Greater scrutiny of government sales under foreign investment regime

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In brief

The sale of certain infrastructure assets by Australian governments will no longer be excluded from the ambit of Australia's foreign investment law, following amendments which came into force on 31 March 2016.

The changes mean that acquisitions of land on which public infrastructure is situated may now be scrutinised by the Treasurer, subject to the standard thresholds and exemptions in the law.

The changes will impact the process and timing of asset sales conducted by State, Territory and Local governments and will likely result in greater involvement by Commonwealth agencies in these processes.

The changes further underline the need for an early assessment of the application of Australia's foreign investment law when structuring transactions, particularly when participating in government asset sales, where such considerations were previously unnecessary.

In detail

Background

Australia has a long-standing policy of welcoming foreign investment, with an assessment being made by the Commonwealth as to the congruence of an investment proposal with Australia's national interest.

As we have previously written, there has been a significant change in the process of assessment of investment proposals over the last 18 months, with the Commonwealth seeking to enhance the integrity of the system in order to strengthen public support for Australia's foreign investment policy. These changes have culminated in a wholesale re-write of the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (the Act) and the *Foreign Acquisitions and Takeovers Regulations 1975* (Cth) (the Regulations).

Previous position in relation to review of government asset sales

The sale of assets by State, Territory and Local governments to private investors has previously been exempt from scrutiny under the Act under regulation 31 of the Regulations. The exemption was limited in scope and did not extend to sales to foreign government investors, who remained subject to the provisions of the Act and the Regulations. The proposal by the 'Power NSW' consortium, which included Chinese

state-owned utility State Grid, to acquire the NSW electricity transmission network in 2015 was an example. In that case the Treasurer had no objection to the proposal.

The scope and application of the exemption was brought into focus following the recent grant of a long-term lease of the Port of Darwin by the Northern Territory government to China's Landbridge Group in late 2015, which generated significant public comment.

New rules on critical infrastructure assets

The Treasurer announced on 18 March 2016 that the scope of the exemption for government asset sales would be narrowed, with the stated intention being to ensure that potential national security risks can be addressed in government sale processes.

The *Foreign Acquisitions and Takeovers Amendment (Government Infrastructure) Regulation 2016* (Cth) was promulgated on 24 March and amends regulation 31 of the Regulation to add a number of exclusions from the exemption in regulation 31(1), namely sales to private investors of land, or a company which holds an interest in land, on which there is:

- 'public infrastructure', except in relation to public roads,
- infrastructure for existing or proposed roads, existing or proposed railways, or existing or proposed inter-modal transfer facilities, within the National Land Transport Network, as defined in the *National Land Transport Act 2014* (Cth),
- infrastructure for existing or proposed roads, existing or proposed railways, or existing or proposed inter-modal transfer facilities, that are designated under a law of a State or Territory as either significant or controlled by the State or Territory,
- the infrastructure (or part of the infrastructure) of a telecommunications network; or
- a nuclear facility.

It is likely that many types of asset sale that may be contemplated by a State, Territory or Local government will fall into one of these categories; in this regard we note the breadth of the definition of 'public infrastructure' in regulation 5 of the Regulations which, in summary, means:

- airports
- maritime ports
- infrastructure for public transport (regardless of whether it is publicly owned),
- electricity, water, gas or sewerage infrastructure.

Impact of changes

We expect that State, Territory and Local governments have, in the past, routinely consulted with relevant Commonwealth agencies in relation to proposed asset sales, although the changes to the Regulation will mean that the Treasurer will, in many cases, now be able to prevent a particular transaction from proceeding, if the Treasurer considers that it would be contrary to Australia's national interest.

It is conceivable that the Treasurer's assessment of Australia's national interest in respect of a particular sale may diverge from that of a State, Territory or Local government, whose interests may be more focused on financial considerations.

In a practical sense, foreign investment screening will result in scrutiny of proposals by Commonwealth regulators (e.g environmental) who would not previously have had an opportunity to consider the merits of a particular transaction. Applicants will need to consider likely regulatory concerns as part of the application process and prepare for the possible need to engage with regulators on these.

The additional scrutiny that will now be applied to government sale proposals will add a degree of complexity to transaction execution and could, in theory, reduce the possible universe of bidders. These issues are, of course, routinely faced in private sector sale processes and may well be manged by a combination of engagement between selling governments and the Commonwealth as part of the pre-sale preparation, as well as early and diligent preparation by bidders of screening applications under the Act which demonstrate, in a comprehensive way, the alignment with Australia's national interest.

The takeaway

The narrowing of the exemption for government asset sales in regulation 31(2) of the Regulations will lead to a greater scrutiny of infrastructure asset sales by Australian governments. We expect that the Commonwealth has always had some involvement in asset disposals conducted by other governments, although the Treasurer now has a right of veto in many cases, which is an important shift.

It will be critical for Australian governments to engage with the Foreign Investment Review Board early when preparing for major sale processes and for bidders to factor in this additional review step when planning their proposals. Where an application for screening is required, it will be important that bidders provide a comprehensive submission as to the alignment of the proposal with Australia's national interest.

Let's talk

Early engagement with legal and tax advisers will be critical in order to avoid additional delay, and advisers with an international and multi-disciplinary focus are well placed to help foreign investors navigate a smoother path in the foreign investment clearance process.

Our legal and tax experts routinely advise foreign investors on all aspects of their investment in Australia, including:

- foreign investment notification requirements and clearance process
- corporate structuring and transaction design
- due diligence, acquisitions, divestments and restructures
- competition impact analysis and ACCC clearance
- tax and duty issues in transaction design
- real property conveyance and leasing
- public benefit and national security considerations
- compliance with requirements in regulated industries
- employment, industrial relations and immigration, and
- administrative review options.

We also bring to our clients the breadth of expertise throughout PwC, within Australia and throughout the world, notably including our tax specialists, corporate finance specialists and deals advisory teams.

To find out more about how these issues might affect you, please contact your usual PwC advisor or:

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