TITLE: **The foreign takeover of GrainCorp – can Joe Hockey demand conditions?**

AUTHOR: **David Richardson**

PUBLICATION: **On Line Opinion**

PUBLICATION DATE: **11/11/2013**

LINK: http://www.onlineopinion.com.au/view.asp?article=15676&page=0

At the moment the Abbott government's position on foreign investment is being put to the test. GrainCorp is subject to a takeover bid by American company Archer Daniels Midland (ADM). This bid has received approval from the Australian Competition and Consumer Commission (ACCC) and we now await the decision of Treasurer, Joe Hockey. He in turn is awaiting the advice of the Foreign Investment Review Board (FIRB).

GrainCorp used to be the NSW Grain Handling Authority until the latter was privatised in 1992. It seems the National Party is concerned that GrainCorp has an effective monopoly on the relevant port and grain handing facilities and so believes that those should not be handed over to foreign interests. Deputy Prime Minister, Warren Truss, is reported to have said 'If we lose (GrainCorp) to foreign ownership then we will lose the potential to have an international standard agribusiness'. He has also suggested that Australia would lose control of its food security.

Other critics point to GrainCorp's virtual monopoly on the east coast. If so there are reasons for concern. GrainCorp made a healthy 14.4 per cent rate of return on equity in 2012 (we do not have the 2013 results in yet). That becomes a 21.5 per cent return on equity before tax, a very healthy return which is likely to reflect some market power. Adjusting for the intangible or fictitious assets the pre-tax return on equity increases to 28.3 per cent. On these figures it is clear why GrainCorp is a juicy target for ADM.

Based on the shareholdings in 2012 and a $13.55 bid price, ADM is bidding a bit over $3 billion for GrainCorp which has an equity value of $1.5 billion and little debt. So after the takeover ADM will be looking to make a healthy return on twice the amount of capital and that is likely to be at the expense of farmers. Given the likely market power it possesses GrainCorp under new owners should be able to raise its charges while appearing to show a return on equity in the same ballpark as before. The only sanction the farmers will have is public opinion and the new owners will be able to justify their charges by pointing to a rate of return roughly in line with earlier years.

Contrary to some media reports while Treasurer Joe Hockey will take formal responsibility for the decision, he's also bound take the decision to Cabinet. The Cabinet handbook states 'As a general rule, ministers should put before their colleagues the sorts of issues on which they themselves would wish to be consulted-matters of public interest, importance, or controversy.' I'm pretty sure Warren Truss and The Nationals would like to be consulted here.

And that consultation should happen fairly soon since the Treasurer has promised a decision by 17 December. That should be a very interesting Cabinet meeting to say the least. According to recent press reports it looks like the Coalition government will approve the proposed takeover but with conditions attached to the decision. Those conditions would be expected to address the lack of competition in the industry and the need to restrain the new owners from exercising too much market power.

This makes it a good time to examine the record of the FIRB and especially its record on monitoring the compliance with conditional foreign investment approvals and what happens when conditions are not met. In 1976 the FIRB was established in part 'to keep in touch with their [foreign-controlled companies] activities' according to the then Treasurer, Phil Lynch. However, the suggestion of a strong monitoring and compliance role for the FIRB is something that was never seriously pursued.

Senator Don Chipp, Leader of the Democrats, never stopped complaining about the lack of a capacity to follow up FIRB decisions in the 1970s and 1980s. There was simply no provision for any sanctions for non-compliance by foreign companies. For example, early on Australian foreign investment policy included guidelines for the appropriate level of foreign equity for different industries. The FIRB was understandably willing to recommend proposals which did not meet the guidelines provided that the foreign investor agreed to allow additional Australian participation in the future. Often the foreign investor was asked to commit itself to a certain timetable for achieving agreed levels of Australian equity. However, once the commitment was obtained and approval given there was no mechanism for ensuring compliance with the commitment and withdrawing approval-it would normally be too late to do anything. Nor is there any evidence that the FIRB seriously monitored its decisions. Most of the decisions were secret but some of the major decisions have been released over the years.

We know of no example where a decision has been revoked because conditions were violated. Nor are there any cases where other sanctions were imposed for non-compliance. The only hope of ensuring compliance seemed to be the threat of not allowing future investments which require approval. An example was foreign-owned broking firm Wigham Poland Australia Pty Limited (WPA) which had agreed to increase its Australian shareholding from 15 to 50 per cent within two years but did nothing and the government took no action. However, in 1982 the government prevented it acquiring H.S. Harvey Pty Limited and gave WPA a further 90 days to 'provide WPA with the opportunity to re-assess the introduction of Australian equity'. It seems that there was very little else that the government could do to enforce its guidelines apart from waiting for a new application by the same company, if it ever came. But the failure to enforce conditions did not stop the government approving takeovers subject to various conditions.

CRA is another good case study. CRA, whose initials had stood for ConZinc Riotinto of Australia, had been concerned to 'Australianise' or reach 50 per cent Australian ownership under the then policy in order to make investments that complied with the FIRB guidelines. The then chair and managing director, Sir Roderick Carnegie, promised CRA would reach 50 per cent 'as fast as we can' and in 1979 CRA announced that the government was granting it 'naturalising' status. Of course CRA took advantage of its 'naturalising' status with investments in the Ashton diamond joint venture agreement, and the takeovers of Australian Biotechnological Holdings Pty Ltd and Techno-Proteins Pty Ltd. The actual agreement and the timetable for 50 per cent Australian ownership was not made public but today Rio Tinto, the successor company, remains more foreign-owned than it was in the 1970s and has well and truly outlasted the 'naturalising' policy. As far as we can tell it never abided by any conditions and got what it wanted anyway.

Various contrivances were used to get around the formal FIRB Australian ownership guidelines and often the companies involved successfully stared down the Treasurer of the day. An example was provided by the Yeelirrie uranium arrangement which provided for 75 per cent ownership by Western Mining Corporation (WMC). However, 35 per cent of the capital costs for which WMC was responsible was to be provided by Esso which, in return was to receive an additional 35 per cent of the output. This arrangement with Esso effectively circumvented the then 75 per cent Australian equity guidelines for uranium projects as Esso was to control 50 per cent of the project and market 50 per cent of the output. The then Treasurer, John Howard, effectively turned a blind eye and admitted the project 'would not fully meet the requirements for 75 per cent Australian equity and Australian control,' but nevertheless granted approval.

Another important example of conditional approval involved National Mutual. On 31 January 1995 the then Treasurer, Ralph Willis, approved the takeover of National Mutual Life Association of Australasia Limited by Axa (AXA SA of France). This decision was significant for a number of reasons, not least the fact that National Mutual was one of the pre-eminent financial institutions in Australia and with the AMP one of just two life offices. Approval was given but was subject to a number of conditions that were made public at the time. Among those was National Mutual remaining a separate entity headquartered in Australia. But very soon there was a new Treasurer and no National Mutual which instead traded as AXA Asia Pacific Holdings Limited, a company with headquarters in Melbourne but clearly showing its subservient relationship to its parent company. Another condition was that AXA would generate its Asian business through National Mutual as the vehicle. Very soon new moves into Asia were undertaken instead by the parent AXA SA and that remains the case.

These examples show how companies were able to flout any agreements they made with the government in order to gain foreign investment approval. Arguably governments eventually understood this. In 2001 Shell was involved in a landmark decision by Peter Costello the Treasurer under the Howard government. Shell attempted a hostile takeover bid against Woodside Petroleum Ltd that raised a good deal of debate in Australia. Shell was and still is a major gas producer with projects all over the world. That was an issue since the commercial imperative for Shell did not necessarily coincide with Australia's interests. Press reports at the time suggested the government was considering conditional approval subject to fairly strict conditions including reducing Shell's eventual holdings to 56 per cent and establishing a new company to undertake the marketing of North West Shelf gas reserves.

Ultimately the Treasurer rejected the Shell bid on national interest grounds and said it was not possible to put 'enduring conditions' in place that would be enforceable. This was historic being the first recorded instance of a Treasurer admitting to the problems of imposing conditions on an approval and the inability to monitor and enforce any such conditions. Peter Costello effectively conceded Don Chipp's accusations decades earlier.

Foreign investors have a strong incentive to ignore conditions and the government either has no enforcement mechanisms or does not wish to use them. Market behaviour suggests that foreign companies know they are immune when they agree to conditions they know they will break and can break with immunity.

This poses a big dilemma for the Abbott government. If it allows the bid for GrainCorp without conditions then the government risks the anger of its junior coalition partner. However given the FIRB's record we know that if the government agrees to allow the bid subject to conditions then it knows that in all probability the conditions will be ignored. In practice conditional approval means the same ultimate outcome as unconditional approval.

David Richardson is a Senior Research Fellow at The Australia Institute, a Canberra based think tank. www.tai.org.au