal practices, as well as the expertise and track record to help make any international investment in Australian assets a smooth and efficient process.

Our foreign investment experience includes navigating some of Australia's largest deals through the foreign investment review process.

We combine our transactional expertise with industry sector experience. We are acknowledged leaders in a number of global sectors including energy, mining and infrastructure, and technology, media and telecommunications.

CHINA, REAL ESTATE AND NORTH AMERICANS: FIRB'S 2015-16 ANNUAL REPORT

FIRB's Annual Report for the year ended 30 June 2016 was released earlier this year. We discuss some key takeaways from the Report.

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Overview

In May this year, the Foreign Investment Review Board (**FIRB**) released its annual report for the year ended 30 June 2016 (**Report**), providing data on the foreign investments applications considered during the year.

In summary, in respect of the 2015-16 period, the Report shows:

- a 29.2% increase in the value of approved foreign investment proposals;
- China remaining the largest source of approved foreign investment by value;
- increased number and value of conditional business approvals (but a drop in overall conditional approvals); and
- 5 rejections of foreign investment proposals in the real estate sector (4 residential and 1 commercial), noting a number of other high profile proposals, including S Kidman and Co. Limited[1] and Ausgrid played out during and following the reporting period.

In addition, the 2015-16 period saw significant reforms to the foreign investment framework[2] and the data from the Report shows the impact of some of these changes, including:

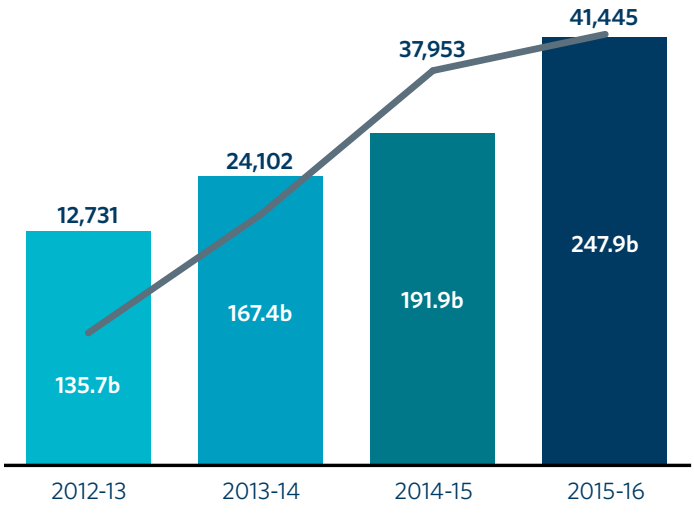
- continued focus on critical infrastructure, amidst an increasing number of asset privatisations and reform requiring approval for critical infrastructure assets for sale by state and territory governments to foreign private investors (in addition to foreign government investors);
- increased flow of agricultural land applications due to a lowering of the screening thresholds;
- new data following the introduction of the agricultural land register, showing foreign interests in 13.6% of agricultural land by area;
- additional scrutiny of foreign investment in residential real estate sector, following transfer of the role to the Australian Taxation Office (**ATO**), including an increased number of divestment orders and new infringement notices; and
- a total of $78 million of fees being collected in the reporting period following the introduction of fees for foreign investment applications ($10.5 million from business investment proposals and $67.5 million from residential investment proposals).

We discuss these findings further below.

Value and type of approvals generally

Foreign investment approvals in 2015-16 grew to 41,445 compared to 37,953 in 2014-15. This represented approximately $248 billion of proposed foreign investment compared to approximately $192 billion in 2014-15, a 29.2% increase, largely driven by increased investment in the real estate sector.

Total value (A$b) and number of foreign investment approvals

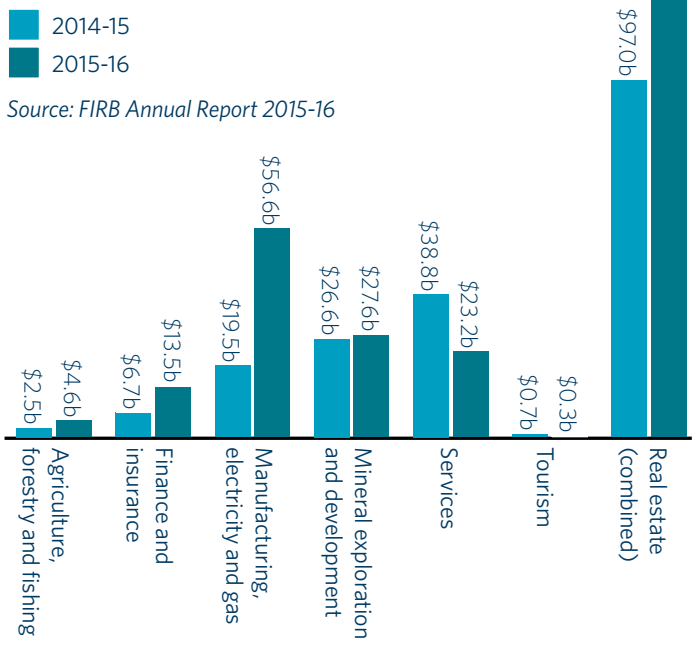


Source: FIRB Annual Report 2015-16

Outside of the real estate sector, there were 662 approvals representing approximately $126 billion in total (a notable increase from 2014-15 which saw 592 approvals representing about $95 billion). This included approvals in the:

- manufacturing, electricity and gas sector of $56.6 billion, almost triple the value of approvals in 2014-15, primarily explained by one-off transactions such as the 99 year lease of Transgrid;
- mineral exploration and development sector of $27.6 billion, a similar level to 2014-15;
- services sector of $23.2 billion, down 40.2%, partially explained by larger one-off transactions in the sector in 2014-15;
- finance and insurance sector of $13.5 billion, double the value of approvals in 2014-15, attributable to high value transactions in 2015-16; and
- agriculture, forestry and fishing sector of $4.6 billion, almost double the value of approvals in 2014-15 explained in part by a lowering of screening thresholds for agricultural land.

Total value (A$b) of foreign investment approvals by sector

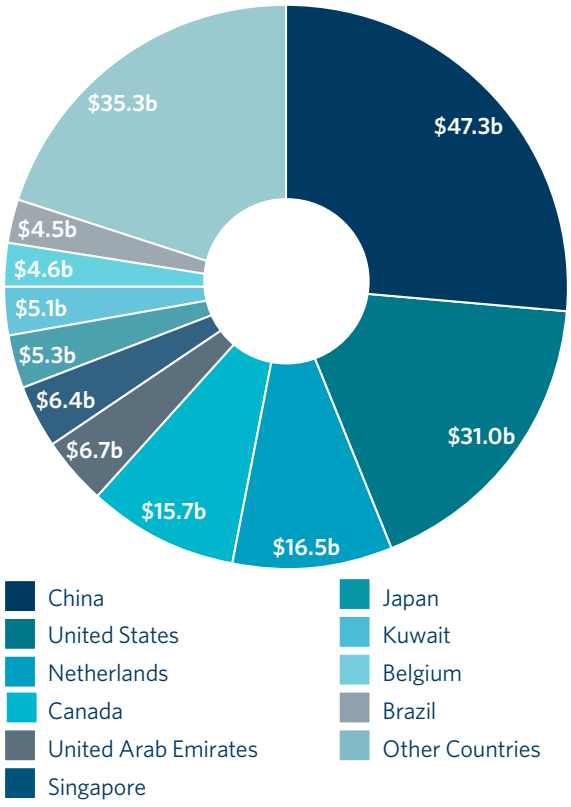


Source: FIRB Annual Report 2015-16

Sources of foreign investment

For the third consecutive year, China remained Australia's largest overall source of approved foreign investment by value ($47.3 billion), followed by the United States ($31.0 billion), Netherlands ($16.5 billion), Canada ($15.7 billion) and the United Arab Emirates ($6.7 billion).[3]

Sources of foreign investment in 2015-16 across all sectors (A$b)

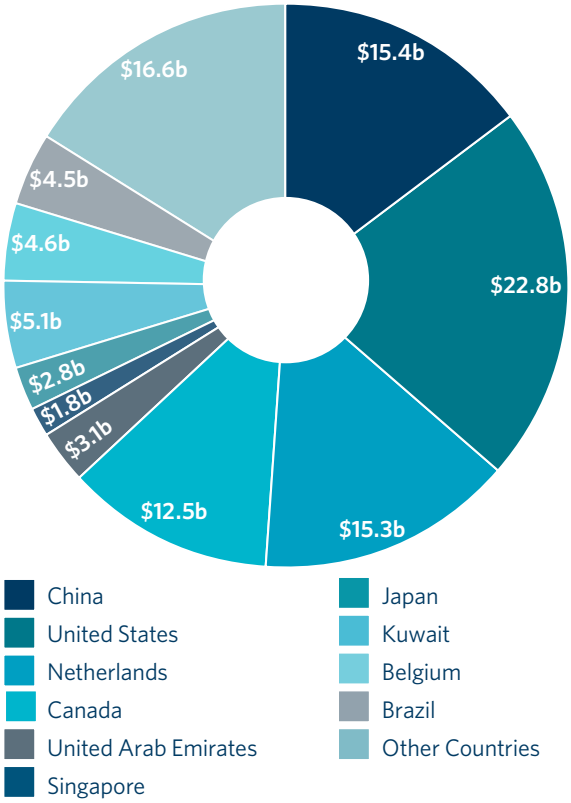


Source: FIRB Annual Report 2015-16

However, the United States was the largest investor in non-real estate sectors ($22.8 billion) followed by China ($15.4 billion).

Chinese interest in real estate remained strong with the value of approvals for Chinese investors in the sector growing by 31% since 2014-15. It is interesting to note that the overall value of approvals for Chinese investors across all sectors increased by less than 6% since 2014-15 compared to a greater than 60% increase in the value of approvals between 2013-14 and 2014-15.

Sources of foreign investment in 2015-16 across non-real estate sectors (A$b)



Source: FIRB Annual Report 2015-16

Rejections and conditional approvals

Five applications were rejected in 2015-16 compared to none in 2014-15. Four of these were in the residential real estate sector and one in the commercial real estate sector. However, significantly, several proposals for the acquisition of S. Kidman and Co. Limited played out in 2015-16[4] and the Treasurer also prohibited the 99-year lease of 50.4% of Ausgrid by foreign investors after the reporting period in late 2016.

Conditions were applied to approximately only 35% of proposals in 2015-16 compared to approximately 44% the previous year. The Report notes that the decrease can be explained by an increase in the number of approvals for new dwellings (which are not typically subject to conditions on approval) combined with a decrease in approvals for established dwellings (which are typically subject to conditions on approval).

Relevantly, the number of conditional business approvals increased in 2015-16 compared to 2014-15 and the value of applications approved with conditions increased significantly from $66.2 billion to $150.8 billion. While the data reflects a number of large, one-off transactions in sensitive sectors, it also appears consistent with the trend to increasingly impose conditions on business approvals, including, for example, standard tax conditions.

Critical infrastructure in the spotlight

The Report notes that in the 2015-16 period the FIRB Secretariat continued to pro-actively engage with state and territory governments in the privatisation of electricity network assets and Australian ports of national significance.

There were also developments in the screening of proposals involving Australia's critical infrastructure and a number of high profile proposals were considered during the period. These include:

- the sale of the Port of Darwin, noting that while the proposal was not subject to foreign investment approval (as it fell within the exemption then applicable to the sale of assets by state and territory governments to foreign private investors), the Report notes that the FIRB Secretariat did engage with potential bidders, including the successful bidder Landbridge;
- reform effective from March 2016 requiring foreign investment approval for critical infrastructure assets for sale by state and territory governments to foreign private investors (in addition to foreign government investors);
- the approval of the 99 year lease of TransGrid to 'NSW Electricity Networks', a consortium comprising Australian investors, a Canadian pension fund and Middle Eastern sovereign wealth funds, noting significant conditions were applied to the approval; and
- the approval of sale of the Port of Melbourne to the Lonsdale consortium, comprising Future Fund, QIC, Global Infrastructure Partners and OMERS, noting again that conditions were applied to the approval.

In addition, following the period of coverage of the Report, in January 2017, a dedicated Critical Infrastructure Centre was launched to manage national security risks to Australia's critical infrastructure.[5]

Increased investment in the agriculture sector

In 2015-16, 227 approvals were given for proposed investment in the agriculture, forestry and fishing sector, representing about $4.6 billion, a significant increase from 2014-15 which only saw 77 proposals representing $2.5 billion. The largest source of proposed investment in the sector was from the United States ($1.3 billion) followed by China ($996 million).

The significant increase from 2014-15 was in part due to the lowering of the agricultural land screening threshold in March 2015 from $252 million per acquisition to $15 million cumulative. The Report notes that due to this change, around 110 proposals for agricultural land valued at approximately $1.4 billion were screened in 2015-16 that otherwise would not have been screened.

Another change introduced during the reporting period was the commencement of the agricultural land register, administered by the ATO. The first report in relation to the register (released in September 2016) showed that, as at 30 June 2016, there were foreign interests in 13.6% of agricultural land by area. The top two source countries were the United Kingdom and the United States.

Continued interest in real estate and tougher enforcement

Foreign interest in the real estate sector continued to grow in 2015-16, with the number of proposals increasing to 40,755 (up 9% from 2014-15) representing $122.1 billion (up 25.9% from 2014-15).

China continued to be the largest source of proposed investment in the sector ($31.9 billion) followed by the United States ($8.2 billion).

A significant change over the reporting period was the transfer of responsibility for administering foreign investment in residential real estate to the ATO. Over the course of 2015-16, operating costs of $9.2 million were incurred by the ATO to employ 55 full-time equivalents and on IT operating costs and corporate overheads in connection with the residential real estate application screening process, data matching and compliance activities, and the development and maintenance of foreign ownership registers.

The shift of responsibility has also seen an increase in compliance and enforcement activities, with divestments issued in 39 cases for residential properties valued at $48.7 million (compared to only one divestment in 2014-15). In addition, 114 infringement notices for breaches were issued totalling $514,020 in penalties.

Conclusion

The Report has provided some useful insights into the initial impact of the recent reforms to the foreign investment framework, including on the number and type of proposals vetted by FIRB, compliance activities and new data from foreign ownership registers. Given the changes only came into effect part way through the 2015-16 reporting period, it will be interesting to review the data in the next annual report which will reflect the full year impact of the reforms.

This article was written by Tony Damian, Partner and Malika Chandrasegaran, Senior Associate, Sydney.

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FOOTNOTES

1. For further details, please refer to the article by Paul Branston entitled 'The Kidman FIRB saga – lessons learned for Australian agribusiness investments' on page 10 of this edition of the Herbert Smith Freehills Australian Foreign Investment Review.
2. See Herbert Smith Freehills Australian Foreign Investment Review – January 2016, seventh edition, for a summary of these reforms.
3. The Report notes that the significant shift in Netherlands' ranking (from 14th in 2014-2015) was due to Royal Dutch Shell's takeover of BG Group Plc, which included Australian assets. There was also a significant shift in the ranking of the United Arab Emirates (from 12th in 2014-2015) which can be explained by investors from the United Arab Emirates being part of the consortium for the 99-year lease of TransGrid as well as several investors from the United Arab Emirates receiving approval for a number of large value investments in commercial real estate.
4. For further details, please refer to the article by Paul Branston entitled 'The Kidman FIRB saga – lessons learned for Australian agribusiness investments' on page 10 of this edition of the Herbert Smith Freehills Australian Foreign Investment Review.
5. For further details, please refer to the article by Robert Nicholson entitled 'Update on the new Critical Infrastructure Centre' on page 09 of this edition of the Herbert Smith Freehills Australian Foreign Investment Review.

UPCOMING CHANGES TO AUSTRALIA'S FOREIGN INVESTMENT LAWS – SOME ROUGH EDGES WILL BE SMOOTHED

As part of the 2017-18 Federal Budget, several amendments to Australia's foreign investment regulation regime were announced. We provide a summary of the key announced changes.

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Introduction

As part of the 2017-18 Federal Budget, several upcoming amendments to Australia's foreign investment regulation have been announced.

These changes are in response to a consultation process undertaken earlier this year, which focussed on unintended anomalies in the new legislation which had become apparent over its first year of operation. The changes will affect how some specific aspects of the legislation operate in practice, rather than altering any underlying policy positions.

The changes will need to be implemented via legislation, and hence their final form is not yet clear – but based on current information, the changes will be as set out below.

Summary of changes to corporate and business investment rules

- **Pre-approvals for investments in securities:** A new business exemption certificate will be introduced, under which foreign investors (including foreign government investors) in securities will be entitled to obtain pre-approval for multiple investments. Further guidance on the types of transactions that this exemption certificate will apply to will be released prior to the effective date of 1 July 2017. Hopefully, the effect will be that financial investors such as private equity funds will have greater flexibility when making investments in Australia, without needing repeated Foreign Investment Review Board (**FIRB**) approvals merely due to the precise composition of their investor register. This is clearly one area where the detail will be extremely important – not only to ascertain what transactions will be covered, but also to identify what residual discretion FIRB will have to review (and potentially unwind) transactions after the fact.
- **Reduced scope of lower threshold land:** The classes of non-vacant commercial land (which are subject to the lower $55 million screening threshold) will be significantly narrowed. Pleasingly, the 'prescribed airspace' limb of the current test – which had the effect of subjecting most commercial properties in Australia's major cities to the lower threshold – will be removed. Guidance material will be provided prior to 1 July 2017.
- **Land used for renewable energy:** Amendments will be made to clarify the treatment of developed solar and wind farms as 'commercial non-vacant land' rather than 'vacant land' or 'agricultural land', which should reduce the number of situations where FIRB approval is required. However, land acquisitions in connection with undeveloped facilities will not get the benefit of this change.
- **Custodians:** A technical correction will be made to confirm that companies with significant foreign custodian holdings (i.e. legal rather than equitable interest holders) are not subject to notification requirements.

Changes to residential property investment rules

- **Cap on foreign sales under exemption certificates:** There will be a 50% cap on the total amount of dwellings a developer can sell to foreign persons under a New Dwelling Exemption Certificate. This change has effect from 9 May 2017.
- **Vacancy charge:** An annual vacancy charge will be imposed on new foreign owners of residential property where the property is not occupied or genuinely available on the rental market for at least six months each year. The amount will equal the relevant foreign investment application fee. This change will also have effect from 9 May 2017.
- **Increased fees for residential property investments:** Application fees for foreign purchases of residential properties valued at less than $10 million will increase by 10%, effective 1 July 2017.
- **Settlement failures:** A new residential exemption certificate will be introduced to allow developers to re-sell to foreign persons off the plan dwellings that failed to settle and would be technically considered 'established'.
- **Widened exemption certificate:** A new residential exemption certificate will be introduced so that only one approval is required for individuals considering a number of residential properties with the intention of only purchasing one. This exemption certificate is currently available for purchases of established dwellings and will be extended to new dwellings.
- **Widened application of commercial residential land:** The definition of 'commercial residential premises' will be amended so that it covers property types that are commercial in nature, such as student accommodation and aged care facilities.

Changes to fee framework

Application fees for acquiring different types of interests will be standardised under a three-tier fee structure. Some current fee relief arrangements, including additional low value fee rules, will also be formalised in legislation.

A summary of the proposed commercial fees from 1 July 2017 is below. These will apply to all foreign persons, including foreign government investors, unless otherwise specified.

Fee by category and value[1,2]

CATEGORY	$10 MILLION OR LESS	ABOVE $10 MILLION	ABOVE $1 BILLION
Commercial land (vacant and developed)[3]	$2,000	$25,300	$101,500
Actions relating to entities and businesses	$2,000	$25,300	$101,500

CATEGORY	$2 MILLION OR LESS	ABOVE $2 MILLION	ABOVE $10 MILLION
Agricultural land	$2,000	$25,300	$101,500

FLAT FEES	
Exemption certificate	$35,000
Mining and production tenements	$25,300
Legal or equitable interest in mining, production or exploration tenement[4]	$10,100
An interest of at least 10 per cent in securities in a mining, production or exploration entity[4]	$10,100
Starting an Australian business[4]	$10,100
Internal reorganisation	$10,100
Variation[5]	$10,100

Conclusions and commentary

While it is pleasing that the Government has moved to address these issues, it is disappointing that several other anomalies – or situations of legislative over-reach – have not been addressed, including:

- Confirming that multiple separate applications, in relation to the same transaction, are not required from the upstream and downstream entities (and consortium members) participating in the transaction.
- Making further clarifications to the land-related definitions in the legislation – for example to better delineate between aspects of 'mixed use' land (e.g. a commercial facility operating within a residential building), or to provide additional guidance on the treatment of various line items when determining whether an entity is an 'Australian land corporation' or 'Australian land trust'.
- Providing greater certainty on the situations where small indirect interests in investment vehicles held by foreign government investors can trace through to cause the investment vehicle itself to be treated as a 'foreign government investor'.
- Reconsideration of the current provisions which automatically deem sovereign wealth funds from one country to be associates of each other, even if they are independently managed (e.g. sovereign funds from different Canadian provinces).

Additionally, in the case of the changes that have been announced, it will be critical to assess their detail as it comes to light.

Hence while these proposed changes are a step in the right direction, in Herbert Smith Freehills' view there is more that can be done to increase the efficiency and workability of the foreign investment framework.

This article was written by Simon Haddy, Partner, Melbourne.

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FOOTNOTES

1. Lower fee rules: these replace the existing de minimis rule. Other legislated lower fee rules will not be changed.
2. Discretionary fee waivers for entities carrying on business acquiring multiple land titles under one agreement or acquiring securities in an entity that primarily holds residential land will be legislated.
3. A $2,000 fee will also apply for foreign government investors for developed commercial land acquisitions under $55 million.
4. Only applicable to foreign government investors. A $2,000 fee will apply where the fee would otherwise be more than 25% of the consideration.
5. The variation fee payable will not exceed the initial application fee.

1 JULY 2017 CHANGES TO THE FOREIGN INVESTMENT FRAMEWORK - FURTHER CLARIFICATION STILL REQUIRED FOR PRIVATE EQUITY AND VENTURE CAPITAL SPONSORS

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On 8 March 2017 the Government released a consultation paper seeking formal views from stakeholders on a suite of proposed changes in the areas of residential land, non-vacant commercial land, low sensitivity business investment and fees. The consultation paper also sought to provide an opportunity for stakeholders to present examples on how technical issues in the legislation could be addressed and any further ideas for reform. Submissions closed on 29 March 2017.

The Australian Private Equity and Venture Capital Association Limited, the Law Council of Australia and a number of other organisations recommended to the Government in their submissions (consistent with previous feedback provided to Treasury) that a new foreign government investor exemption certificate should be made available to professional private equity (**PE**) and venture capital (**VC**) sponsors due to the passive nature of their foreign investor base.

The Government announced in the Federal Budget handed down on 9 May 2017 that on 1 July 2017 it will introduce a new business exemption certificate that will allow foreign investors (including foreign government investors) to obtain pre-approval for multiple investments in the one application rather than having to apply separately for each investment. However, no indication was provided as to whether that new business certificate would be available to PE and VC funds or whether the design features of such exemption certificates would adequately address the concerns raised in submissions and feedback sent to Treasury to date (e.g reporting requirements, definition of 'low sensitivity investment', annual investment and transaction limits, investor and fund information disclosure settings and removing the ability of Government to revoke pre-approvals given under exemption certificates).

The Government has promised to issue further details and guidance on the new business certificate exemption (and the other proposed changes to the foreign investment framework) prior to the legislative changes coming into effect on 1 July 2017.

This space will need to be monitored until such further details are released.

This article was written by Damien Hazard, Partner and Jenny Altherr, Solicitor, Sydney.

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UPDATE ON THE NEW CRITICAL INFRASTRUCTURE CENTRE

Six months ago, the Government announced the establishment of the Critical Infrastructure Centre (**Centre**). We provide a recap of the key points around the establishment and operation of the Centre.

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Establishment and current status

The Government announced in January 2017 the establishment of a new Centre which will focus on critical infrastructure in order to develop a deeper understanding of the national security risks of sabotage, espionage and coercion and ensure that strategies are in place to mitigate those risks.

The Centre will be based within the Attorney General's Department but work closely with other government agencies, including the Foreign Investment Review Board (**FIRB**) and State and Territory Governments. The Government is understood to be recruiting officers with knowledge of the relevant sectors to assist in its work.

The Government is undertaking consultation on the new measures with a view to introducing legislation to establish the Centre within the next few months.

What is 'critical infrastructure'?

The Government's current view is that critical infrastructure would include infrastructure associated with telecommunications, electricity, water and ports. Gas was a curious omission.

It is not yet clear how far the requirement to register will extend. Each sector comprises both large and small assets. It is hoped there will be a threshold below which there is no requirement to register.

Information gathering

The Centre's first task would be to compile a register of all critical infrastructure and establish who owns it, where it is located, how it is organised and managed, details of operational access and control, the nature of relevant security risks and how they are managed.

Asset owners would be obliged to submit this information to the register and update any changes, including to ownership, as they occur. The register would not be public but would be available to government agencies.

Powers of direction

The Government is considering seeking powers akin to those of the Telecommunications Sector Security Reforms introduced in November 2016 which would give the Attorney General the power to issue directives to do or refrain from doing specified acts or things where there is a perceived risk to national security, the direction is required to reduce the risk and efforts have been made to negotiate a solution with the owner.

The detail of these powers will need to be carefully examined. There has been a suggestion that the UK Government is considering powers of divestment where the continued holding of a critical infrastructure asset by an investor is no longer regarded as being in the national interest, despite being cleared under the *Enterprise Act 2016* (UK). Such a power would increase the risk profile of investments in the sector.

There is some apprehension that the Centre might require utilities to make material investments in new systems or materially alter their operational arrangements. There is a strong view that generally accepted industry standards should be sufficient. Indeed, since all the industries of concern already have extensive regulated operational requirements, these are likely to be a better place to introduce any new requirements that may be required, following consultation.

Foreign investment decisions

It is proposed that the existing foreign investment framework under the *Foreign Acquisitions and Takeovers Act 1975 (Cth)* will continue but, where one of the critical infrastructure sectors is involved, the Centre would be consulted and will provide advice to the Treasurer as the relevant decision maker.

In recent times, investments in these sectors have experienced significant delays in approval processes. Some decisions have been difficult to reconcile. The conditions applicable to decisions have changed from one investment to the next, with little apparent logic. There is a heightened uncertainty as to the Government's likely approach to applications.

If the Centre can develop a deeper understanding of the relevant sectors this may improve the speed with which national security issues relevant to FIRB applications can be assessed. It is hoped that a more consistent and predictable environment may emerge.

This article was written by Robert Nicholson, Partner, Melbourne.

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THE KIDMAN SAGA – LESSONS LEARNED FOR AUSTRALIAN AGRIBUSINESS INVESTMENTS

In 2015-16 there was much speculation surrounding two proposals to acquire S Kidman & Co (**Kidman**). We take a look at the proposals (both successful and unsuccessful) and consider some lessons learned for agribusiness investments in Australia.

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Introduction

With beef prices at high levels and growing demand from Asia, Australian beef assets have been the subject of strong interest from both domestic and foreign buyers, with a number of large deals having been announced recently.

The purchase of many of these assets by foreign buyers has received significant public, and therefore political, attention. No sale in the sector was more closely followed than that of Kidman, Australia's largest private land owner, and the holder of a number of significant cattle stations throughout Australia.

The Australian Foreign Investment Review Board (**FIRB**) and the Treasurer were heavily involved in the lengthy Kidman sale process, blocking two proposals by foreign buyers, before approving the sale of Kidman to Australian Outback Beef Pty Ltd (**AOB**) (a joint venture between Australia's Hancock Beef (67%) and Shanghai CRED (33%)) in December 2016.

A closer look at the Kidman sales process provides a number of valuable lessons for both foreign acquirers of Australian agribusiness assets and vendors and those involved in running sales processes.

Background

Kidman, headquartered in Adelaide, was Australia's largest private land owner, holding approximately 1.3% of Australia's total land area, and 2.5% of Australia's agricultural land. These holdings, mostly cattle stations located throughout Australia, supported a long term average herd of 185,000 cattle. Anna Creek station (the largest landholding) sits partly within the prohibited area surrounding the Woomera weapons testing range in South Australia.

In April 2015, the Kidman family announced the intention to sell their entire interest in Kidman.

The nature of the assets held by Kidman (being principally land) meant that any sale to a foreign person required FIRB approval under the *Foreign Acquisitions and Takeovers Act 1975* (Cth). Accordingly, the Treasurer, acting on the advice of FIRB, was required to form the view that the sale to a foreign person would not be contrary to Australia's national interest.

Summary of the sale process

There were a number of twists and turns in the 20 month sale process as summarised below.

April 2015	Sale process announced.
October 2015	Scheduled date for close of final bids.
19 November 2015	The Treasurer announced that, on the advice of FIRB, it would be contrary to Australia's national interest for a foreign person to acquire Kidman in its current form. This decision was based on the size and significance of the portfolio of the properties and the national security issues arising from the fact that 50% of the Anna Creek lease was located in the Woomera Prohibited Area (**WPA**). The Treasurer left it open to the vendors to consider how they wished to proceed with offering composite interests for sale. The Treasurer's announcement did not name any bidders but it was rumoured at the time that two large Chinese bidders were the frontrunners.
1 December 2015	A package of significant changes to Australia's foreign investment legislation commenced in force.[1] These changes included measures increasing scrutiny on foreign investment in the agricultural sector, with lower thresholds introduced for investments in Australian agribusinesses and agricultural land.
10 December 2015	Kidman announced it had determined to excise Anna Creek from any potential sale to foreign buyers and was running a separate and contemporaneous process for this station. Kidman also announced that foreign buyers in the process were considering teaming with Australian partners.
10 February 2016	Kidman confirmed that while it was progressing the proposals from existing bidders, should the Treasurer approve any of those bids, Australian bidders who did not have a requirement for FIRB approval would still have an opportunity to lodge a later bid via the Australian takeovers process.[2] In a media release the Treasurer welcomed the decision to 'reopen the company's sale process for Australian parties'.
19 April 2016	Kidman entered an agreement for the acquisition of Kidman (excluding Anna Creek) with China's Dakang Australia Holdings Pty Ltd and the ASX-listed Australian Rural Capital Limited (**ARC**) by way of off-market takeover bid for $370 million. Under the consortium arrangements, Dakang would hold 80% and ARC 20%. The Dakang / ARC bid was subject to FIRB approval and it was announced that the Treasurer had issued an interim order extending the period in which he had to make a decision for 90 days.[3]
29 April 2016	The Treasurer announced he had informed Dakang that his preliminary view of the Dakang / ARC proposal was that it was contrary to the national interest given the size and significance of the Kidman portfolio. This was notwithstanding that Anna Creek had been excised and Dakang had teamed with an Australian (minority) partner. The Treasurer also referred to concerns that the form in which the Kidman sale had been offered – as a single aggregated asset - had rendered it difficult for Australian bidders to make a competitive bid. The Treasurer also announced that he was providing Dakang with a natural justice period until 3 May 2016 (2 business days later) for Dakang to respond. The Treasurer's media release also referred to an external and independent review of the sale by Graeme Samuel AC (the former Chairman of the Australian Competition and Consumer Commission) commissioned on 20 April 2016. The review found the Kidman sale process followed satisfactory commercial practice and allowed Australian parties to make an offer, but that there remained significant domestic interest in the sale.
3 May 2016	In response to the Treasurer's announcement, Dakang and ARC terminated their joint bidding arrangements in relation to Kidman.
9 October 2016	Hancock Beef and Shanghai CRED entered an implementation agreement with Kidman for an off-market takeover bid by AOB valuing Kidman (ex. Anna Creek) at approximately $365 million. The offer was subject to a number of conditions, including FIRB approval. Under the proposal, Anna Creek would be sold to a local farming family with adjoining properties.
9 December 2016	The Treasurer approved the acquisition of Kidman by AOB noting that Hancock Beef will control the board of AOB and the day-to-day operation of the business and that Kidman will remain majority Australian-owned and headquartered in South Australia. AOB also committed to significant investments in the Kidman business increasing herd size and various capital improvements. These investments would increase employment, including locally to Kidman's operations.

Lessons from the Kidman sale process

As only the second time the purchase of a major agricultural asset has been blocked by the Treasurer and FIRB,[4] the Kidman sale process provides a number of useful insights into foreign acquisition of Australian agribusiness. The process was particularly noteworthy owing to the deep involvement of FIRB over the course of the lengthy sales process and the impact FIRB had on the outcome of the sale, in that Kidman (ex. Anna Creek) was ultimately sold to an Australian controlled entity with foreign investors having only minority exposure. Key lessons include:

- **National security considerations remain a key focus of FIRB:** Any transaction that involves a defence site will face additional scrutiny from FIRB. It should not have come as a surprise that a transaction in which a foreign investor obtained rights over part of the WPA may have been problematic. In 2009, FIRB intervened in a sale of a mining company that held tenements covering the WPA, leading to those tenements being excised from the transaction.
- **Size matters:** The Kidman process demonstrated that the national interest test is broad and flexible. FIRB's policy outlines a number of national interest factors – national security, competition, other government policies (including tax), impact on the economy and the community and the character of the investor. In addition, there are specific factors listed for agricultural assets.

  In balancing the recognition that Australia (and in particular Australian agriculture) requires foreign investment and public perception and opinion on the level of investment in Australian agriculture,[5] the Treasurer appeared to focus on the sale process itself and whether the structure (i.e. size) of the sale deprived Australian purchasers of an opportunity to participate. Ultimately, FIRB was of the view that a foreign investor acquiring such a large and significant land portfolio was not in the national interest. It appears a different conclusion may have been reached if the Kidman assets were sold in their constituent parts.
- **Engage with FIRB early:** If FIRB approval is likely to be a sensitive issue, which is more likely to be the case where the assets involved are significant in terms of size or their uniqueness (i.e. they are 'iconic'), both buyers and sellers should engage with FIRB early to understand any particular national interest concerns FIRB may have.

  Vendors may also consult with FIRB regarding the sale process and should establish a sales process that aligns with FIRB's expectations. This will minimise the risk of unexpected intervention during the process.

  Similarly, foreign investors should also engage with FIRB to understand any conditions the Treasurer may impose and FIRB's anticipated timing for approval to maximise the competitiveness of their bid. Foreign investors will want to provide bids with low conditionality and vendors will want to be in a position where the approval of buyers' FIRB applications can be aligned with milestone dates in the process so that offers are received (preferably) on an unconditional basis.
- **Promote the merits of the proposal:** Foreign investors should be prepared to explain why their proposal is beneficial to Australia and to promote their proposal in their correspondence with FIRB and publicly if required. Where will the company be headquartered? What further investments will be made by the company in Australia? How many Australian jobs will be created by the proposal?
- **Partnering with an Australian company may be advantageous (or necessary):** Where assets are particularly sensitive, partnering with an Australian company may enhance the prospects of FIRB supporting the transaction. In some cases it may be necessary that an Australian company has a controlling interest for the Treasurer to consider that the proposal is not contrary to Australia's national interest.

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FOOTNOTES

1. See Herbert Smith Freehills Australian Foreign Investment Review – January 2016, seventh edition, for a summary of these reforms.
2. At the time Kidman was an Australian company with more than 50 shareholders, meaning it was subject to the Australian takeovers provisions contained in the *Corporations Act 2001* (Cth). The transaction would be structured as an off-market takeover bid, that could be trumped by a higher bidder after announcement.
3. This appears to be a departure from the typical practice of FIRB requesting that a foreign investor agree to extend the review period, usually for less than 90 days.
4. The other being the $3.4 billion bid by Archer Daniels Midland for Graincorp in 2013.
5. The Treasurer's 29 April 2016 media release referred to the Treasurer taking into account the size and significance of the proposal combined with the impact the decision may have on broader Australian support for foreign investment in Australian agriculture. This appears to suggest there is concern that if such a large proposal for foreign investment was approved it would leave little room to approve further proposals for foreign investment.

IMPACT OF FIRB APPLICATION FEES ON AUSTRALIAN M&A AND FDI: A RETROSPECTIVE REVIEW

We take a look back over the preceding 18 months to see what impact, if any, the introduction of application fees has had on M&A transactions and FDI, in Australia.

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Overview

On 1 December 2015, fees on all Foreign Investment Review Board (**FIRB**) applications were introduced by the Government pursuant to the *Foreign Acquisitions and Takeovers Fees Imposition Bill 2015* (Cth). Recently, the Government also announced proposed changes to the FIRB application fees in the 2017-18 Federal Budget.[1]

At the time of introduction in 2015, there were concerns around the potential impact the introduction of application fees may have on the Australian M&A market and Australia's status as a favourable destination for foreign direct investment (**FDI**).

Recap of current FIRB application fees

Prior to 1 December 2015, no fees were payable when making an application or giving notice to FIRB under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**).

The current FIRB application fees are indexed annually and are generally as follows:

FEE	TRANSACTION
$5,000	Acquisitions of an interest in residential or agricultural land (<$1 million).
$10,000	Acquisition of an interest in vacant commercial land, internal reorganisations and for a foreign government investor to start an Australian business, acquire an interest in a tenement or a 10% interest in a mining, production or exploration entity.
$25,000	Acquisitions of interests in (i) non-vacant commercial land, (ii) mining or production tenements or (iii) an Australian entity (<$1 billion).
$100,000	Acquisitions of interests in an Australian entity/business (>$1 billion).

Key impacts of FIRB application fee regime

As noted above, the concerns and speculation surrounding the introduction of the FIRB application fees can be broadly segregated into two categories: the impact on Australian M&A and the broader impact on Australia as a destination for FDI.

Impact on Australian M&A

Prior to the introduction of FIRB application fees in 2015, bidders in a competitive M&A process would typically be required by vendors to 'front-end' FIRB approvals by obtaining their approval prior to lodging a binding bid. This approach was particularly attractive to vendors as they were able to seek (and regularly obtain) 'clean bids' that were not conditional on the bidders obtaining FIRB approval, ensuring deal certainty.

Following the introduction of the application fees, vendors have the choice of requiring bidders to absorb the application fees as a transaction cost or accepting bids conditional upon bidders obtaining FIRB approval.

One of the groups most impacted by absorbing FIRB application fees are financial sponsors. Financial sponsors are often deemed 'foreign persons' and 'foreign government investors' as a result of their fund structures being domiciled overseas, as well as the identity of the passive investors in their funds (e.g. sovereign wealth funds). As a result, financial sponsors often require FIRB approval for all acquisitions they undertake, which represents an 'added cost of doing business in Australia'.[2]

On the other hand, a recent example of the issues that may arise when vendors accept conditional bids was the New South Wales Government's initial process for the privatisation of Ausgrid, the New South Wales electricity transmission and distribution business. The Government accepted FIRB conditional bids from State Grid Corporation of China (**State Grid**) and Cheung Kong Infrastructure (**CKI**), being the two parties that submitted binding bids. Unfortunately, both State Grid and CKI were unsuccessful in obtaining FIRB approval and the Government was forced to abandon the privatisation process which was drawing towards a close after a number of months (this was prior to receiving the IFM / Australian Super consortium's ultimately successful unsolicited proposal).

While the Ausgrid example of accepting FIRB conditional bids is an exception and not the rule in the context of privatisations (i.e. bidders in a privatisation process are usually required to obtain FIRB approval (and all other regulatory approvals) prior to submitting their binding bids), the increased vendor risk in accepting conditional bids equally applies to vendors in a general M&A context.

Impact on Australia's image as a favourable FDI destination

One of the key concerns with the current application fee structure, in addition to the 'added cost of doing business in Australia', was that the non-refundable nature of the application fee may act as a deterrent to FDI into Australia. Currently, if the foreign investor fails to gain FIRB approval or is ultimately unsuccessful in executing the transaction, the application fee is unable to be recovered.

In contrast to this, foreign investors looking to invest in a number of other major FDI jurisdictions do not incur filing fees at all (e.g. the United States, United Kingdom etc.).

However there does not yet appear to have been an observable impact on the level of FDI into Australia (FIRB applications were up 9% in 2015-16 representing $247.9 billion of proposed investment, up from $191.9 billion in 2014-15).

A review of the application fee rationale

The Government indicated that the FIRB application fees were imposed as a revenue measure to assist in funding a range of initiatives including processing and assessing applications, the introduction of a specialised investigative and enforcement area within the Australian Tax Office (**ATO**), improvements in the collection of data in relation to foreign investment in Australia and to boost the resources allocated towards investigating alleged breaches of the FATA.

On the investigation and enforcement front, we have seen a significant increase in the involvement of the ATO in undertaking granular reviews of proposed acquisition structures to identify any leakage from the Australian taxation base. Similarly, there has certainly been an increase in enforcement activity in the residential real estate space, with a number of divestment orders being issued.

However, it appears to be too early to make a material assessment of whether there has been an improvement in the processing and assessing of applications as a result of the imposition of the application fees.

With many applications still exceeding the standard 30 day assessment application period, there has not yet been a marked improvement in the processing of applications (FIRB has a number of 'clock stoppers' it can rely on in extending the 30 day period). As FIRB continues its transition to a better resourced 'user pays model', as funded by the application fees, we expect to see improvements in this area.

Conclusion

It is too early at this stage to observe any potential medium term impacts of the introduction of the FIRB application fees. For the moment, the Australian M&A market and FDI into Australia are going from strength to strength, so it is difficult to point to the introduction of the filing fees as having had a material impact on the Australian market.[3]

The 'user pays model' appears to be here to stay, so for those most impacted by the introduction of the FIRB application fees (e.g. financial sponsors), this has become an assumed cost of doing business in Australia.

This article was written by Matthew FitzGerald, Partner and Ben Sheehan, Solicitor, Brisbane.

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FOOTNOTES

1. For further details, please refer to the article by Simon Haddy entitled 'Upcoming changes to Australia's foreign investment laws – some rough edges will be smoothed' on page 06 of this edition of the Herbert Smith Freehills Australian Foreign Investment Review.
2. For further details on FIRB changes relevant to financial sponsors, please refer to the article by Damien Hazard entitled '1 July 2017 changes to the foreign investment framework – further clarification still required to private equity and venture capital sponsors' on page 08 of this edition of the Herbert Smith Freehills Australian Foreign Investment Review.
3. For further details, please refer to the article entitled 'China, Real Estate and North Americans: FIRB's 2015-16 Annual Report' by Tony Damian and Malika Chandrasegaran on page 02 of this edition of the Herbert Smith Freehills Australian Foreign Investment Review.

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