Attention: Mr Adam McKissack

Dear Mr McKissack,

Private Equity and Venture Capital
Submission re Low Sensitivity Business Investment

The Foreign Investment Committee of the Business Law Section of the Law Council of Australia welcomes the Australian Government’s initiative in reviewing the 2015 reforms to the foreign investment framework. We also appreciated the opportunity to meet with you to discuss some preliminary potential changes.

You indicated in that meeting that if there were any additional matters which we felt should be included in the Consultation Paper, we should send you details with our thinking on why they should be included.

One matter which has been identified, and which was discussed at our meeting on 3 February, is the fact that some investments of relatively low value and low sensitivity have been caught in the regulatory net. This particularly relates to some persons caught by the definition of "foreign government investors" (FGIs).

We understand that one approach being considered to address this is the introduction of a new exemption certificate for interests in securities that would provide broad pre-approval for foreign persons acquiring securities.

We are broadly supportive of an approach of this kind and are aware of the submissions that have been made to the Government by the Australian Private Equity and Venture Capital Association (AVCAL) supporting such an approach.

However, we would go further and submit that it is an “overreach” for commercial private equity and venture capital organisations to be regarded as FGIs. We would request that...
you consider including a proposal in the Consultation Paper to exclude organisations of this kind from the definition of "foreign government investor".

There do not appear to us to be any sound policy reasons for private equity and venture capital organisations to be caught in this definition. It seems to us that this has resulted not only in an unnecessary and, in our view, unjustified regulatory burden on this industry but also in matters being required to be considered by the FIRB when there appears to be no real policy sensitivity.

We say this because the structure of these private equity and venture capital funds is such that the limited partners or investors in funds managed by private equity or venture capital are entirely passive investors. All decision making power is exercised by the fund manager or general partner pursuant to a limited partnership agreement or management agreement.

This has resulted in:

- The FIRB having to consider and process proposals for acquisitions of companies and businesses of less than $252 million in non sensitive businesses by entities that are clearly "commercial", imposing an unnecessary burden on the FIRB and unnecessary "red tape".

- Fairly small downstream acquisitions by investee companies owned by private equity or venture capital funds also having to be processed as proposals by FGIs. It seems to us to be overreaching to consider investee companies of this kind to be FGIs as well as an unnecessary burden on the system, which is currently straining to meet timeframe expectations. To quote one active PE fund executive, "ever since we started paying fees the response times have considerably lengthened"

In our submission, where the general partner or fund manager of a private equity or venture capital fund of this kind has clear management control, and the investors or limited partners are clearly passive, with no participation in the management or control of the partnership or the relevant entity, then the fund should not be regarded as a FGI. They would still be a ‘foreign person’ if the relevant thresholds (i.e. 20% individually or 40% in aggregate) were met.

In our submission, this would ensure that true foreign government investors were treated as such, with the consequence that proposals by private equity or venture capital fund managers, that are clearly low risk from a policy perspective, are no longer taking up the finite resources of the FIRB.
If there was a concern about investments in sensitive businesses, a lower threshold limit could be specified for funds of this kind in respect of specified sensitive businesses.

There is some precedent for this approach in the regulations in regulation 45(3), where limited partners are not taken to be associates of each other if they are not in a position to participate in the management or control of the partnership or of any of the general partners.

In summary, we submit that:

- There is no sensible policy rationale for treating private equity or venture capital funds as FGIs - this has resulted in proposals of low or no sensitivity being required to be considered by the FIRB.

- Policy could be adequately met by having entities of this kind treated as non government foreign persons provided that the management and control was vested in the general partner or fund manager, and the investors or limited partners are passive investors.

In our view, this could be achieved by relatively simple amendments to the FATA regulations.

We would urge Treasury to consider including a proposal of this kind in the Consultation Paper which it proposes to release later this month. That would enable Treasury to receive feedback on this potential approach and test whether there were any sensitivities or concerns.

If you have any question in relation to this submission, in the first instance please contact the Committee Chair, Malcolm Brennan, on 02-6217 6054 or via email: malcolm.brennan@au.kwm.com

Yours sincerely,

Teresa Dyson, Chairman
Business Law Section