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The Treasury
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MAJOR REFORMS TO THE FOREIGN INVESTMENT REVIEW FRAMEWORK – Ai GROUP SUBMISSION

The Australian Industry Group (Ai Group) welcomes the chance to make a submission to the Treasury's consultation process on changes to the *Foreign Acquisitions and Takeovers Act 1975* (FATA). Our members are businesses of all sizes and many sectors across Australia. Many have some degree of foreign ownership, or are Australian-owned but invest overseas.

Overall, Ai Group emphasises that foreign investment (and reciprocal openness to Australian overseas investment) is very important to Australia's prosperity. It should be cultivated through fair treatment on an equal footing with domestic investment.

Australia's current foreign investment regime has been successful, demonstrating relative transparency, predictability and fairness in addressing ownership and sovereignty issues that are concerns in every country but rarely so well handled. Australia has been the world's tenth biggest destination for foreign direct investment in recent years. Access to foreign capital and expertise is of great value in expanding the quantity and quality of infrastructure, goods and services that Australians can enjoy. It is important to preserve all this as the Government moves to address new, somewhat inchoate security concerns.

While the Government has frequently stated its commitment to reducing regulation and promoting investment, in recent years a range of new regulatory powers and interventions have been proposed or introduced concerning national security, access to data and secure systems, payment times reporting, energy markets and more. While these have all had cases to be made for them, collectively they increase regulatory burdens and add to uncertainty for a wide range of businesses. These burdens are as real as any others. We should be cautious in adding to them.

In that context the new national security stream of FATA and its associated obligations and powers, including the potential for post-approval forced divestiture, would be major changes. They involve a significant increase in the regulatory burdens and risks that face investors and should be applied as narrowly as necessary to safeguard against genuine risks to national security. In this regard, the parallel reforms to the *Security of Critical Infrastructure Act 2018* (SCIA) that are now under development risk interacting with the FATA changes to wildly expand the scope of the national security-significant category.

We recommend that the scope of the critical infrastructure covered by the national security stream be limited solely to those categories covered by the current SCIA, and should not automatically pick up any expansions of the SCIA without a further process of policy consultation, regulatory analysis and legislative amendment. Furthermore, the proposed FATA reforms should not go through until and unless regulatory analysis indicates, based on a clear and final agreed scope for the national security stream, that the reforms are superior to alternatives. Options considered should include returning to the pre-2020 financial thresholds while improving enforcement of existing security laws. The regulatory analysis should be tested through consultation with stakeholders prior to the introduction of legislation.

Further comments

Purpose of the national security stream

The Government has been somewhat ambiguous and nonspecific in its description of the need for the FATA changes or why, and against whom, they may be used. Three concerns appear to limit the clarity with which the Government can discuss the potential operation of these amendments:

- Trade non-discrimination – we are obliged not to discriminate among our trading partners
- Foreign policy and national security secrecy – the Government may not wish to reveal the nature of strategic concerns, vulnerabilities, or intelligence that underpin its choices
- Operational flexibility – given the breadth of assets that may imaginably become significant to national interest or security, the Government may wish to preserve a broad ambit for potential response.

Each of these concerns is legitimate. But the result is at best a fairly wooly debate. At worst, we may end up with a system that is so broad in reach as to be open to abuse by future governments. It is important that the reforms ensure strong scrutiny, transparency and checks on the exercise of these expanded powers.

With respect to the underlying case for action, it is not clear what the perceived security threat is or why FATA amendments are needed to protect against it:

- If there is a concern that assets such as food or pharmaceuticals may be sent overseas during emergency conditions, the Commonwealth has constitutional power over international trade and scope under our international trade agreements to restrict exports where necessary to protect human life or health. Such restrictions, while not lightly to be imposed, are a more direct and effective answer than prior restriction of business ownership – especially since Australian-owned businesses are otherwise free to sell products to foreign buyers.
- If there is a concern about potential sabotage or espionage on behalf of foreign powers, restriction of ownership does not seem meaningfully to reduce the opportunities for this. Enforcement of laws against treason and espionage is a more direct response.
- If there is a concern about asset ownership giving foreign countries greater influence over Australia, we should consider whether the reverse may be true. Assets bought in Australia remain in Australia, subject to Australian laws and policy decisions. As foreign investors are all too aware, their fate is in the hands of their hosts.

The Government should ensure that the advantages of their proposed changes over these existing avenues are clearly articulated and demonstrated in regulatory impact analysis.

Furthermore, in industry briefings there was some ambiguity about whether the changes are intended solely to protect against active threats to Australia's national interest and/or national security, or to help bolster Australia's sovereign capability. The latter would be a much more expansive goal. Clarity is needed on this front as well.

Scope of the national security stream

The definition of 'sensitive national security businesses' is extremely important, as an overly broad scope would spread uncertainty across the economy while giving the Government an impossibly large task – a recipe for arbitrary decision-making.

The draft regulation defining these businesses is mostly appropriate, referring to businesses that develop or supply critical products, technologies and services for Australian defence and intelligence activities and personnel; businesses that are carriers or carriage service providers under the *Telecommunications Act*; and businesses that are responsible for or direct interest holders in critical infrastructure assets as defined under the SCIA.

It appears that the defence and intelligence element is well tailored to capture relevant businesses, such as makers of weapons for the Department of Defence, and exclude irrelevant ones, such as makers of office supplies purchased by the Department of Defence.

However, the critical infrastructure element has the potential to introduce considerable uncertainty to a wide range of important investments.

The SCIA currently covers electricity, gas, water and maritime port infrastructure. Foreign investment is extremely important to Australian infrastructure, including in energy, and many assets are already held partly or wholly by foreign owners. While the Government has clarified that it will not apply the National Security stream to assets purchased before the reforms come into force, the reach will expand over time as assets and corporate ownership structures turn over. Given the significance of foreign investment to the provision of Australian infrastructure, we should be cautious about introducing additional costs or uncertainties through modification of the FATA regime.

However there is a risk that the coverage ends up going much further. We note that the Department of Home Affairs is currently consulting on changes to the critical infrastructure security framework that would potentially expand the SCIA to a much wider range of sectors, including:

- Banking and finance;
- Communications;
- Data and the Cloud;
- Defence industry;
- Education, research and innovation;
- Energy;
- Food and grocery;
- Health;
- Space;
- Transport; and
- Water.

The scope and detail of these changes is not yet determined, but if they proceed and the FATA changes are made as proposed they will automatically expand the scope of sectors subject to the proposed national security stream, including new obligations, the call-in power and the divestiture power. That would represent a dramatic expansion of national security powers, administrative burdens and investment uncertainty across the Australian economy. No case has been made in the FATA consultation for such an expansion, and the Home Affairs policy process does not appear to be taking any account of interactions with FATA. The result could easily be that Australia blunders into imposition of national security restrictions on wide swathes of our economy without any proper consideration of the costs and benefits.

Since the current FATA consultation cannot determine the outcome of the critical infrastructure reforms, we recommend that if the FATA changes go ahead the definition of critical infrastructure should be changed to replace the blanket reference to all SCIA assets with a more limited reference only to “critical electricity, maritime port, water and gas assets covered by the Security of Critical Infrastructure Act 2018.”

The outcomes of any decisions on scope, including the separate changes to SCIA, should inform the final regulatory analysis on the FATA changes.

Divestiture power

One area of concern in the FATA changes is the last-resort divestiture power for sensitive national security businesses, where an acquisition has been previously approved but the Treasurer subsequently comes to believe it presents a national security risk in light of changed circumstances. This is the second recent expansion of the Government’s powers to forcibly divest private assets, following the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Act 2019* (the so-called ‘Big Stick’ legislation). While persistently described as a ‘last resort’, persistently and conspicuously adding this weapon to the arsenal sends a negative signal to investors generally. The

lack of clarity about what concerns may animate future national security divestiture decisions, and the lack of foreign investor control over the diplomatic and security relationships of their home countries with Australia, increase the hit to certainty.

As one Ai Group member noted,

> "a provision whereby the government can issue a 'mandatory divestiture' notice increases business uncertainty at a time when investment is already struggling due to uncertainty arising from COVID-19 and trade impacts arising. This provision would represent a further disincentive to invest by foreign owned companies in national security sensitive sectors which [may] include gas, electricity, ports, transport, food manufacturing and health / pharmaceutical at a time when Commonwealth and State Governments are trying to encourage investment."

That said, we welcome the clarification in briefings that the divestiture power won't be applicable to assets purchased prior to the latest reforms (though the turnover of assets and corporate identities and ownership would increase the reach of the divestiture power over time).

Regulatory analysis

We welcome the Treasury's confirmation that a Regulation Impact Statement is being prepared to inform decisions about the FATA changes. A comprehensive RIS process is essential for this economically sensitive issue. The RIS should assess impacts on investment and consider alternatives, including the use of existing laws against treason and espionage and powers over exports to manage security concerns. The RIS should be based on the full final scope of the proposal, including any impacts from broadening critical infrastructure legislation. There should be an opportunity for full stakeholder consideration of the RIS and incorporation of feedback prior to the introduction of any legislation to the Parliament.

Resourcing

The Government's indication that administrative resources for the FATA would be substantially strengthened would make the expanded system more workable. These resources are already needed; the decision earlier in 2020 to reduce thresholds for FATA consideration risks blowing out approval times, concerning investors and delaying valuable projects (for instance in energy and infrastructure). However, we note that the impacts of the COVID-19 pandemic and economic recovery from our present recession place huge demands on the focus and resources of business and governments. While additional resources are needed to make the FATA amendments operable, the Government should consider carefully whether the changes and expanded assessments that necessitate those resources are really a higher priority than national recovery.

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Sincerely yours,

Innes Willox

Chief Executive